

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, 2015

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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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, 2015

**Report Number:
271-0401-16**

**Released:
May 2016**

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 March 3, 2016.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
MSF did not have sufficient internal control procedures 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: www.audgen.michigan.gov

Office of the Auditor General
201 N. Washington Square, Sixth Floor
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Doug A. Ringler, CPA, CIA
Auditor General

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Doug A. Ringler, CPA, CIA
Auditor General

May 3, 2016

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, 2015 and have issued a separate report thereon dated March 3, 2016. 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, 2015.

Your agency provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above 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 "Doug Ringler". The signature is written in a cursive style with a large, prominent "D" and "R".

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



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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, 2015 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 March 3, 2016.

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.

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 certain deficiencies in internal control, as described in Findings #1 and #2, that we consider to be significant deficiencies.

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
March 3, 2016

FISCAL YEAR 2015
FINDINGS, RECOMMENDATIONS, AND
AGENCY PRELIMINARY RESPONSES

FINDING #1

Development of controls is necessary to ensure that financial activity is properly recorded and reported.

The lack of documented procedures may have contributed to these misstatements.

The Michigan Strategic Fund (MSF) did not have sufficient internal control* procedures 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 had to prepare numerous revisions to ensure the accuracy of the accounting records and the corresponding financial statements.

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 misstatements resulting from internal control weaknesses, such as the lack of documented procedures. After our review, MSF recorded adjusting entries to correct most of the identified misstatements. Although MSF's final, audited financial statements were materially correct, MSF should develop internal control procedures to help ensure the proper recording and reporting of accounting transactions and financial statement balances in future years. We noted:

- a. MSF did not record all necessary fair market value adjusting entries for its investments. Also, the entries were not always based on sufficient, appropriate information. Prior to processing adjusting entries, investments, net increase (decrease) in fair value of investments, and fund balance were understated by \$15.0 million in the Jobs for Michigan Investment Fund and overstated by \$0.4 million in the General Operations Fund and investments, net increase (decrease) in fair value of investments, and net position were understated by \$14.6 million in the entity-wide financial statements.
- b. MSF did not record investment impairment losses in accordance with GAAP. Prior to processing adjusting entries, MSF overstated its investments, net increase (decrease) in fair value of investments, and fund balance by \$3.2 million in the Jobs for Michigan Investment Fund and overstated investments, net increase (decrease) in fair value of investments, and net position by \$3.2 million in the entity-wide financial statements.
- c. MSF did not report certain activity totaling \$4.4 million in its financial statements. As a result, current assets and current liabilities were understated by \$4.4 million in the Workforce Development Agency Fund balance sheet and in the entity-wide statement of net position.

* See glossary at end of report for definition.

RECOMMENDATION

We recommend that MSF improve its internal control procedures 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 that improvements in its internal control related to investment fair market valuation and impairment are needed. MSF began an engagement with outside consultants on this issue in January 2016, whose preliminary recommendations will be available by May 2016 for review and implementation. MSF anticipates improved policies and procedures to be implemented prior to the year-end closing process for fiscal year 2016. In addition, MSF will update its year-end procedures to ensure that balance sheet activity as indicated above is fully addressed.

FINDING #2

Timeliness of financial reporting should be improved.

Since the prior audit, MSF has made notable improvements in quality of the draft financial statements and notes to the financial statements provided during the year-end closing process.

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 in a timely manner in compliance with State law.

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 promptly after the end of the reporting period in order for the financial reports to be useful and to impact decision making.

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 19, 2015. Although MSF made notable improvements in the quality of the information provided since the prior audit, MSF did not adhere to key completion dates as follows:

- a. MSF finalized accounting entries 28 days after the established deadlines.
- b. MSF provided draft financial statements and other necessary information 19 to 42 days after established deadlines.

MSF maintained an internal schedule listing activities and transactions to record at the end of the fiscal year, which included performing various procedures necessary to finalize its financial statements accurately and in a timely manner; however, the schedule was intended only as an internal guide and MSF acknowledged that deviations from the schedule may have been needed to ensure that entries were done accurately.

RECOMMENDATION

We recommend that MSF continue to 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 that it can continue to improve its internal control to make additional progress toward meeting year-end activity deadlines. MSF acknowledges and appreciates the comments from the Office of the Auditor General on the significant improvements that have occurred since fiscal year 2014. MSF has begun to develop additional training and year-end planning tools to improve its year-end performance even more for fiscal year 2016. MSF will also continue to work with the Office of

the Auditor General on year-end deadlines to ensure that sufficient time is included in year-end planning to meet State and auditor requirements moving forward.

FISCAL YEAR 2014
REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS
FOLLOW-UP

Below is the status of the reported findings from the fiscal year 2014 MSF report on internal control, compliance, and other matters:

<u>Prior Audit Finding Number</u>	<u>Topic Area</u>	<u>Current Status</u>	<u>Current Finding Number</u>
1	Controls Over Financial Reporting	Repeated	1
2	Timeliness of Financial Reporting	Repeated	2

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.
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.

