

MEMORANDUM

To: Mr. Aaron Payment, Tribal Chairman
Forensic Audit Committee Members
Board of Directors
Sault Ste. Marie Tribe of Chippewa Indians

From: Chris Peterson, CPA, CFE
UHY Advisors MI, Inc.

Date: 9/16/04

RE: Tuition and expense payments – K. Henry

Issue:

The Tribe paid \$13,285 towards tuition and expenses for Kristi Henry to attend the Fashion Institute of Design & Merchandising in Los Angeles, CA. Ms. Henry is pursuing an advanced graduate degree in Costume Design for Film & Television. The Tribe paid \$10,000 of tuition in March 2004 and \$3,285 of expenses in June 2004.

The Tribe's Education Dept. oversees higher education grants and scholarships. The Education Dept. was not informed of the arrangements for Ms. Henry and there are no Tribal programs that would offer this large of a payment. The maximum award is \$800 per year for the Tribe's Higher Education Grant Program and \$1,000 per year for the Higher Education Self-Sufficiency Fund Program.

Findings:

A letter from Bernard Bouschor, former Tribal Chairman, accompanied the tuition payment. The letter confirms the Tribe's contribution of \$10,000 towards Ms. Henry's tuition. Per discussions with Jack Kibble, Education Director and Kristi Little, Deputy Executive Director, the letter contained grammatical errors that are not typical of Bouschor's writing and the signature appears forged. The expense reimbursement was paid from Ms. Henry's May 2004 FIDM Statement of account and no detail on the nature of the expense was reported. Both disbursements were initiated from General fund disbursement vouchers that were signed by Bernard Bouschor. The transactions were posted to the Tribe's General Fund, Tribal Operations – Miscellaneous expense (a/c 101-1160-7621). The payments on Ms. Henry's behalf, are apparently justified through the Chairman's \$50,000 signature authority (per Tribal Board Resolution 97-63).

Conclusions:

Tribal Board Resolution 97-63 authorizes the Chairman “to make any expenditure of \$50,000 or less, for any Tribal purpose or business”. While the resolution is broad, the payments of Ms. Henry’s do not appear to constitute a Tribal purpose or Tribal business. In addition, the authenticity of the letter from Bouschor to the FIDM appears dubious. We recommend the Tribe request a full \$13,285 reimbursement from Ms. Henry with respect to the funds disbursed to FIDM. If the reimbursement is contested or not collectible, the Tribe should consider reporting the \$13,285 as income to Ms. Henry on Form 1099 (submitted to the Internal Revenue Service).

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To: Mr. Aaron Payment, Tribal Chairman
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Board of Directors
Sault Ste. Marie Tribe of Chippewa Indians

From: Chris Peterson, CPA, CFE
UHY Advisors MI, Inc.

Date: 2/7/05

RE: CASINO SLOT MACHINE PAYOUTS IN CANADIAN CURRENCY

Observations:

The following narrative is based on discussions and information provided by Rick McDowell, CFO of Casino Operations and our test observations on January 14, 2005 at Kewadin Casino in Sault Ste Marie.

During the initial interview with Rick McDowell, he stated that the 5¢ slot machines will generally account for a higher Canadian coinage mix (20-30%) than 25¢ slots. The higher Canadian coinage mix for 5¢ slots is due to identical size and alloys used for the U.S. and Canadian nickel. Sensors in the nickel slot machines are not sensitive enough to distinguish U.S. and Canadian coins. Per Mr. McDowell, the 25¢ coins are more distinct and there should be very minimal Canadian coinage in the mix. Five cent slots account for 110 machines (14%) while 25¢ slots account for 249 machines (32%) of all slot machines on the Kewadin Casino floor. This count also includes the Huron Room's machines which were temporarily in storage due to the renovation.

