



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS

STATE OF MICHIGAN 401K PLAN

Fiscal Year Ended September 30, 2013



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

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

*Report on Internal Control, Compliance, and  
 Other Matters*

Report Number:  
 071-0156-14M

*State of Michigan 401K Plan*

*Fiscal Year Ended September 30, 2013*

Released:  
 March 2014

*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 the financial audit. This report is being issued in conjunction with our financial audit of the State of Michigan 401K Plan.*

**Financial Statements:**

**Auditor's Report Issued**

We have audited the State of Michigan 401K Plan's basic financial statements as of and for the fiscal year ended September 30, 2013 and have issued a separate report thereon dated December 18, 2013. We issued an unmodified opinion on the State of Michigan 401K Plan's basic financial statements.

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**Internal Control Over Financial Reporting**

We considered the Plan's internal control over financial reporting (internal control) for the purpose of expressing our opinion on the basic financial statements. Our consideration of internal control was not designed to identify all deficiencies that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control that we consider to material weaknesses; however, we did identify a significant deficiency (Finding 1).

Reconciling Financial Activity

Financial Services, within the Department of Technology, Management, and Budget (DTMB), could improve its process to reconcile the State of Michigan 401K Plan's financial activity with the information provided by the third party administrator (Finding 1).

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**Noncompliance and Other Matters**

**Material to the Financial Statements**

We performed tests of the Plan's 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. We did not identify any instances of noncompliance or other matters applicable to the basic financial statements that are required to be reported under *Government Auditing Standards*.

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**Agency Response:**

This report contains 1 finding and 1 corresponding recommendation. DTMB's preliminary response indicates that it agrees with the recommendation.

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**Background:**

The State of Michigan 401K Plan is a deferred compensation fund and a defined contribution retirement fund 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.

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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



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

March 7, 2014

Mr. David B. Behen, Director  
Department of Technology, Management, and Budget  
Lewis Cass Building  
and  
Mr. Phillip J. Stoddard, Director  
Office of Retirement Services  
Department of Technology, Management, and Budget  
General Office Building  
Lansing, Michigan

Dear Mr. Behen and Mr. Stoddard:

We have audited the basic financial statements of the State of Michigan 401K Plan as of and for the fiscal year ended September 30, 2013 and have issued a separate report thereon dated December 18, 2013. In planning and performing our audit of the financial statements, we considered the State of Michigan 401K Plan's internal control over financial reporting and compliance and other matters. This report on internal control, compliance, and other matters is being issued in conjunction with our financial audit of the State of Michigan 401K Plan for the fiscal year ended September 30, 2013.

This report contains our report summary; our independent auditor's report on internal control over financial reporting and on compliance and other matters; our finding, our recommendation, and the agency preliminary response; and a glossary of abbreviations and terms.

The agency preliminary response was taken from the agency's response at the end of our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendation and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

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



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INDEPENDENT AUDITOR'S REPORT ON  
INTERNAL CONTROL AND COMPLIANCE



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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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the State of Michigan 401K Plan as of and for the fiscal year ended September 30, 2013 and the related notes to the basic financial statements and have issued our report thereon dated December 18, 2013.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the basic financial statements, we considered the Plan's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control. Accordingly, we do not express an opinion on the effectiveness of the Plan'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. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, as described in Finding 1, that we consider to be a significant deficiency.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Plan'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*.

### **Plan's Response to Finding**

The Plan's preliminary response to the finding identified in our audit is included in the body of our report. The Plan'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,



Thomas H. McTavish, C.P.A.

Auditor General

December 18, 2013

**FINDING, RECOMMENDATION, AND  
AGENCY PRELIMINARY RESPONSE**

## **FINDING**

### **1. Reconciliation of Financial Activity**

Financial Services, within the Department of Technology, Management, and Budget (DTMB), could improve its process to reconcile the State of Michigan 401K Plan's financial activity with the information provided by the third party administrator (TPA). As a result of the weaknesses in the current reconciliation process, the Plan's participant loans balance, net appreciation in fair value of investments, and net position were each overstated by \$8.4 million as of September 30, 2013.

Section 18.1485 of the *Michigan Compiled Laws* requires each department to establish and maintain an internal accounting and administrative control system, including internal control techniques that are effective and efficient.

The Office of Retirement Services contracted with a TPA to provide recordkeeping, administration, custodial, and education services for the Plan and had a business partnership agreement with Financial Services to provide accounting and financial reporting services. The TPA provided Financial Services with monthly financial activity reports as well as other detailed information to enable Financial Services to record the Plan's accounting entries and prepare the Plan's annual financial statements.

Our audit procedures identified the following:

- a. Financial Services did not ensure that the Plan's participant loans balance, as of September 30, 2013, reconciled to the balance reported by the TPA. As a result, Financial Services incorrectly included \$8.4 million of defaulted loans in the Plan's participant loans balance. Financial Services explained that it misinterpreted the TPA's defaulted loan reporting process and balances reported by the TPA as of September 30, 2013, resulting in this error.
- b. Financial Services did not ensure that the Plan's net appreciation in fair value of investments for the fiscal year ended September 30, 2013 reconciled to the amount reported by the TPA. As a result, Financial Services overstated net appreciation in fair value of investments by \$8.4 million. We determined that \$7.8 million of this overstatement related to Financial Services recording

duplicate loan earnings. Financial Services explained that it identified this variance during its reconciliation process; however, because of timing and the immaterial amount, it did not resolve the variance.

### **RECOMMENDATION**

We recommend that Financial Services, within DTMB, improve its process to reconcile the Plan's financial activity with the information provided by the TPA.

### **AGENCY PRELIMINARY RESPONSE**

DTMB agrees with the recommendation but notes that the State's accounting records and the published financial statements were materially accurate. DTMB informed us that, due to timing and materiality, it will correct the errors in fiscal year 2013-14. Also, Financial Services indicated that it will work with the TPA to improve shared understanding and documentation of data provided by the TPA.

# GLOSSARY

## Glossary of Abbreviations and Terms

deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
DTMB	Department of Technology, Management, and Budget.
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.
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.
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.

unmodified opinion

The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the basic financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.





