



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

PERFORMANCE AUDIT
OF

MEMBER DATA OF THE
MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

OFFICE OF RETIREMENT SERVICES
DEPARTMENT OF TECHNOLOGY, MANAGEMENT, AND BUDGET

June 2014



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

Performance Audit

Member Data of the Michigan Public School Employees' Retirement System

Office of Retirement Services, Department of Technology, Management, and Budget

Report Number:
071-1153-12L

Released:
June 2014

The Michigan Public School Employees' Retirement System (MPERS) is a cost-sharing, multiple-employer, Statewide, defined benefit public employee retirement plan governed by the State of Michigan. MPERS's pension plan provides retirement, survivor, and disability benefits to eligible employees in public school districts, intermediate school districts, certain public school academies, district libraries, tax-supported community or junior colleges, and certain universities. In addition, MPERS's health plan provides eligible retirees with the option of receiving health, dental, and vision coverage.

Audit Objective:

To assess the effectiveness of the Office of Retirement Services' (ORS's) efforts in monitoring the accuracy and validity of MPERS member data.

Audit Conclusion:

We concluded that ORS's efforts in monitoring the accuracy and validity of MPERS member data were moderately effective. We noted four reportable conditions (Findings 1 through 4).

Reportable Conditions:

ORS's internal control did not ensure the accuracy and completeness of MPERS members' wage and hour data reported to ORS by reporting units. Also, ORS had not established a data sharing arrangement with the Unemployment Insurance Agency to obtain the necessary wage data for comparison to ensure the accuracy of employer-reported wage data and resulting contributions to MPERS (Finding 1).

ORS had not implemented an effective review process to ensure that ORS enrolls new MPERS members in the proper benefit structure (Finding 2).

ORS had not implemented a process to ensure that wages reported by reporting units for public school employees under the age of 19 years were reportable to MPERS (Finding 3).

ORS had not implemented an effective review process to ensure the proper reporting of wages for MPERS retirees who return to work (Finding 4).

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Agency Response:

Our audit report contains 4 findings and 5 corresponding recommendations. ORS's preliminary response indicates that it agrees with all 5 recommendations.

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obtained by calling 517.334.8050
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<http://audgen.michigan.gov>



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June 6, 2014

Mr. Scott Koenigs knecht, Chair
Michigan Public School Employees' Retirement System Board
General Office Building
and
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. Koenigs knecht, Mr. Behen, and Mr. Stoddard:

This is our report on the performance audit of Member Data of the Michigan Public School Employees' Retirement System, Office of Retirement Services, Department of Technology, Management, and Budget.

This report contains our report summary; a description agency; our audit objective, scope, and methodology and agency responses; comment, findings, recommendations, and agency preliminary responses; and a glossary of abbreviations and terms.

The agency preliminary responses were 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 recommendations 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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Description of Agency

The Michigan Public School Employees' Retirement System (MPERS) is a cost-sharing, multiple-employer, Statewide, defined benefit public employee retirement plan governed by the State of Michigan, originally created under Act 136, P.A. 1945, and recodified and currently operating under the provisions of Act 300, P.A. 1980, as amended. MPERS's pension plan provides retirement, survivor, and disability benefits to eligible employees in public school districts, intermediate school districts, certain public school academies, district libraries, tax-supported community or junior colleges, and certain universities (referred to as "reporting units" in this report). In addition, MPERS's health plan provides eligible retirees with the option of receiving health, dental, and vision coverage.

MPERS is administered by a 12-member board composed of the Superintendent of Public Instruction and 11 members appointed by the Governor with the advice and consent of the Senate.

The Office of Retirement Services (ORS), within the Department of Technology, Management, and Budget, acts as the central administrative unit for MPERS and other State-managed retirement systems. ORS's mission* is to be an innovative retirement organization driven to empower its customers for a successful today and a secure tomorrow.

ORS's primary responsibilities include maintaining accurate active member* history files, adding new retirees to the pension payrolls, collecting employer and member contributions, and refunding member contributions. As of September 30, 2013, ORS had 157 employees. For fiscal year 2012-13, ORS had payroll expenditures of \$11.3 million, of which \$8.5 million was charged to MPERS.

