



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
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:

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Michigan *Office of the Auditor General* **REPORT SUMMARY**

Financial Audit

State of Michigan 457 Plan

*Fiscal Years Ended September 30, 2012 and
September 30, 2011*

Report Number:
071-0157-13

Released:
April 2013

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with requirements material to the financial statements. This financial audit of the State of Michigan 457 Plan was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the State of Michigan 457 Plan's basic financial statements.

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Internal Control Over Financial Reporting

We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, we did identify a significant deficiency ([Finding 1](#)).

The Office of Retirement Services and Financial Services, within the Department of Technology, Management, and Budget (DTMB), did not adhere to established deadlines to ensure that they recorded the State of Michigan 457 Plan's financial activity and prepared drafts of the Plan's financial statements and notes timely ([Finding 1](#)).

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Noncompliance and Other Matters Material to the Financial Statements

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are required to be reported under *Government Auditing Standards*. However, we noted an instance of other noncompliance ([Finding 1](#)).

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Agency Response:

Our audit report includes 1 finding and 1 corresponding recommendation. DTMB's preliminary response indicates that it agrees with the recommendation and will comply.

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Background:

The State of Michigan 457 Plan is a deferred compensation plan sponsored by the State of Michigan. The Plan was established by the Civil Service

Commission in 1974 as a means for employees to save for retirement. The Plan covers employees of the State of Michigan, employees of the Michigan public school reporting units hired on or after July 1, 2010, and employees of the Education Achievement Authority. Employees are eligible to participate in the Plan on the first day of employment and may voluntarily contribute a portion of their compensation up to the established Internal Revenue Code limits.

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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>



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

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

April 23, 2013

John E. Nixon, C.P.A., Director
Department of Technology, Management, and Budget
George W. Romney Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management, and Budget
General Office Building
Lansing, Michigan

Dear Mr. Nixon and Mr. Stoddard:

This is our report on the financial audit of the State of Michigan 457 Plan for the fiscal years ended September 30, 2012 and September 30, 2011.

This report contains our report summary, our independent auditor's report on the financial statements, the Plan management's discussion and analysis, and the Plan's basic financial statements. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters; our finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

The agency preliminary response was taken from the agency's response subsequent to 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,

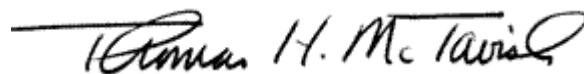

Thomas H. McTavish, C.P.A.
Auditor General

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INDEPENDENT AUDITOR'S REPORT



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

John E. Nixon, C.P.A., Director
Department of Technology, Management, and Budget
George W. Romney Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management, and Budget
General Office Building
Lansing, Michigan

Dear Mr. Nixon and Mr. Stoddard:

We have audited the accompanying basic financial statements of the State of Michigan 457 Plan as of and for the fiscal years ended September 30, 2012 and September 30, 2011, as identified in the table of contents. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the State of Michigan 457 Plan and do not purport to, and do not, present fairly the financial position of the State of Michigan or its pension (and other employee benefit) trust funds as of September 30,

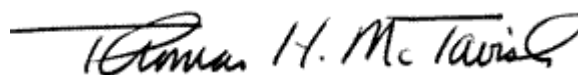
2012 and September 30, 2011 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the plan net assets of the State of Michigan 457 Plan as of September 30, 2012 and September 30, 2011 and the changes in its plan net assets for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 28, 2013 on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 11 through 14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.

Auditor General

February 28, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents our discussion and analysis of the State of Michigan 457 Plan's (the Plan's) financial performance and provides an overview of the Plan's financial activities for the fiscal years ended September 30, 2012, September 30, 2011, and September 30, 2010. This section should be read in conjunction with the Plan's basic financial statements.

