

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, 2016

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

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 Economic Development Corporation

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

Fiscal Year Ended September 30, 2016

Report Number:
271-0406-17

Released:
June 2017

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 April 21, 2017.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
MEDC should improve the internal control procedures for its 401(a) defined contribution plan trust fund. This would improve MEDC's ability to detect errors and validate information provided by the third party administrator (<u>Finding #1</u>).		X	Agrees

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Doug A. Ringler, CPA, CIA
Auditor General

June 29, 2017

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:

I am pleased to provide this report on internal control, compliance, and other matters of the Michigan Economic Development Corporation for the fiscal year ended September 30, 2016.

Your agency provided a preliminary response to the recommendation 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, flowing style.

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, Chief Executive Officer
and
Mr. Doug Rothwell, Executive Committee Chair
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 financial statements of the business-type activities and the aggregate remaining fund information 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, 2016 and the related notes to the financial statements, which collectively comprise MEDC's basic financial statements, and have issued our report thereon dated April 21, 2017.

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 opinions 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.

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 MEDC'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*.

MEDC's Response to Finding

MEDC's preliminary response to the finding identified in our audit is included in the body of our report. MEDC'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
April 21, 2017

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FISCAL YEAR 2016
FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

FINDING #1

Development of controls is necessary to ensure the accuracy of the 401(a) plan financial statements.

The Michigan Economic Development Corporation (MEDC) should improve the internal control* procedures for its 401(a) defined contribution plan trust fund. The enhancement of controls would improve MEDC's ability to detect errors and validate information provided by the third party administrator (TPA) for the 401(a) plan financial statements and related notes.

Section 18.1485 of the *Michigan Compiled Laws* requires each department to establish and maintain an internal accounting and administrative control system using generally accepted accounting principles* and recordkeeping procedures to control assets, liabilities, revenues, and expenditures. Also, the State of Michigan Financial Management Guide (Part VII, Chapter 1, Section 1000) requires oversight of a third party service organization's internal control system when those services have a material effect on an entity's operation and reporting.

MEDC contracted with a TPA to provide recordkeeping, administrative services, and investment advisory services for its 401(a) defined contribution plan.

During our review of MEDC's preparation of the 401(a) plan financial statements and the related notes, we noted these examples of controls that should be improved:

- a. Although MEDC obtained copies of the TPA's Service Organization Controls (SOC) 1, type 2 report*, it did not have a process in place to review the report. The SOC report identified controls that should be in operation at MEDC. For example, MEDC should perform timely reviews of all reports provided by the TPA of participant account balances and related activity and provide written notice of the discrepancies to the TPA. MEDC did not review the reports generated by the TPA. In fiscal year 2016, the total of participant directed investments was \$5.8 million.
- b. MEDC did not reconcile the amount of benefits paid to participants reported by the TPA with the information retained by MEDC. Plan participants are required to complete a distribution form. MEDC retains a copy and provides a copy to the TPA. In fiscal year 2016, the benefits paid to participants were \$1.3 million.
- c. MEDC did not validate the forfeiture and loan amounts reported by its TPA with the information retained by MEDC. The amounts reported by the TPA were \$120,186 and \$114,523, respectively.

Because of a reevaluation of Governmental Accounting Standards Board* Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and*

* See glossary at end of report for definition.

Local Governments, it was determined that the 401(a) defined contribution plan met the definition of a fiduciary fund. Therefore, MEDC presented this fund in its fiscal year 2016 financial statements but had not fully implemented related controls.

RECOMMENDATION

We recommend that MEDC improve the internal control procedures for its 401(a) defined contribution plan trust fund.

**AGENCY
PRELIMINARY
RESPONSE**

MEDC provided us with the following response:

- a. *MEDC agrees and will comply. MEDC Finance's Audit and Financial Compliance (AFC) unit has begun establishing a procedure and process that will ensure staff perform timely monitoring reviews of all TPA's SOC reports to assess compliance and identify issues requiring follow-up. Follow-up actions and outcomes will be documented and communicated to the appropriate stakeholders. In addition, AFC will create and maintain a tracking log to record relevant SOC report information such as event dates, deadlines, contacts, etc.*
- b. *MEDC agrees and will comply. MEDC Finance will establish a procedure for reconciling benefit payment information reported by the TPA in a timely manner that provides the needed assurances. We anticipate implementing the reconciliation process prior to onset of the year-end close process for fiscal year 2017.*
- c. *MEDC agrees and will comply. MEDC Finance will establish a procedure for validating forfeiture and loan amounts reported by the TPA to confirm their accuracy. We anticipate implementing the validation process prior to onset of the year-end close process for fiscal year 2017.*

FISCAL YEAR 2015
REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS
FOLLOW-UP

Below is the status of the reported finding from the fiscal year 2015 MEDC 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	Accuracy of Investment Transactions and Financial Statement Balances	Complied	Not applicable

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.

Service Organization Controls (SOC) report

Designed to help organizations that provide services to user entities build trust and confidence in their delivery processes and controls through a report by an independent certified public accountant (CPA). Each type of SOC report is designed to help service organizations meet specific user needs:

- SOC 1 (Report on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting) - Intended for user entities and the CPAs auditing their financial statements in evaluating the effect of the service organization's controls on the user entities' financial statements.
- SOC 2 (Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy) - Intended for a broad range of users that need information and assurance about a service organization's controls relevant to any combination of the five predefined control principles.

There are two types of SOC 1 and SOC 2 reports:

- Type 1 - Reports on the fairness of the service organization's description of controls and the suitability of the design of the controls to achieve the related control objectives included in the description, as of a specified date.
- Type 2 - Includes the information in a type 1 report and also addresses the operating effectiveness of the controls to achieve the related control objectives included in the description, throughout a specified period.
- SOC 3 (Trust Services Report for a Service Organization) - Intended for those needing assurance about a service organization's controls that affect the security, availability, or processing integrity of the systems a service organization employs to process user entities' information, or the confidentiality or privacy of that information, but do not have the need for or the knowledge necessary to make effective use of a SOC 2 report.

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.

TPA

third party administrator.



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