As of September 30, 2013, MPERS had 706 reporting units* and 423,093 members and a net asset balance of \$42.6 billion. During the 12-month period ended September 30, 2013, ORS paid pension benefits of \$4.2 billion on behalf of 200,952 retirees, health benefits of \$613.0 million on behalf of 147,260 retirees, and dental and vision benefits of \$98.6 million on behalf of 159,152 retirees.

* See glossary at end of report for definition.

Audit Objective, Scope, and Methodology and Agency Responses

Audit Objective

The objective of our performance audit* of Member Data of the Michigan Public School Employees' Retirement System (MPERS), Office of Retirement Services (ORS), Department of Technology, Management, and Budget, was to assess the effectiveness* of ORS's efforts in monitoring the accuracy and validity of MPERS member data*.

Audit Scope

Our audit scope was to examine the member data and other records of the Michigan Public School Employees' Retirement System related to assessing the completeness of the Office of Retirement Services' monitoring efforts. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusion based on our audit objective. Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered the period July 1, 2010 through June 30, 2013.

Audit Methodology

We conducted a preliminary survey of ORS's operations to establish our audit objective and scope. Our preliminary survey included interviewing various members of ORS management and staff; reviewing applicable State laws, policies, procedures, and manuals; and obtaining an understanding of and documenting ORS's internal control* related to monitoring the accuracy and validity of member wage and hour data.

To accomplish our objective, we examined ORS's process for obtaining member wage and hour data from reporting units. We interviewed ORS staff to gain an understanding of the process for ensuring the accuracy and validity of reported member wage and hour data, which includes an annual wage review, a review of retirees with miscoded wages, and reviews of members' benefit structure* designation. We randomly sampled

* See glossary at end of report for definition.

members subject to each review to verify that ORS obtained documentation to conclude that the members' reported wages, hours worked, and benefit structure were accurate and that corrections were made, if necessary.

We obtained wage and hour data reported by reporting units to ORS. We reviewed 16 reporting units from a random sample of 50 reporting units and judgmentally selected 1 additional reporting unit. We obtained detailed payroll records from the 17 reporting units to verify the accuracy of the wage and hour data reported to ORS, and we performed audit procedures on discrepancies, including direct follow-up with the reporting units.

We performed cross matches of reporting unit wage data reported to ORS with Unemployment Insurance Agency (UIA) wage data to verify that the wage data reported to ORS by reporting units was complete, and we performed audit procedures on discrepancies. We also performed a cross match with UIA wage data to identify members receiving a disability pension who had also returned to work. We randomly selected a sample of members receiving a disability pension who had returned to work to verify that the members reported their earnings to ORS and that ORS appropriately adjusted the members' pension when they exceeded their earnings limit.

We completed a trend analysis of reported wages, reported hours worked, and MPERS plan membership by reporting unit, and we performed audit procedures on significant fluctuations. We selected a random sample of MPERS members identified by ORS as having had a change in their benefit structure to verify the accuracy of employee and employer contributions on reported wages.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary survey. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

Agency Responses

Our audit report contains 4 findings and 5 corresponding recommendations. ORS's preliminary response indicates that it agrees with all 5 recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require ORS to develop a plan to comply with the audit recommendations 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.

COMMENT, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

MONITORING THE ACCURACY AND VALIDITY OF MPSERS MEMBER DATA

COMMENT

Audit Objective: To assess the effectiveness of the Office of Retirement Services' (ORS's) efforts in monitoring the accuracy and validity of the Michigan Public School Employees' Retirement System (MPSERS) member data.

Audit Conclusion: We concluded that ORS's efforts in monitoring the accuracy and validity of MPSERS member data were moderately effective.

Our audit conclusion was based on our audit efforts as described in the audit scope and audit methodology sections and the resulting reportable conditions* noted in the comment, findings, recommendations, and agency preliminary responses section.