Using This Annual Financial Report

This annual financial report consists of two parts: (1) management's discussion and analysis (this section) and (2) the Plan's basic financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the two prior years:

	Fiscal Years Ended September 30		
	2012	2011	2010
Plan Net Assets	\$1,689,407,101	\$1,587,296,984	\$1,764,910,216
Net investment gain (loss)	\$ 197,105,838	\$ 81,952	\$ 113,808,568
Contributions - Employees	48,746,370	49,169,638	59,302,100
Contributions - Employers	171,725		
Contributions - From other systems	77,461	254,019	322,665
Benefits paid	(71,011,836)	(87,803,975)	(63,506,079)
Refunds and payments to other systems	(67,267,075)	(136,221,867)	(66,664,389)
Other income and expenses - net	(4,473,174)	(3,093,000)	(1,856,409)
Net Increase (Decrease) in Plan Net Assets	\$ 103,349,309	\$ (177,613,232)	\$ 41,406,456

During fiscal year 2010-11, Act 185, P.A. 2010, provided for an incentivized retirement program for State employees. Approximately 4,750 State employees retired under this program. As a result, employee contributions decreased and benefits paid and refunds and payments to other systems increased in the State of Michigan 457 Plan in fiscal year 2010-11.

Overall Fund Structure and Objectives

The Plan was established by the Civil Service Commission in 1974 as a means for State employees to save for retirement. State employees are eligible to participate in the Plan as of the first day of employment and may voluntarily contribute a portion of their compensation up to the established Internal Revenue Code limits.

The Plan was amended in fiscal year 2009-10 to expand the definition of employer to include Michigan public school reporting units and participants to include members of the Michigan Public School Employees' Retirement System hired on or after July 1, 2010. These participants are offered the pension plus plan that includes both defined benefit and defined contribution retirement benefits. The defined benefit component is accounted for in the Michigan Public School Employees' Retirement System. For the defined contribution component, participant contributions are accounted for in the State of Michigan 457 Plan and employer contributions are accounted for in the State of Michigan 401K Plan as specified in the Plan Documents.

Effective December 15, 2011, Acts 264 and 265, P.A. 2011, amended the State Employees' Retirement Act (Act 240, P.A. 1943) and the Public Employee Retirement Health Care Funding Act (Act 77, P.A. 2010), respectively. The change provided for a refund of the 3% employee contributions withheld under Act 185, P.A. 2010, and gave employees the option to contribute all or a portion of their refunds into the State of Michigan 401K Plan or 457 Plan. This amendment also provided existing defined contribution retirement plan participants with the option to retain the current retiree health insurance plan or to choose a portable personal healthcare fund, which may be used to pay healthcare expenses in retirement. The defined contribution plan participants who elected to switch to a personal healthcare fund would monetize existing years of service for deposit into the State of Michigan 401K Plan or 457 Plan and would receive an employer match of up to 2% of future compensation. The amendment also eliminated the retiree health insurance plan for employees hired on or after January 1, 2012 and replaced it with a portable personal healthcare fund in which employees receive an employer match of up to 2% of compensation that is deposited into the State of Michigan 401K Plan or 457 Plan.

During fiscal year 2011-12, an Interlocal Agreement between the Education Achievement Authority (EAA) and the Department of Technology, Management, and Budget allowed EAA employees to participate in the State of Michigan 401K Plan and 457 Plan.

Effective September 4, 2012, Act 300, P.A. 2012, provided public school employees with options on future retirement pension benefits. Existing defined benefit participants could elect to freeze pension benefits earned to date and move to the defined contribution plan for future years of service. Employees hired on or after September 4, 2012 could elect the defined contribution plan instead of the current pension plus plan.

Asset Allocation

All participants have the ability to direct the investments of their accounts under the Plan, in accordance with the investment choices as are made available and those policies or procedures as are determined by the trustee and the administration from time to time. The Plan has no control over investment decisions made by the participants. Plan assets may be invested and reinvested in various instruments as deemed appropriate by the trustee and Plan management. Several investment tiers have been developed and made available to participants. A summary of the types of investments is listed in Note 4.

Investment Results

Despite a declining global economy and a looming fiscal battle in the legislative chambers of Washington, D.C., the collective enthusiasm of the markets in the quarter ended September 30, 2012 was unshaken in anticipation of global central banks' support of the European Central Bank's introduction in early September of the Outright Monetary Transactions program.

