

EXECUTIVE DIGEST

STATE EMPLOYEES' DEFERRED COMPENSATION FUND I AND FUND II

INTRODUCTION

This report contains the results of our financial audit of the State Employees' Deferred Compensation Fund I (457 Plan) and Fund II (401(k) Plan), Department of Civil Service, for the period October 1, 1991 through September 30, 1993.

AUDIT PURPOSE

This financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.

BACKGROUND

The State Employees' Deferred Compensation Fund I (457 Plan) and Fund II (401(k) Plan) are administered by the Employee Benefits Division, Employee Benefits and Health Services Bureau, Department of Civil Service, in accordance with the Internal Revenue Code, Internal Revenue Service requirements, and plan regulations. The Civil Service Commission formally adopted the plan for Fund I in April 1974 and the plan for Fund II in August 1985. The plans allow employees to set aside a portion of their earnings and defer the payment of taxes until benefits are paid to the

employees or their beneficiaries upon retirement, disability, death, or separation from State service. A member may also receive payment in the event of a financial emergency.

Section 38.1151 of the *Michigan Compiled Laws* (Act 306, P.A. 1976) authorized the Department of Civil Service to invest deferred compensation funds. Currently, the department deposits the funds in the State Treasurer's common cash account and subsequently invests the majority of the funds in guaranteed investment contracts (GIC's) with insurance companies. The department also made available mutual fund investment alternatives to Fund II members in December 1987. In May 1994, members were given the opportunity to transfer a portion of their existing balances in Fund I GIC's to a mutual fund investment alternative. The investment policies and practices are based on the advice of the Deferred Compensation Advisory Committee. The committee established investment guidelines, effective July 1, 1987, which define the investment objectives of the plans. The investment guidelines also serve to define the strategy and discipline for the management of all funds.

For the fiscal year ended September 30, 1993, Fund I had investment income of over \$99 million, contributions of over \$81 million, and had paid over \$68 million in benefits. Fund II had investment income of over \$29 million, contributions of over \$45 million, and had paid over \$4 million in benefits.

The \$1.8 million cost to operate both plans was derived from plan investment income. As of September 30, 1993, there were approximately 74,000 members in both plans and

approximately 6,800 members were receiving compensation payments.

**AUDIT
OBJECTIVES
AND
CONCLUSIONS**

Audit Objective: To assess the adequacy of the funds' internal control structure.

Conclusion: Our assessment of the funds' internal control structure did not disclose any material weaknesses. However, we did note some internal control problems related to investment regulations, cash reserves, call options, data processing controls, amortization schedules, contract representatives, and records management (Findings 1 through 7).

Audit Objective: To assess the funds' compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and department policies and procedures.

Conclusion: Our assessment of the funds' compliance did not disclose any material noncompliance issues. However, our assessment did disclose compliance problems with nondiscrimination testing at the Department of Civil Service (Finding 8). We also noted compliance problems relating to fund deposits by the Department of Treasury (Finding 9).

Audit Objective: To audit the funds' financial statements for the fiscal years ended September 30, 1993 and September 30, 1992.

Conclusion: We issued unqualified opinions on the funds' financial statements. We have no findings to report for this objective.

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the State Employees' Deferred Compensation Fund I (457 Plan) and Fund II (401(k) Plan) for the period October 1, 1991 through September 30, 1993. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

**AGENCY
RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report includes 9 findings and 9 corresponding recommendations. The agency preliminary response for our audit indicated that the agency agreed with all our recommendations.

The department had complied with 10 of our 18 prior audit recommendations.