We noted four reportable conditions related to the reported member wage and hour data, verification of new hire benefit structure enrollment, members under the age of 19 years, and retiree wage review (Findings 1 through 4). In our professional judgment, these matters are less severe than a material condition* but represent opportunities for improvement.

In reaching our conclusion, we considered the significance of the reportable conditions and other areas reviewed in relation to the MPSERS total contributions of \$3.1 billion in fiscal year 2012-13 and the net asset balance of \$42.6 billion as of September 30, 2013. In addition, we considered qualitative factors, such as the lack of known instances of fraud and the public perception of MPSERS. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

FINDING

1. **Reported Member Wage and Hour Data**

ORS's internal control did not ensure the accuracy and completeness of MPSERS members' wage and hour data reported to ORS by reporting units. Also, ORS had not established a data sharing arrangement with the Unemployment Insurance Agency (UIA) to obtain the necessary wage data for comparison to ensure the accuracy of employer-reported wage data and resulting contributions to MPSERS.

* See glossary at end of report for definition.

As a result, we estimated that reporting units did not report to ORS approximately 8,500 MPERS members with an associated \$50.7 million in wages and 2.5 million hours worked, resulting in a \$2.3 million underpayment of employee and employer contributions. In addition, we estimated that reporting units overreported members' wages by \$7.9 million, resulting in a \$1.4 million overpayment of employee and employer contributions.

Inaccurate and incomplete reporting of members' wages and hours worked could impact the members' service credit earned and their final average compensation*, two significant factors that impact the calculation of a member's retirement pension amount. In addition, the inaccurate and incomplete reporting of members' wages will impact the amount of required employee and employer contributions due to MPERS, which is used to fund retiree pension and health benefits.

ORS conducts a variety of audits of reporting units to ensure the accuracy and completeness of the wage and hour data reported. Two of the primary audits include targeted audits of selected reporting units and an annual wage review. During a targeted audit, ORS selects a reporting unit and obtains detailed wage and hour data to verify the accuracy and completeness of wages reported to ORS. However, from July 1, 2010 through June 30, 2013, ORS conducted only 5 targeted audits. During an annual wage review, ORS tests a random sample of members who have a change in reported wages that exceeds a calculated percent from the prior year and obtains supporting documentation from the reporting unit to verify the accuracy of the wages reported to ORS.

Section 38.1342(6) of the *Michigan Compiled Laws* states that each reporting unit shall submit to the retirement system a report that includes persons employed, wages or amounts paid, hours, and required contributions. Section 38.1303a(2) of the *Michigan Compiled Laws* defines the reportable types of compensation paid to a member for services performed as a public school employee and includes wages earned, but not limited to, teaching, coaching, and participation in extracurricular activities. Also, Section 38.1303a(3) of the *Michigan Compiled Laws* excludes payments for unused sick and annual leave, termination pay, and bonus payments from reportable compensation. In addition, Section 38.1341(7) of the *Michigan Compiled Laws* states that the ORS director may require evidence of correctness

* See glossary at end of report for definition.

and may conduct an audit of the aggregate compensation that the ORS director considers necessary to establish its correctness. Further, Section 421.11(b)(1)(vi) of the *Michigan Compiled Laws* (a section of the Michigan Employment Security Act) states that wage data obtained by UIA in connection with the administration of this act may be made available to State departments upon the completion of a data sharing arrangement with UIA.

UIA requires employers Statewide to report, on a quarterly basis, all wages paid to employees. ORS can cross match the UIA employee wage data to ORS's database of employee-reported wages to help ORS identify employers that are potentially not reporting employees eligible for a MPSERS pension, overreporting or underreporting employee wages to ORS, or misclassifying some of their employees as independent contractors, all of which would impact the amount of contributions due to MPSERS and impact a member's future retirement benefits.