Although there have been no bonds purchased through the Outright Monetary Transactions program to date, the U.S. Federal Reserve plans to buy \$40 billion of mortgage-backed securities each month until the job market improves substantially and also announced that it would keep the federal funds rate near zero through at least mid-2015 and maintain these low rates even after the economy begins to build momentum.

For international markets, the Morgan Stanley Capital International (MSCI) Europe, Australasia, and Far East Index was up 6.1%, led by Europe. The MSCI Emerging Markets Index surged 7.0% in the quarter ended September 30, 2012, led by Europe. Treasury rates were mixed during the quarter. The yield on the benchmark ten-year Treasury note closed in September 2012 at 1.65%. Yields on money market instruments remained very low throughout September 2012 as the federal funds target rate traded within the 0.00% - 0.25% range.

By the time fiscal year 2011-12 closed, the Plan posted a net investment gain of \$197.1 million or 12.4% of beginning net assets as compared to fiscal year 2010-11, which posted a net investment gain of \$82.0 thousand or less than 1% of beginning net assets.

For fiscal year 2010-11, U.S. Treasury bills as a whole were up 6.5% and long bonds gained 25%. Although they lagged the performance of the U.S. Treasury heavy aggregate index, most domestic bond market sectors were positive, with the notable exception of high yield bonds. Yields on money market instruments, such as U.S. Treasury bills, short-term agency securities and high-quality commercial paper, remained very low throughout September 2011 as the federal funds target rate traded within the 0.00% - 0.25% range.

Contacting Management

This report is designed to provide the retirement board, Plan participants, taxpayers, investors, and creditors with a general overview of the Plan's finances and to demonstrate the Plan's accountability for the money it receives. If you have any questions about this report or need additional information, contact the Office of Retirement Services, P.O. Box 30171, Lansing, MI 48909-7671.

BASIC FINANCIAL STATEMENTS

STATE OF MICHIGAN 457 PLAN
Statement of Plan Net Assets

	As of		
	State of Michigan Deferred Compensation Fund	State of Michigan Personal Healthcare Fund	Public School Deferred Compensation Fund
Assets			
Equity in common cash	\$ 1,400,180	\$	\$ 436,624
Participant-directed investments - At fair value/contract value (Note 4):			
Stable Value Fund	697,233,136	3,663	2,206
ING Small Cap Growth Equity Fund	34,326,343	968	11,945
Mutual funds	391,536,731	13,223	109,391
Common trust funds	511,610,821	52,326	8,190,574
Tier III Investments	45,076,704		
Other receivable	181,186	147,259	427,381
Total assets	<u>\$ 1,681,365,101</u>	<u>\$ 217,438</u>	<u>\$ 9,178,121</u>
Liabilities			
Accounts payable	\$ 1,319,982	\$	\$ 108,490
Total liabilities	<u>\$ 1,319,982</u>	<u>\$ 0</u>	<u>\$ 108,490</u>
Plan Net Assets	<u>\$ 1,680,045,119</u>	<u>\$ 217,438</u>	<u>\$ 9,069,631</u>

The accompanying notes are an integral part of the financial statements.

September 30, 2012		As of September 30, 2011
Education Achievement Authority - Deferred Compensation Fund	Total	Total
\$	\$ 1,836,804	\$ 1,943,991
	697,239,005	741,005,793
	34,339,256	30,173,424
	391,659,345	363,266,787
74,913	519,928,635	410,550,216
	45,076,704	40,139,654
	755,825	278,649
<u>\$ 74,913</u>	<u>\$ 1,690,835,573</u>	<u>\$ 1,587,358,513</u>
<u>\$</u>	<u>\$ 1,428,472</u>	<u>\$ 61,529</u>
<u>\$ 0</u>	<u>\$ 1,428,472</u>	<u>\$ 61,529</u>
<u>\$ 74,913</u>	<u>\$ 1,689,407,101</u>	<u>\$ 1,587,296,984</u>