To date, McDowell has not implemented formal procedures to reduce the Canadian coinage. There will always be play with Canadian coins because of the proximity to the Canadian border. The cost for sorting coinage is not inexpensive. Also, coin deposits are minimal; most coins are recirculated within the casino facility. Coin recirculation happens because most patrons bring and leave dollar currency. The Casino is taking measures to reduce the number of 5¢ coin slots with token slots and watch for patrons who may bring a higher than normal amount of Canadian coinage into the facility. The current exchange rates also serve as less of an incentive to use Canadian coin.

Findings:

We randomly sampled five 25¢ bags (\$400 value per bag) from the cage and two 25¢ slot machines from the Casino floor. We observed \$7.50 in Canadian quarters out of \$2,769.75 total counted (.27%).

Conclusion:

Sampling of the 25¢ coinage produced a very low Canadian coinage mix (.27%) and does not appear to constitute a significant problem. We did not test the 5¢ coinage due to the lower denomination and less machines in operation. We understand there is typically \$40,000 of nickels between coins in the vault and slot machines on the floor. The expected Canadian nickels would be about \$10,000 Canadian with a US equivalent of about \$8,000. The difference is not significant enough to merit further inves

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To: Mr. Aaron Payment, Tribal Chairman
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From: Chris Peterson, CPA, CFE
UHY Advisors MI, Inc.

Date: 1/12/05

RE: SELF-INSURANCE THROUGH CAPTIVE INSURANCE CO.

Observations:

The following narrative is based on discussions and information provided by Cathy Bunker, Tribal Insurance/Risk Manager.

The Tribe was self-insured through a captive offshore insurance company (Churchill Casualty Ltd.) from March 1998 to March 2002. During these four years, the Tribe paid estimated premiums of approximately \$5,087,000 for workers compensation, automobile and general liability coverage (see exhibit). Premiums were adjusted annually based on insurance audits after the policy year ended. The actual premiums were approximately \$4,175,000 based on the audits. The cumulative estimated premiums paid-in-excess of actual premiums was \$912,000. It appears \$332,000 of the excess premiums was refunded to the Tribe and the balance of \$580,000 applied to deferred cash or deferred premiums. In addition, the Tribe paid additional funds of \$750,000 to reduce borrowings on letters of credit to fulfill insurance obligations during 2001 and 2003. The Tribe received a summary as of February 29, 2004 which disclosed it had approximately \$1,600,000 of equity in the captive. The Tribe received \$128,637 in August 2004 from Churchill Casualty Ltd. which represents a 50% partial distribution from the 1999/2000 policy year.

The Tribe did its own claims adjusting for the captive insurance company. Claim years are held open for approximately 5 years; activity is projected through 2007. Dan Weaver, Tribe CFO, oversaw all activity with the captive offshore insurance company. Cathy Bunker has handled all of the detailed work and reconciliations since June 1999. Bunker has over 20 years experience in the insurance industry (her predecessor had no prior experience).

The Tribe's audited financial statements do not disclose information on the prior year's self-insurance or the equity in the captive offshore insurance company.

Issue:

Self insurance through captive offshore insurance companies is a common practice for businesses with significant insurance premiums. Lack of federal regulation decreases captive insurance company costs but also increases opportunities for abuse.

The Tribe's insurance/risk manager, Cathy Bunker, appears technically competent and well organized. Bunker's day to day work on self-insurance seems thorough and timely. However, money returned to the Tribe from the captive offshore insurance company via claims, premium refunds and distributions was not reviewed by Bunker.

Accordingly, receipts from the captive would be susceptible to misappropriation and easily disguised due to the complexity of the captive insurance accounting and Weaver's oversight. There is also a possibility that key personnel received kickbacks.

Recommendation:

Review analysis of cash receipts from captive offshore insurance company for 1998 – 2004. Reconcile to amounts disbursed per annual statements from the captive. Interview third party personnel from insurance agencies.

Data provided by Tribe personal:

- Schedule of cash receipts from captive by year with date, amount, description and general ledger posting.
- Annual statements from the captive.