From July 1, 2010 through June 30, 2012, 726 reporting units participating in the MPSERS plan reported \$18.6 billion in wages and approximately 580 million hours worked for 299,188 members. We tested a random sample of 16 reporting units and judgmentally selected 1 reporting unit to determine the accuracy and completeness of the MPSERS members' wages and hours reported to ORS. Our review disclosed:

- a. Four of the 17 reporting units understated wages for 2,377 (5.3%) of the 44,436 members tested, resulting in the understatement of wages reported to ORS by \$8.1 million and the underpayment of employee and employer contributions by \$3.3 million. In addition, 2 of the 17 reporting units overstated wages for 503 (1.1%) of the 44,436 members tested, resulting in an overstatement of wages reported to ORS by approximately \$900,000 and the overpayment of employee and employer contributions by approximately \$238,000.

Using the results of the 16 randomly selected reporting units, we estimated that reporting units overstated member wages by \$15.9 million from July 1, 2010 through June 30, 2012 and that reporting units overpaid employee and employer contributions by \$4.7 million.

In addition, for the 1 judgmentally selected reporting unit, we identified an understatement of member wages by \$8.0 million from July 1, 2010 through June 30, 2012 and the reporting unit underpaid employee and employer contributions by \$3.3 million.

- b. Six of the 17 reporting units did not report wages paid and hours worked for 526 MPSERS members, resulting in \$3.4 million in unreported wages and approximately 206,000 unreported hours worked. We determined that \$1.0 million in employee and employer contributions were not paid to ORS by the reporting units on these wages.

Using the results of the 16 randomly selected reporting units, we estimated that reporting units did not report \$4.9 million in member wages and 33,000 in hours worked to ORS for approximately 350 MPSERS members from July 1, 2010 through June 30, 2012 and reporting units did not pay \$1.3 million in employee and employer contributions.

In addition, for the 1 judgmentally selected reporting unit, we determined that the reporting unit did not report \$3.4 million in member wages and 205,000 in hours worked to ORS for 511 MPSERS members from July 1, 2010 through June 30, 2012 and that the reporting unit did not pay \$1.0 million in employee and employer contributions.

- c. Three of the 17 reporting units did not report wages paid and hours worked for 524 MPSERS retirees who had returned to work, resulting in \$2.7 million in unreported wages and 133,000 unreported hours worked. In addition, 4 of the 17 reporting units did not report the correct wages for 109 (10.9%) of the 1,000 MPSERS retirees who had returned to work, resulting in \$330,000 in unreported wages. During our audit period, reporting units were not required to pay employee and employer contributions on the wages earned by retirees who returned to work. However, retirees are subject to earnings limits and retirees' pensions would be reduced if they exceeded their earnings limits.

Using the results of the 16 randomly selected reporting units, we estimated that reporting units did not report \$41.4 million in member wages and 2.2 million in hours worked to ORS for approximately 7,300 MPSERS retirees from July 1, 2010 through June 30, 2012.

In addition, for the 1 judgmentally selected reporting unit, we determined that the reporting unit did not report \$1.0 million in member wages and 33,500 in hours worked to ORS for 315 MPSERS retirees from July 1, 2010 through June 30, 2012.

Beginning in fiscal year 2014-15, MPSERS will be implementing the Governmental Accounting Standards Board Statement 67, *Financial Reporting for Pension Plans*. As part of this implementation, the auditors of MPSERS will be required to audit a minimum percentage of the school district reported demographic and wage data. Consequently, ORS's development of internal control should consider the expanded audit requirements.

RECOMMENDATIONS

We recommend that ORS improve its internal control to ensure the accuracy and completeness of MPSERS members' wage and hour data reported to ORS by reporting units.

We also recommend that ORS establish a data sharing arrangement with UIA to obtain the necessary wage data for comparison to ensure the accuracy of employer-reported wage data and resulting contributions to MPSERS.

AGENCY PRELIMINARY RESPONSE

ORS agrees with the recommendations. ORS acknowledges the Office of the Auditor General's (OAG's) innovative recommendation of using the UIA data and will perform a cost-benefit analysis to determine whether using the UIA data is a viable option.

ORS notes the OAG included a very large school district that has been identified by the Michigan Department of Education as having financial management difficulties. This may have produced results that are not reflective on the true MPSERS universe.