STATE OF MICHIGAN 457 PLAN
Statement of Changes in Plan Net Assets

	Fiscal Year Ended		
	State of Michigan Deferred Compensation Fund	State of Michigan Personal Healthcare Fund	Public School Deferred Compensation Fund
Additions to Net Assets			
Investment income (loss):			
Interest and dividends	\$ 26,610,862	\$ 329	\$ 85,500
Net appreciation (depreciation) in fair value of investments	169,500,641	1,400	906,305
Total investment income (loss)	\$ 196,111,503	\$ 1,729	\$ 991,805
Contributions:			
Employees	\$ 42,849,014	\$ 44,250	\$ 5,778,992
Employers		171,725	
From other systems	76,457		1,004
Total contributions	\$ 42,925,471	\$ 215,976	\$ 5,779,996
Miscellaneous income	\$ 661,457	\$ 0	\$ 0
Total additions	\$ 239,698,432	\$ 217,705	\$ 6,771,801
Deductions from Net Assets			
Benefits paid to participants	\$ 70,973,487	\$ 198	\$ 38,152
Administrative and investment expenses	4,305,225	69	829,336
Refunds and payments to other systems	67,262,875		4,200
Total deductions	\$ 142,541,587	\$ 267	\$ 871,688
Net Increase (Decrease)	\$ 97,156,845	\$ 217,438	\$ 5,900,113
Plan Net Assets			
Beginning of fiscal year	\$ 1,584,127,467	\$	\$ 3,169,517
Prior period adjustment (Note 3)	(1,239,192)		
Beginning of fiscal year - Restated	\$ 1,582,888,275	\$ 0	\$ 3,169,517
End of fiscal year	\$ 1,680,045,119	\$ 217,438	\$ 9,069,631

The accompanying notes are an integral part of the financial statements.

September 30, 2012		Fiscal Year Ended September 30, 2011	
Education Achievement Authority Deferred Compensation Fund	Total	Total	
\$ 68	\$ 26,696,760	\$ 29,544,363	
731	170,409,078	(29,462,411)	
\$ 800	\$ 197,105,838	\$ 81,952	
\$ 74,114	\$ 48,746,370	\$ 49,169,638	
	171,725		
	77,461	254,019	
\$ 74,114	\$ 48,995,556	\$ 49,423,657	
\$ 0	\$ 661,457	\$ 806,399	
\$ 74,913	\$ 246,762,851	\$ 50,312,008	
\$	\$ 71,011,836	\$ 87,803,975	
	5,134,631	3,899,399	
	67,267,075	136,221,867	
\$ 0	\$ 143,413,542	\$ 227,925,241	
\$ 74,913	\$ 103,349,309	\$ (177,613,232)	
\$	\$ 1,587,296,984	\$ 1,764,910,216	
	(1,239,192)	0	
\$ 0	\$ 1,586,057,792	\$ 1,764,910,216	
\$ 74,913	\$ 1,689,407,101	\$ 1,587,296,984	

Notes to the Financial Statements

Note 1 Summary of Significant Accounting Policies

The State of Michigan 457 Plan is a deferred compensation plan sponsored by the State of Michigan. The Plan is considered part of the State and is included in the *State of Michigan Comprehensive Annual Financial Report* as a pension (and other employee benefit) trust fund.

The Plan covers employees of the State of Michigan, employees of the Michigan public school reporting units hired on or after July 1, 2010, and employees of the Education Achievement Authority (EAA). Act 264, P.A. 2011, established the Personal Healthcare Fund within the Plan for State employees, which can be used to pay healthcare expenses in retirement.

Basis of Presentation - The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. The accompanying financial statements present only the State of Michigan 457 Plan. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position of the State of Michigan as a whole or its pension (and other postemployment benefit) trust funds in conformity with accounting principles generally accepted in the United States of America.

Measurement Focus and Basis of Accounting - The Plan uses the economic resources measurement focus and the accrual basis of accounting. Employee contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions.