Estimated fee:

- \$8,700 – \$1,200 Tribal discount = \$7,500
- Estimated fee includes fieldwork, report preparation and travel (estimated = 56 hours)

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To: Mr. Aaron Payment, Tribal Chairman
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Sault Ste. Marie Tribe of Chippewa Indians

From: Chris Peterson, CPA, CFE
UHY Advisors MI, Inc.

Date: 6/3/05

RE: Greenville, Mississippi casino barge project

Issue:

Assess the governance controls with respect to the Tribe's investment in the Greenville casino barge project.

Background and observations:

Allard Teeple prepared a memorandum on December 18, 1995 for Bernard Bouschor, Tribe Chairman, to address an opportunity to provide bridge financing for a riverboat casino project. The Tribe's involvement in the project was initiated by Ted Gatzaros and Jim Pappas; they had been approached in October 1995 to bail out a floundering proposed development. The project involved obtaining an existing barge and securing real estate to develop a floating casino in Greenville, Mississippi. The Tribe was to provide a \$2 million loan to the project; \$1,200,000 to buy the Barge under an option held by Theodore Stern and \$800,000 as a partial payment for the real estate. The cost of the project was to be financed with a \$35 million bond issuance through Loofbourrow, Inc. The Tribe, Gatzaros, Pappas and Stern would all own interests in entities to be created to operate the Casino. It appears the Tribe provided the initial \$1,200,000 of funding for Greenville Casino project on January 9, 1996 – only three weeks later.

A proposal for the Greenville Mississippi casino project was presented to the Business development committee of the Tribe's Economic Development Commission (EDC) on January 23, 1996. The meeting took place two weeks after Bouschor had spent \$1,200,000 of Tribal funds on the project. The Committee reviewed the proposal during the "new business" portion of its agenda. The minutes of the meeting indicate the committee wanted to "observe the conditions on the existing property, set-up a team to look further into the arrangement, and control finances and contingency requirements". A motion by Commissioner Mulder to "look into the Greenville Mississippi Casino Proposal" was unanimously carried. Agendas for meetings of the Committee and the EDC in the four months that followed (February – May 1996) show some discussions with respect to the project. However, no further actions were authorized by either the Business development committee or the EDC.

The day after the EDC meeting in January 1996, Bernard Bouschor wrote a memorandum to Ted Gatzaros with a counter-offer to the proposed financing. Bouschor's proposal suggested the Sault Tribe should own the Barge until the final financing was available. He also sought control of the project by designating the Sault Tribe as the Managing Agent with a 7% management fee on gross operating revenue. In addition, The Tribe's equity in the project was to be increased from 20% to 40%. The proposed venture was to be documented through a Letter of Intent. Within seven days of Bouschor's counter proposal, a Memorandum of understanding between 400 Monroe Partners, The Sault Tribe and Theodore Stern was executed (dated January 31, 1996). The Memorandum promised \$4 million to Stern at the closing of the permanent financing and \$1 million per year for four years from the Casino operations (instead of the equity position Stern had previously requested). The Tribe's copy of this document does not indicate who was to sign on the Tribe's behalf and the signature line is unsigned.

Other agreements were executed for Stern's assignment of his option to purchase the barge from Casino One Corp for \$1,200,000 and an escrow agreement to facilitate the Barge acquisition by the Sault Tribe. The Casino One option with Stern was set to expire on January 31, 1996 – it was only a 30 day option. The Tribe exercised the option and the transaction to purchase the barge was completed on February 9, 1996.

The option to purchase the Barge had an unusually short duration. The brevity of the option was apparently used to create a sense of urgency for the Tribe's investment in the project. The option's short duration should have been identified as a "red herring" during Bouschor's initial consideration of the project. The proposed Greenville Casino Development analysis which Stern had initially provided to Gatzaros and Pappas in October 1995, clearly indicates a barge was central in the casino design. The analysis called for a two-story 45,000 square foot facility needed to "float in a moat".

