Office of the Auditor General

Report on Internal Control Over Financial Reporting

Michigan Public School Employees' Retirement System

Schedules of Employer Allocations and Schedule of Collective Pension Amounts

Fiscal Year Ended September 30, 2014

December 2015

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

071-0164-15

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

Office of the Auditor General

Report Summary

Report on Internal Control Over Financial Reporting
Michigan Public School Employees' Retirement System - Schedules of Employer Allocations and Schedule of Collective Pension Amounts
Fiscal Year Ended September 30, 2014

Report Number:
071-0164-15

Released:
December 2015

Generally accepted auditing standards require that an auditor report to management and those charged with governance any significant deficiencies or material weaknesses that come to the auditor's attention during a financial audit. We are issuing this report in conjunction with our independent auditor's report dated October 15, 2015 on the Michigan Public School Employees' Retirement System's (MPSERS's) schedules of employer allocations and schedule of collective pension amounts as of and for the fiscal year ended September 30, 2014.

Findings Related to Internal Control Over Financial Reporting	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Office of Retirement Services and Financial Services, Department of Technology, Management, and Budget, did not have sufficient controls to ensure the proper allocation of MPSERS's net pension liability between non-universities and universities on the schedule of collective pension amounts (Finding #1).		X	Agrees

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.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

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December 11, 2015

Mr. Scott Koenigsknecht, Chair
Michigan Public School Employees' Retirement System Board
Stevens T. Mason Building
and
Mr. David B. Behen, Director
Department of Technology, Management, and Budget
Lewis Cass Building
and
Ms. Kerrie L. Vanden Bosch, Acting Director
Office of Retirement Services
Steven T. Mason Building
Lansing, Michigan

Dear Mr. Koenigsknecht, Mr. Behen, and Ms. Vanden Bosch:

We have audited the Michigan Public School Employees' Retirement System's (MPSERS's) schedules of employer allocations and specified column totals of the schedule of collective pension amounts as of and for the fiscal year ended September 30, 2014 and related notes. We have issued a separate report thereon dated October 15, 2015. In planning and performing our audit of the financial schedules, we considered MPSERS's internal control over financial reporting. This is our report on internal control over financial reporting for the fiscal year ended September 30, 2014.

Your agency provided a preliminary response to the recommendation at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above 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,

Doug Ringler

Doug Ringler
Auditor General

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ON INTERNAL CONTROL

Office of the Auditor General
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201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • www.audgen.michigan.gov

Independent Auditor's Report on Internal Control Over Financial Reporting

Mr. Scott Koenigsknecht, Chair
Michigan Public School Employees' Retirement System Board
Stevens T. Mason Building
and
Mr. David B. Behen, Director
Department of Technology, Management, and Budget
Lewis Cass Building
and
Ms. Kerrie L. Vanden Bosch, Acting Director
Office of Retirement Services
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Koenigsknecht, Mr. Behen, and Ms. Vanden Bosch:

We planned and performed our audit of the Michigan Public School Employees' Retirement System's schedules of employer allocations and the specified column totals of the schedule of collective pension amounts as of and for the fiscal year ended September 30, 2014 and the related notes in accordance with auditing standards generally accepted in the United States of America. We considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the schedules of employer allocations and on the specified column totals on the schedule of collective pension amounts, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System'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 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 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.

The System's preliminary response to the significant deficiency identified in our audit was not subjected to the auditing procedures applied in the audit of the schedules of employer allocations and the specified column totals of the schedule of collective pension amounts and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the Michigan Public School Employees' Retirement System Board, the Department of Technology, Management, and Budget, and the Office of Retirement Services and is not intended to be, and should not be, used by anyone other than these specified parties.

Sincerely,

Doug Ringler

Doug Ringler
Auditor General
October 15, 2015

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FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

BACKGROUND

Effective January 1, 1996, Public Act 272 of 1995 amended the Public School Employees' Retirement Act to exclude new university employees from the Michigan Public School Employees' Retirement System (MPSERS) and required that the seven participating university employers be responsible for their own unfunded actuarial accrued liability. In fiscal year 1995, the Office of Retirement Services (ORS), with assistance from its third-party actuaries, allocated MPSERS's fiduciary net position between non-university employers and university employers based on the employer groups' share of the unfunded actuarial accrued liability. Also, beginning in fiscal year 1996, ORS and its actuaries accounted for the member activity and applied the applicable actuarial assumptions for university employers to determine the university employers' fiduciary net position. With the implementation of Governmental Accounting Standards Board* (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, ORS required its actuaries to prepare separate valuations for non-university employers and university employers that calculate the total pension liability.

** See glossary at end of report for definition.*

FINDING #1

Improvements in controls needed to ensure proper allocation of net pension liability between non-universities and universities.

ORS and Financial Services, Department of Technology, Management, and Budget, did not have sufficient controls to ensure the proper allocation of MPSERS's net pension liability between non-universities and universities on the schedule of collective pension amounts.

GASB Statement No. 68 requires employers participating in a cost-sharing pension plan to recognize in their financial statements the proportionate share of the collective net pension liability, deferred inflows and deferred outflows of resources, and pension expense. The calculation of these amounts for non-universities and universities is dependent on the completeness and accuracy of the underlying member activity data.

In addition, 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.

We audited the university member activity from fiscal years 1996 through 2014 and noted:

- Transfers to and from the budget stabilization subaccount were improperly included in the valuation of universities' and non-universities' assets, resulting in an overstatement of universities' assets and an understatement of non-universities' assets by $21.8 million.

- The asset valuation for MPSERS from fiscal years 1996 through 2005 included financial statement activity that did not reconcile to MPSERS's audited financial statements. An accounting adjustment affecting fiscal years 1996 through 2005 was inappropriately corrected in fiscal year 2006 instead of retroactively to each of the affected years, resulting in an understatement of universities' assets and an overstatement of non-universities' assets by $4.2 million.

- Benefit payments for retirees of universities were improperly reported in the valuation of universities' assets, resulting in an understatement of universities' assets and an overstatement of non-universities' assets by $6.1 million.

Although these errors did not have a material impact on the allocation of the net pension liability between non-universities and universities, improving controls would help limit the risk that a material error could occur.

** See glossary at end of report for definition.*

RECOMMENDATION

We recommend that ORS and Financial Services implement sufficient controls to ensure the proper allocation of MPSERS's net pension liability between non-universities and universities on the schedule of collective pension amounts.

AGENCY PRELIMINARY RESPONSE

ORS provided us with the following response:

ORS agrees with and has complied with the recommendation. As identified by the Office of the Auditor General, the financial errors do not have a material impact. According to ORS, this is due to their historical nature, i.e., they occurred over the course of a 19-year period, and does not represent MPSERS's current control environment. As of 2007, ORS retained a new actuary and has improved controls over the allocation of the net pension liability between non-universities and universities to help limit the risk that a material error could occur in the future.

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.
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 accordance with the applicable financial reporting framework.
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."
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, 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 financial statements will not be prevented, or detected and corrected, on a timely basis.
MPSERS	Michigan Public School Employees' Retirement System.
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.

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