Investments - Investments in the ING Small Cap Growth Equity Fund, mutual funds, common trust funds, and Tier III investments are stated at fair value based on quoted market prices. The Stable Value Fund is stated at contract value (see Note 4 for additional information). Investments in common trust funds are funds managed by State Street Global Advisors (SSgA) and Rainer

Investment Management, similar to mutual funds though not registered like mutual funds. The value of the Plan's position in the common cash fund is equivalent to the fair value of the common cash fund shares.

Note 2 General Description of the Plan

The following description provides only general information. Participants should refer to the Plan Document for a more complete description of the Plan's provisions. The Plan Document is available on the State of Michigan's Office of Retirement Services' Web site.

General - The Plan was established by the Civil Service Commission in 1974. The first enrollment was on April 17, 1975, with contributions starting in May 1975. The Plan Document was last amended and restated effective January 1, 2012 to incorporate all amendments, update changes required by law, and add new sections for changes in provisions made during the Plan year. As of September 30, 2012, the Plan included 27,176 State of Michigan participants, 30,553 Michigan public school participants, and 24 EAA participants.

Eligibility - Employees of the State of Michigan, public school employees hired on or after July 1, 2010, and EAA employees are eligible to participate in the Plan as of the first day of employment.

Contributions - Employees may voluntarily elect to contribute a portion of their compensation to the Plan through payroll deductions, limited in accordance with the Internal Revenue Code. Certain employees may also be allowed to make "catch-up" contributions in accordance with the Internal Revenue Code.

The Plan provides for the Personal Healthcare Fund for State of Michigan employees hired on or after January 1, 2012 to account for employee contributions and an employer match of up to 2% of compensation. State employees hired prior to January 1, 2012 and who opted out of the graded premium receive an employer match of up to 2% of future compensation plus a monetized amount for existing years of service upon terminating employment.

Contributions From Other Systems - Active employees may roll over money from another 457 plan into their State of Michigan 457 Plan account. Participants may withdraw funds rolled into the Plan at any time.

Participant Account - Each participant's account is credited with his or her contributions and an allocation of the Plan's earnings. Allocations are based on the participant's account balance to reflect the effect of income or losses from the particular investments. The benefit to which a participant is entitled is limited to the benefit that can be provided from the participant's account.

Vesting - Participants are 100% vested in their contributions and related earnings or losses at all times. Participants in the Personal Healthcare Fund are vested in employer contributions based on years of service over a four-year period. A participant is 100% vested after four years of service credit. A year of service is defined as 2,080 hours.

Payment of Benefits - Participants may withdraw their funds upon leaving employment. Withdrawal of participant funds may be by lump sum, monthly payments, annual payments, or rollovers to other qualified plans. Payments may occur over a period not to exceed life expectancy from the date that the payments begin. In-service benefit payments are permitted for various reasons as outlined in the Plan Document.

Refunds and Payments to Other Systems - Upon leaving employment, participants may roll over all or a portion of their account balances to other qualified plans or use all or a portion of their account balances to purchase preapproved service credit in the State of Michigan's Defined Benefit Retirement Plan.

Tax Status - The U.S. Department of Treasury made a determination on July 16, 1975 that the Plan constitutes a qualified trust under Section 401(a) of the Internal Revenue Code and is, therefore, exempt from federal income tax. Although the Plan has been subsequently amended and restated, management believes that the Plan continues to operate as a qualified trust.

Note 3 Restatement

Fiscal year 2011-12 beginning net assets were restated to account for the previously unrecorded liability related to payments issued to participants of the Plan prior to fiscal year 2011-12 that were returned as undeliverable. This prior period adjustment increased accounts payable and decreased the Plan's beginning net assets by \$1.2 million.