The preliminary agreements leading to the Barge acquisition were followed by a letter of intent between the Tribe and Gatzaros and Pappas, signed April 30, 1996. The letter of intent formalized the arrangements by creating a company known as Sunstar Resort Casinos, Inc. owned 50% by the Tribe, 25% Gatzaros and 25% Pappas. The Tribe was to manage the operations for a 5% management fee and supply the furniture, fixtures and equipment. The agreement also called for \$41 million in "permanent financing" (up from \$35 million in the initial proposal). The letter was prepared and signed by Bernard Bouschor, as chairman of the Sault Ste. Marie Tribe of Chippewa Indians. There was no reference to the Tribe's EDC.

Two weeks after the letter of intent was signed, Allard Teeple gave a presentation on the Greenville Project to the Tribe's Board of Directors at the May 14, 1996 meeting. This appears to be the first formal information shared with the Tribe's Board. Coincidentally, earlier that same day, the CPA firm of KPMG sent Marta Diaz a memo suggesting the casino market in Mississippi was saturated. Marta Diaz had a key role in the project with responsibilities for action plan development, financing and financial information. The KPMG analysis led a group of the Tribe's staff (Marta Diaz, Victor Matson, Jr. and others) to analyze the project with an outside gaming consultant, Gary Baldwin. The "Baldwin group" issued a report on the feasibility of the Greenville Casino project to Bouschor on June 2, 1996. The report concluded the project's cash flow was inadequate, the availability of permanent financing was questionable, preliminary projections were not reliable and the Tribe faced substantial future financial risks. The Group recommended the Tribe not proceed under the proposed terms and called for a complete redesign of the project, including a new location.

Only one month after signing the letter of intent for the Greenville Casino Project, Bouschor was aware that it was not a viable business endeavor, based on the memorandum from KPMG and the report of the Baldwin group.

Attempts to restructure the terms of the project were undertaken during the next several months according to Jim Jannetta's report to the Board of Directors, dated September 2, 2003. These efforts were effectively dashed when another casino (the third in the Greenville marketplace) opened in October 1996. The prospects for the Greenville Casino project ended, but the Tribe's financial commitment did not. The Tribe owned a barge that had been modified for a specific purpose which was no longer viable; the prospects for selling the barge were very poor. The Tribe had to pay \$10,000 per month for mooring/wharfage charges for the Barge plus insurance and security costs. These costs approximated \$165,000 per year.

The situation was complicated by Hurricane Georges in September 1998. Strong winds and an eight foot storm surge in the Mississippi River caused by the hurricane forced the Barge from its moorings. The Barge eventually became lodged in an industrial seaway, between a breakwall and another barge. It appears there was adequate insurance coverage on the Barge for the cost of the damages. The Tribe's Board of Directors authorized the sale of the Barge during its meeting in December 15, 1998. The Barge was repaired and in February 1999 an outside consultant (Eagle Maritime Consultants) estimated its fair market value at \$350,000. However, at the time no buyer was interested. Eventually, the Barge was sold to Grand Casinos of Mississippi-Gulfport on April 30, 2001 for \$275,000, less a \$16,500 broker's commission.

Bill Connolly, Tribe Comptroller prepared a financial analysis of the cost of the Greenville Casino Project which was included in the information Jim Jannetta presented to the Tribe's Board of Directors in September 2003. The Tribe spent a total of \$2,610,492 in direct costs (including \$1,200,000 for the barge purchase) from 1996 – 2001 on the Greenville Casino Project. After considering proceeds received from the sale of the Barge, the net direct expenditure was approximately \$2,350,000. The indirect cost relating to the time and efforts of Tribal personnel has not been calculated.

Conclusion:

The Tribe's involvement in the Greenville Casino Project was ill-conceived and poorly timed. The investment of Tribal funds was not done with adequate due diligence; the accuracy of market analysis and financial forecasts, prepared by business brokers months before the investment, was not adequately challenged prior to committing the Tribe to the project.