FINDING

2. Verification of New Hire Benefit Structure Enrollment

ORS had not implemented an effective review process to ensure that ORS enrolls new MPSERS members in the proper benefit structure. As a result, we estimated

that 242 MPSERS members are enrolled in an incorrect benefit structure, which could impact the amount of required employee and employer contributions and the level of pension and health care benefits that the members would receive upon retirement.

MPSERS currently has 10 benefit structures, with varying enrollment eligibility periods, some of which are closed to new members. Member eligibility for these benefit structures is determined by the first day a member works for a MPSERS reporting unit. For example, members with a first day worked of July 1, 2010 or later are not eligible for a pension until age 60 and must have at least 10 years of service. However, a member with a first day worked during the period from January 1, 1990 through June 30, 2010 is not eligible for a pension until the member has either 30 years of service or when the member reaches age 60 with 10 years of service. Also, members whose first day worked is prior to September 4, 2012 are eligible for health care benefits upon retirement. However, a member with a first day worked on or after September 4, 2012 is not eligible for health care benefits upon retirement and, instead, would receive up to a 2.0% employer match into a defined contribution account. However, ORS does not enroll a new member into a benefit structure based on the member's first day worked but rather on the reporting unit's reporting of the hire date or the first day in the pay period in which the member's wages are reported if no hire date is provided.

In fiscal years 2007-08, 2009-10, and 2011-12, legislative changes impacted the pension and health care benefits that a member receives upon retirement. In fiscal years 2007-08, 2009-10, and 2011-12, ORS conducted a review to identify all new members who had wages reported for the first time between June 1, 2008 and July 31, 2008, June 1, 2010 and July 31, 2010, and August 1, 2012 and September 30, 2012, respectively. ORS requested the reporting unit to verify the members' first day worked.

During our review:

- a. We identified 6,784 new MPSERS members who had initial wages reported to ORS between June 1, 2010 and July 31, 2010 or August 1, 2012 and September 30, 2012. We selected a sample of 50 members to determine if

ORS had obtained documentation from the applicable reporting units to verify the members' first day worked. Our review disclosed:

- (1) ORS did not obtain responses from reporting units for 12 (24.0%) of the 50 members to confirm the members' first day worked.
 - (2) ORS did not follow up 1 (2.0%) instance in which a reporting unit indicated that a member's start date was 24 days after the reporting unit first reported the member's wages. Using the incorrect start date for this member allowed for enrollment in a benefit structure that the member was not eligible for. After we notified ORS of the exception, ORS obtained additional information from the reporting unit that confirmed the member was in the correct plan.
- b. We analyzed MPSERS member data as of June 2013 and identified 1,033 members enrolled in the MIP Graded benefit structure and 279 members enrolled in the MIP Plus benefit structure who did not have their first wages reported to ORS until after June 30, 2008 and June 30, 2010, respectively. However, eligibility in the MIP Graded benefit structure required MPSERS members to have first worked on or after January 1, 1990 but before July 1, 2008, and eligibility in the MIP Plus benefit structure required MPSERS members to have first worked on or after July 1, 2008 but before July 1, 2010.

We tested a sample of 25 MIP Graded members and 8 MIP Plus members to determine if ORS enrolled the members in the proper benefit structure. Our review disclosed:

- (1) Five (20.0%) of the 25 MIP Graded members tested had first worked after the MIP Graded benefit structure closed to new members on June 30, 2008 and, therefore, should have been placed in a different benefit structure.
- (2) One (12.5%) of the 8 MIP Plus members tested had first worked after the MIP Plus benefit structure closed to new members on June 30, 2010. In addition, we identified approximately 1,100 inactive MIP Plus members who have not had wages reported to ORS who could begin working at a reporting unit and would be enrolled in the wrong benefit structure.

RECOMMENDATION

We recommend that ORS implement an effective review process to ensure that ORS enrolls new MPSERS members in the proper benefit structure.