Note 4 Investments

All investments are participant directed. The mutual funds are registered with the Securities and Exchange Commission, and the guaranteed investment contracts (GICs) are regulated by State insurance departments. Several investment tiers have been developed and made available to participants. A brief summary of the types of investments included in each tier follows:

Tier I - Stable Value Fund and common trust funds that include SSgA Yield Enhanced STIF, SSgA Bond Market Index Fund, SSgA S&P 500 Index Fund, SSgA S&P Mid Cap Index Fund, SSgA Russell 2000 Index Fund, SSgA Global All Cap Equity ex-U.S. Index Fund, SSgA Target Retirement Income Fund, and SSgA Target Retirement Funds ranging in retirement dates from 2010 through 2055.

Tier II - ING Small Cap Growth Equity Fund, Rainier Large Cap Growth Equity Fund (common trust fund), and mutual funds that include MFS Total Return Fund (the MFS Total Return Fund was closed in January 2012 and all investment balances in this fund were transferred to the Oakmark Equity and Income Fund), Dodge & Cox Stock Fund, Oakmark Equity and Income Fund, T. Rowe Price Mid Cap Value Fund, Ridgeworth Small Cap Value Equity Fund, American Funds EuroPacific Growth Fund, Artisan Mid Cap Fund, PIMCO Total Return Fund, and SSgA Emerging Markets Fund.

Tier III - Individual stocks and bonds and thousands of mutual funds (load, no-load, and no-fee/no-load) from a multitude of fund families are available through the Plan's third party administrator. The various types of investments within Tier III are self-managed by the participants and are not separately classified by type of investment by the Plan's third party administrator. These self-managed stocks, bonds, and mutual funds are presented on the statement of plan net assets as Tier III investments.

Investment Risk:

The Plan's investments are subject to several types of risk. As of September 30, 2012 and September 30, 2011, the Plan did not have any investments subject to custodial credit risk or concentration of credit risk. Other types of risk are examined in more detail below:

a. Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Plan's investment policy does not restrict investment maturities. As of year-end, the weighted average maturities of investments subject to interest rate risk were as follows:

Investment Type	Fair Value/ Contract Value	Weighted Average Maturity (Years)
2012		
Stable Value Fund:		
Synthetic contracts*	\$634,210,560	3.8
SSgA STIF*	\$ 63,028,446	0.11
Common trust funds:		
SSgA Bond Market Index Fund	\$102,781,468	6.64
SSgA Yield Enhanced STIF	\$ 24,470,419	0.01
Mutual funds:		
PIMCO Total Return Fund	\$ 49,098,226	5.93
2011		
Stable Value Fund:		
Traditional GICs*	\$ 18,191,643	0.61
Synthetic contracts*	\$647,940,842	3.81
SSgA STIF*	\$ 74,873,307	0.05
Common trust funds:		
SSgA Bond Market Index Fund	\$ 86,066,204	7.16
SSgA Yield Enhanced STIF	\$ 22,901,014	0.00
Mutual funds:		
PIMCO Total Return Fund	\$ 38,739,625	8.97
MFS Total Return Fund	\$ 15,562,622	6.39

* These investments are reported at contract value as disclosed in Note 1.

b. Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligation. The Plan has an investment policy that limits its investment choices. The investment choices offered to participants are defined by tiers as described in the preceding paragraphs. As of year-end, the credit quality ratings of debt securities subject to credit risk (other than U.S. government securities) were as follows:

Investment Type	Fair Value/ Contract Value	Rating	Rating Organization
2012			
Stable Value Fund:			
Synthetic contracts*	\$634,210,560	BBB to AAA	S&P
SSgA STIF*	\$ 63,028,446	A1/P1 to Aa	Moody's
Common Trust Funds:			
SSgA Bond Market Index Fund	\$102,781,468	Baa to Aaa	Moody's
SSgA Yield Enhanced STIF	\$ 24,470,419	A1/P1 to Aa	Moody's
Mutual Funds:			
PIMCO Total Return Fund	\$ 49,098,226	Below B to AAA	S&P
2011			
Stable Value Fund:			
Traditional GICs*	\$ 18,191,643	A to A+	S&P
Synthetic contracts*	\$647,940,842	NR to AAA	S&P
SSgA STIF*	\$ 74,873,307	A1/P1 to Aaa	Moody's
Common Trust Funds:			
SSgA Bond Market Index Fund	\$ 86,066,204	Baa to Aaa	Moody's
SSgA Yield Enhanced STIF	\$ 22,901,014	NR	
Mutual Funds:			
PIMCO Total Return Fund	\$ 38,739,625	Below B to AAA	S&P
MFS Total Return Fund	\$ 15,562,622	NR to AAA	S&P