Chairman Bouschor controlled the decision-making on the project under the auspices of his authority as Business development director and CEO of the Tribe's EDC. However, he failed to exercise due care in carrying out the duties and responsibilities of that position. Bouschor's actions indicate a complete disregard for approval of the investment in the project by the EDC's Business development committee. Bouschor also circumvented the Tribal Board's decision-making process for the appropriation of funds for the project. Bouschor appears to have consistently misled the Board members and EDC commissioners; notifying them of negotiations and transactions after they had already been completed.

Key personnel on the Greenville Casino project, an outside gaming consultant and the Tribe's CPA firm all advised Bouschor that the project was fatally flawed within a few months of the initial investment. However, it took five years for the Tribe to extricate itself from the project. Bouschor's abuse of executive authority and his lack of due care caused a direct economic loss to the Tribe of at least \$2,350,000.

Data provided by Tribe personal:

The memorandum is based on information provided by Candace Blocher, Tribal Legal Dept. and interviews with Jim Halvorsen, EDC Commissioner and Bill Connolly, Tribe Comptroller. Specific documents reviewed:

- Greenville Project Presentation to Board of Directors on 9/2/2003, prepared by Jim Jannetta, Tribal Legal Dept. (includes responses to inquiries of Director Lambert, Analysis of Project Costs and Attachments to presentation).
- Project Memorandum dated 1/23/96 for Business Development Committee of the Tribe's Economic Development Committee.
- Memorandum of October 7, 1998 from Terri Fitzpatrick to Bernard Bouschor and Tribal legal counsel with respect to Barge damages.
- Desktop Valuation of the Barge as of 2/22/1999 by Eagle Maritime Consultants.
- Agenda and minutes of EDC Board meetings for January 24 through May 28, 1996.
- Closing statement for sale of Barge on April 30, 2001.

MEMORANDUM

To: Mr. Aaron Payment, Tribal Chairman and
Forensic audit committee members
Sault Ste. Marie Tribe of Chippewa Indians

From: Chris Peterson, CPA, CFE
UHY Advisors MI, Inc.

Date: 11/1/04

RE: Reconciliation of ballots – 6/25/04 General Election

Issue: The Tribe's members cast their votes in the General election with mail-in ballots. The mail-in ballots are sent to tribal members approximately 3 weeks prior to the General election. The members mail their completed ballots to the U.S. Post Office in Sault Ste. Marie. Walk-in ballots can also be dropped off at the same location. Each day, a worker at the Post Office deposits the ballots received into a special locked box. The box remains sealed until it is transported to the Count site and opened on 6/25/04. The U.S. Post Office handles the ballots as Business Reply Mail; they charge the Tribe .47c per ballot (.37c postage and .10c special handling). The Tribe can determine how many ballots were received as Business Reply Mail, but this has not been reconciled to the total votes counted by election workers at the Count site.

Findings: I interviewed Postmaster Brenda Stain and Postal worker Larry Charbonneau on 9/14/04. We discussed the procedures the Post Office implemented to handle the Tribe's General election ballots. The Post Office's control with respect to handling the ballots appeared reasonable. I received a Trust Fund Account statement from the Post Office which contained nine charges for ballots received from 6/4 – 6/25/04. I was also given the Postal receipts for the individual charges; Tribal employees failed to pick up the receipts after several calls from the Post Office. The Trust Fund Account statement and receipts were copied and given to Aaron Payment on 9/14/04.

Conclusions: The Post Office's Trust Fund Account disclosed \$3,862 in Business Reply Mail charges with respect to the Tribe's General election. There were 8,217 individual ballots per the receipts (@ .47c per ballots = \$3,862). The Tribe's Election committee counted 8,182 ballots in the general. The difference in the two counts of 35 ballots appears to relate to spoiled ballots (charged by Post Office for mail, but not counted due to improper votes/marks on ballot). The reconciliation appears reasonable.