AGENCY PRELIMINARY RESPONSE

ORS agrees with the recommendation and stated that it complied with this recommendation in January 2014. ORS informed us that it has implemented process enhancements which confirm and document newly hired MPSERS members reported to its system. ORS also informed us that this enhancement includes a benefit structure monitoring system as well as a proactive communication effort to MPSERS reporting units on new hires. Lastly, ORS has informed us that it has two system enhancements planned for fiscal year 2015 that will address how a benefit structure is created in the Clarety system.

FINDING

3. Members Under the Age of 19 Years

ORS had not implemented a process to ensure that wages reported by reporting units for public school employees under the age of 19 years were reportable to MPSERS. As a result, approximately 7,500 seasonal and part-time public school employees under the age of 19 years had wages reported to ORS prior to qualifying as eligible members of MPSERS. The failure to remove ineligible wages and associated service credits will have additional long-term impacts on MPSERS. The ineligible reported wages and service credits could cause the members to be enrolled in the wrong benefit structure and could also result in an overstatement of the members' service credits earned.

Section 38.1305(1)(l) of the *Michigan Compiled Laws*, effective June 10, 1998, states that a member means a public school employee but specifically excludes a person who is employed by a reporting unit in a temporary, intermittent, or irregular seasonal or athletic position and who is under the age of 19 years.

ORS completed a review of reported wages from July 2007 through January 2011 that identified approximately 3,100 members with wages reported to MPSERS prior to the members reaching the age of 19 years. ORS determined that 94% of the

members under the age of 19 years were in part-time or seasonal positions and their reported wages, prior to turning 19, did not qualify as reportable to MPSERS. However, ORS did not ensure that reporting units had removed the ineligible wages and associated service credits from MPSERS for the members identified.

Each MPSERS benefit structure has different requirements regarding the required employee and employer contribution rates and the level of pension and health care benefits the member will receive upon retirement. The first day an eligible member works dictates which benefit structure a member qualifies for.

We tested a random sample of 25 members identified by ORS as having wages prior to reaching the age of 19 years that did not qualify as reportable to MPSERS to determine if the members were enrolled in the proper benefit structure. Our review disclosed:

- a. Four (16.0%) of the 25 members were enrolled in an incorrect benefit structure. All four members continued employment beyond age 19 and their eligible wages starting at age 19 should have placed these members in a different benefit structure. In one instance, the reporting unit reversed the members' wages earned prior to age 19 (on October 28, 2011), but ORS did not correct the members' benefit structure placement.
- b. Twelve (48.0%) of the 25 members did not have any wages reported to ORS after reaching the age of 19 years. If these members return to work as a public school employee, they potentially could be enrolled in an incorrect benefit structure.
- c. Nine (36.0%) of the 25 members were enrolled in the proper benefit structure.

We completed a review of reported wages from July 1998 through September 2012 and identified approximately 8,000 members who had wages reported to MPSERS prior to the members reaching the age of 19 years. We applied the 94% exception rate calculated by ORS during its review and we estimated that approximately 7,500 members could have wages reported to ORS prior to qualifying as eligible members of MPSERS.

RECOMMENDATION

We recommend that ORS implement a process to ensure that wages reported by reporting units for public school employees under the age of 19 years are reportable to MPSERS.

AGENCY PRELIMINARY RESPONSE

ORS agrees with the recommendation and stated that it complied with this recommendation on July 1, 2013. ORS informed us that it has implemented an annual process to review members reported under the age of 19 and established controls to improve the standards to how members are placed into a benefit structure. ORS is continuing to improve and resolve members identified during the review moving forward.

FINDING

4. Retiree Wage Review

ORS had not implemented an effective review process to ensure the proper reporting of wages for MPSERS retirees who return to work. As a result, we estimated that ORS improperly collected approximately \$76,000 in employee and employer contributions from September 1, 2011 through July 26, 2012.

The Public School Employees Retirement Act of 1979 (Act 300, P.A. 1980, as amended) does not require employee and employer contributions on wages for MPSERS retirees who return to work, with the exception of retirees who return to work at a reporting unit under Act 464, P.A. 2012 (Section 38.1361 of the *Michigan Compiled Laws*). However, during our audit period, ORS required reporting units to report wages paid to retirees who return to work, which ORS uses to ensure that retirees do not exceed established earnings limits, which can impact a retiree's pension.