* These investments are reported at contract value as disclosed in Note 1.

c. Foreign Currency Risk

Foreign currency risk is the risk that changes in foreign currency rates will adversely affect the fair value of an investment. As of year-end, the following investments (other than U.S. government securities) were subject to foreign currency risk:

Investment Type	Foreign Currency	Fair Value
2012		
Mutual funds:		
American Funds EuroPacific Growth Fund	Various	\$104,855,379
SSgA Emerging Markets Fund	Various	\$ 40,962,827
PIMCO Total Return Fund	Various	\$ 49,098,226
SSgA Global All Cap Equity ex-U.S. Index Fund	Various	\$ 19,813,250
2011		
Mutual funds:		
American Funds EuroPacific Growth Fund	Various	\$102,197,498
SSgA Emerging Markets Fund	Various	\$ 43,242,585
PIMCO Total Return Fund	Various	\$ 38,739,625

Fully Benefit Responsive Synthetic Guaranteed Investment

Contract (SGIC):

As part of the Stable Value Fund, the Plan uses SGIC investment derivatives that invest in a portfolio of underlying securities and a benefit response wrap contract. The wrap contract produces a floating rate of return that is adjusted periodically, but not below zero, to reflect the underlying investment portfolio and generally provides for participant withdrawals at contract value (principal plus accrued interest). Following are the fair values as of September 30, 2012 and September 30, 2011:

	2012	2011
SGIC Components:		
Underlying investments	\$676,058,579	\$679,935,307
Wrap contract	*	*
Total	\$676,058,579	\$679,935,307

- * The market value of the SGIC's underlying investments was higher than the SGIC's contract value; therefore, the wrap contract does not have a value.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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

John E. Nixon, C.P.A., Director
Department of Technology, Management, and Budget
George W. Romney Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management, and Budget
General Office Building
Lansing, Michigan

Dear Mr. Nixon and Mr. Stoddard:

We have audited the basic financial statements of the State of Michigan 457 Plan as of and for the fiscal years ended September 30, 2012 and September 30, 2011, as identified in the table of contents, and have issued our report thereon dated February 28, 2013. We conducted our audit in accordance with 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.

Internal Control Over Financial Reporting

Management of the Plan is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph. However, we identified a deficiency in internal control over financial reporting, as described in Finding 1, that we consider to be a significant deficiency in internal control over financial reporting. 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.

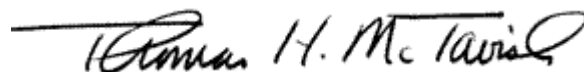
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's financial statements are free of 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*. However, we noted an instance of other noncompliance as described in Finding 1.

The agency preliminary response to the finding identified in our audit is included in the body of our report. We did not audit the agency preliminary response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Governor, the Legislature, the State of Michigan 457 Plan management, and others within the Department of Technology, Management, and Budget and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
February 28, 2013

FINDING, RECOMMENDATION,
AND AGENCY PRELIMINARY RESPONSE

FINDING

1. Adhering to Established Deadlines

The Office of Retirement Services (ORS) and Financial Services, within the Department of Technology, Management, and Budget (DTMB), did not adhere to established deadlines to ensure that they recorded the State of Michigan 457 Plan's financial activity and prepared drafts of the Plan's financial statements and notes timely. As a result, the Plan's audited financial statements were not finalized until February 28, 2013, two months after the statutory deadline.

