



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS

STATE OF MICHIGAN 401K PLAN

Fiscal Year Ended September 30, 2014



Doug A. Ringler, CPA, CIA  
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:

*<http://audgen.michigan.gov>*



# OAG

Office of the Auditor General

## Report Summary

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

### *State of Michigan 401K Plan*

### *Fiscal Year Ended September 30, 2014*

**Report Number:  
071-0156-15M**

**Released:  
April 2015**

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 State of Michigan 401K Plan's financial statements dated December 29, 2014.

<b>Finding Related to Internal Control, Compliance, and Other Matters</b>	<b>Material Weakness</b>	<b>Significant Deficiency</b>	<b>Agency Preliminary Response</b>
The Office of Retirement Services and Financial Services did not have sufficient internal control in place to ensure the proper classification of investments and the proper recording of financial activity on the State of Michigan 401K Plan financial statements ( <a href="#">Finding 1</a> ).		X	Agrees

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>

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

**Doug A. Ringler, CPA, CIA**  
Auditor General

**Laura J. Hirst, CPA**  
Deputy Auditor General





# OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • <http://audgen.michigan.gov>

**Doug A. Ringler, CPA, CIA**  
Auditor General

April 7, 2015

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, 2014 and have issued a separate report thereon dated December 29, 2014. 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 is our report on internal control, compliance, and other matters of the State of Michigan 401K Plan for the fiscal year ended September 30, 2014.

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 "Doug Ringler". The signature is written in a cursive style with a large, prominent 'D' and 'R'.

Doug Ringler  
Auditor General



## TABLE OF CONTENTS

### STATE OF MICHIGAN 401K PLAN

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE	
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	8
FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE	
1. Accounting for Investment Activity	12
GLOSSARY	
Glossary of Abbreviations and Terms	18



INDEPENDENT AUDITOR'S REPORT ON  
INTERNAL CONTROL AND COMPLIANCE



# OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • <http://audgen.michigan.gov>

**Doug A. Ringler, CPA, CIA**  
Auditor General

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

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, 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, 2014 and the related notes to the basic financial statements and have issued our report thereon dated December 29, 2014.

### **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. 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,



Doug Ringler  
Auditor General  
December 29, 2014



FINDING, RECOMMENDATION, AND  
AGENCY PRELIMINARY RESPONSE

## **FINDING**

### 1. Accounting for Investment Activity

The Office of Retirement Services (ORS) and Financial Services did not have sufficient internal control\* in place to ensure the proper classification of investments and the proper recording of financial activity on the State of Michigan 401K Plan financial statements.

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\*, including recordkeeping procedures and internal control techniques that are effective and efficient.

Our audit procedures noted:

- a. Financial Services did not identify a change in the classification of investments during the fiscal year, resulting in the following classification errors on the draft statement of plan fiduciary net position:

<u>Financial Statement Line Item</u>	<u>Misstatement (In Thousands)</u>
Investments:	
Mutual funds	Overstated \$ 528,583.0
Dodge & Cox Stock Fund	Understated \$ 461,381.1
Artisan Mid Cap Fund	Understated \$ 67,201.9
Impact on Plan Net Position	\$ 0

During the fiscal year, the classification of the Dodge & Cox Stock Fund and the Artisan Mid Cap Fund changed from a mutual fund to a separate account as the funds are now for the exclusive use and benefit of State of Michigan 401K Plan participants. ORS was involved in the change in the investment strategies for these investments; however, the impact on the financial statements was not identified.

\* See glossary at end of report for definition.

Subsequent to our review, Financial Services corrected the identified classification errors. Although the financial statements were materially correct, ORS and Financial Services should establish effective internal control to ensure the proper classification of investment balances in future years.

- b. Financial Services incorrectly allocated the value of investment balances between investment types on the statement of plan fiduciary net position and financial activity between line items on the statement of changes in plan fiduciary net position for individuals who were participants of both the defined contribution fund and deferred compensation fund.

Financial Services' allocation methodology determined the overall adjustment in net position and changes in net position for the defined contribution fund and deferred compensation fund and allocated the adjustment to the critical lines on the Plan's financial statements. However, the adjustments resulted in the following estimated financial statement errors on the final statement of plan fiduciary net position and the final statement of changes in plan fiduciary net position:

#### Statement of Plan Fiduciary Net Position

Financial Statement Line Item	Misstatement (In Thousands)
Investments:	
Common trust funds	Understated \$11,287.6
Stable Value Fund	Overstated \$ 6,704.6
Dodge & Cox Stock Fund	Overstated \$ 3,289.8
Jennison Large Cap Growth Equity Fund	Overstated \$ 1,460.4
Voya Small Cap Growth Strategy Fund	Understated \$ 63.8
Tier III investments	Understated \$ 43.6
Mutual funds	Understated \$ 32.9
Artisan Mid Cap Fund	Understated \$ 26.9
Impact on Plan Net Position	\$ 0

## Statement of Changes in Plan Fiduciary Net Position

Financial Statement Line Item	Misstatement (In Thousands)
Additions to Net Position:	
Interest and Dividends	Understated \$ 3,973.6
Net increase in fair value of investments	Understated \$ 20,120.4
Contributions – Employees	Understated \$ 5,106.3
Contributions – Employers	Overstated \$ 1,726.4
Transfers from other systems	Understated \$ 157.3
Deductions from Net Position:	
Benefits paid to participants	Understated \$ 14,649.6
Refunds and payments to other systems	Understated \$ 12,226.5
Administrative and investment expenses	Understated \$ 755.1
Impact on Net Increase (Decrease) in Net Position	\$ 0

Because of year-end deadlines for processing accounting entries, Financial Services implemented a new methodology for recording the balances and financial activity for individuals who were participants of both the defined contribution fund and the deferred compensation fund. However, Financial Services focused on ensuring that overall net position was accurate and inadvertently did not consider the effect the new methodology had on the Plan's individual financial statement line items.

### **RECOMMENDATION**

We recommend that ORS and Financial Services implement sufficient internal control to ensure the proper classification of investments and the proper recording of financial activity on the State of Michigan 401K Plan financial statements.

## **AGENCY PRELIMINARY RESPONSE**

The Department of Technology, Management, and Budget (DTMB) provided us with the following response:

*DTMB agrees with the recommendation. However, DTMB notes that the State of Michigan 401K Plan's accounting records and the published financial statements were materially accurate and the deficiency noted had no impact on participant accounts. ORS and Financial Services will work to improve the investment balance work sheet that is used to allocate investment balances and activity between the defined contribution and deferred compensation funds. Additionally, Financial Services will work to strengthen internal control by performing periodic reviews and reconciliations of the financial activity reports.*



# 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.
generally accepted accounting principles	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the basic financial statements that causes the statements to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.

material weakness in internal control over financial reporting

A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the basic financial statements will not be prevented, or detected and corrected, on a timely basis.

ORS

Office of Retirement Services.

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.