ORS conducts periodic reviews to identify MPSERS retirees who have returned to work with wages improperly reported to ORS as nonretired wages by their employer, which results in overpayments of employee and employer contributions for the reported wages. ORS then requests the reporting unit to correct the improperly reported wages.

ORS identified 429 pay periods, relating to 207 retirees, from September 1, 2011 through July 26, 2012, in which a reporting unit improperly reported retiree wages as nonretired wages. We selected a random sample of 25 pay periods, relating to 24 retirees, to determine if the reporting units had corrected the improperly reported wages. Our review disclosed:

- a. Reporting units did not correct 18 (72.0%) of the 25 pay periods, resulting in an overpayment of \$951 in employee contributions and \$3,461 in employer contributions to MPSERS. We estimated that approximately \$76,000 in employee and employer contributions were improperly collected from reporting units from September 1, 2011 through July 26, 2012.
- b. Reporting units in 3 (12.0%) of the 25 pay periods reversed the improperly reported wages but did not repost the wages as retiree wages. Section 38.1361 of the *Michigan Compiled Laws* establishes earnings limits for retirees based on a retiree's final average compensation, the retirement effective date, the retiree's age, and the position at the reporting unit. For example, a retiree with a retirement effective date on or after July 1, 2010 who returns to work at a reporting unit as a substitute teacher will forfeit his or her pension and retiree insurance premium subsidy once the member earns one-third of his or her final average compensation in a calendar year. We determined that, in all 3 pay periods, the proper reporting of wages would not have caused the retirees to exceed their earnings limit.
- c. ORS's periodic reviews did not identify all pay periods when the 207 retirees had wages reported as a nonretired member. ORS did not identify an additional 12 pay periods of improperly reported wages for the 24 retirees tested from September 1, 2011 through July 26, 2012. We determined that, in all 12 pay periods, the proper reporting of wages would not have caused the retirees to exceed their earnings limit.

RECOMMENDATION

We recommend that ORS implement an effective review process to ensure the proper reporting of wages for MPSERS retirees who return to work.

AGENCY PRELIMINARY RESPONSE

ORS agrees with the recommendation and stated that it complied with this recommendation on July 1, 2013. ORS informed us that it has implemented a comprehensive review of retiree wages performed quarterly to ensure reporting compliance with members who return to work. However, ORS would like to note that the data selected and analyzed by the OAG was immediately preceding the time period when ORS implemented the quarterly audit on retirees who returned to work.

GLOSSARY

Glossary of Abbreviations and Terms

benefit structure	Categorizes a member's retirement plan type, which varies based on available benefits, eligibility requirements, contribution rates, and pension factors. MPSERS currently supports 10 benefit structures for public school employees: MIP Fixed, MIP Graded, MIP Plus, MIP 7%, MIP DC Converted, Basic, Basic 4%, Basic DC Converted, Pension Plus, and the Defined Contribution Plan.
effectiveness	Success in achieving mission and goals.
final average compensation	The aggregate amount of a member's compensation earned within the averaging period in which the aggregate amount of compensation was highest divided by the member's number of years, including any fraction of a year, of credited service during the averaging period.
internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.

member	A retiree or beneficiary currently receiving benefits, a current employee, or an inactive employee entitled to benefits and not yet receiving benefits.
member data	Data reported by reporting units to ORS for active members, which includes reportable wages, hours worked, and member demographics. Demographic data includes the member's date of birth and date of hire, which determine a member's benefit structure.
mission	The main purpose of a program or an entity or the reason that the program or the entity was established.
MPSERS	Michigan Public School Employees' Retirement System.
OAG	Office of the Auditor General.
ORS	Office of Retirement Services.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.
reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives;

significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

reporting unit

A public school district, an intermediate school district, a public school academy, a district library, a tax-supported community or junior college, or a university.

UIA

Unemployment Insurance Agency.