Section 18.1492 of the *Michigan Compiled Laws* requires the 457 Plan's financial statements to be audited and submitted to DTMB's Office of Financial Management (OFM) for inclusion in the *State of Michigan Comprehensive Annual Financial Report* within 90 days of the close of the State's fiscal year. Also, to help ensure compliance with this requirement, OFM and Financial Services agreed on deadlines for recording accounting entries and submitting the draft financial statements to OFM. To accomplish this, Financial Services developed a detailed year-end calendar identifying specific completion dates for performing reconciliations and other various procedures necessary to finalize accounting entries; prepare financial statements and note disclosures; and provide draft statements and other necessary information to the auditors.

Financial Services did not adhere to key completion dates as follows:

- a. Financial Services did not have all accounting entries recorded by the November 16, 2012 due date. Financial Services processed the final entry on December 12, 2012, 26 days past the due date.
- b. Financial Services did not prepare the draft financial statements and notes, and provide them to the auditors, by the November 21, 2012 due date. Financial Services provided the first draft of the financial statements and notes to the auditors on December 18, 2012, 27 days past the due date.
- c. Financial Services did not prepare the draft financial statements and note disclosures required for the *State of Michigan Comprehensive Annual Financial Report* and provide them to OFM by the November 26, 2012 due date. Financial Services provided these draft financial statements to OFM on

January 16, 2013, 51 days past the deadline. Also, Financial Services provided these draft note disclosures to OFM on February 6, 2013, 72 days past the due date.

We noted that the one staff person who is primarily responsible for the State of Michigan 457 Plan's year-end closing process is also responsible for other significant year-end closing processes with equally time sensitive due dates. We noted that this person's work load contributed to the preceding delays.

Also, the auditors had planned the audit and committed sufficient audit resources to be able to meet the statutory deadline based on Financial Services' year-end calendar. However, by the time Financial Services recorded all of the entries and prepared and provided the draft financial statements and notes to the auditors, the auditors had committed a significant portion of the audit resources to other projects that also had statutory mandated deadlines. Therefore, the auditors could not complete the necessary audit procedures until February 28, 2013.

Because adherence to established completion dates is essential, Financial Services management could consider reallocating staffing resources to ensure that work loads do not adversely affect the timely completion of the year-end closing process.

RECOMMENDATION

We recommend that ORS and Financial Services, within DTMB, adhere to established deadlines to ensure that they record the State of Michigan 457 Plan's financial activity and prepare drafts of the Plan's financial statements and notes timely.

AGENCY PRELIMINARY RESPONSE

DTMB agrees with the recommendation. DTMB informed us that, during the fiscal year, ORS and Financial Services implemented significant changes related to legislative reforms that required new data elements and reporting changes, resulting in significant additional staff effort to ensure that the activity was properly reflected in the financial statements. DTMB also informed us that Financial Services will revisit existing financial statement preparation and review processes to enhance existing controls and update Plan time lines to ensure that the audited *Comprehensive Annual Financial Report* will be submitted by the deadline required by State law.

GLOSSARY

Glossary of Acronyms 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.
DTMB	Department of Technology, Management, and Budget.
Education Achievement Authority (EAA)	A Michigan Statewide school system for low-performing schools.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements of an audited entity are presented fairly, in all material respects, in conformity with the disclosed basis of accounting.
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."
GICs	guaranteed investment contracts.
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 financial statements that causes the statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
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 financial statements will not be prevented, or detected and corrected, on a timely basis.
MFS	MFS Investment Management.
Moody's	Moody's Investors Service, Inc. A credit rating agency that, among other things, provides credit ratings for issuers of certain debt obligations or debt instruments.
MSCI	Morgan Stanley Capital International.
OFM	Office of Financial Management.
ORS	Office of Retirement Services.
PIMCO	Pacific Investment Management Company, LLC.
S&P	Standard & Poor's. A credit rating agency that, among other things, provides credit ratings for issuers of certain debt obligations or debt instruments.
SGIC	synthetic guaranteed investment contract.
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.

SSgA	State Street Global Advisors.
STIF	short-term investment fund.
unqualified opinion	An auditor's opinion in which the auditor states that the financial statements presenting the basic financial information of the audited entity are fairly presented in conformity with the disclosed basis of accounting.

