MICHIGAN

OFFICE OF THE AUDITOR GENERAL

MANAGEMENT LETTER

MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

October 1, 2008 through September 30, 2010

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

071-0152-11M

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

Michigan

Office of the Auditor General

REPORT SUMMARY

Management Letter

Michigan Public School Employees' Retirement System

October 1, 2008 through September 30, 2010

Report Number:
071-0152-11M

Released:
March 2011

The management letter is used to report significant deficiencies in internal control over financial reporting and other matters that come to the auditor's attention during the completion of the financial audit conducted in accordance with generally accepted government auditing standards. This management letter is being issued in conjunction with our financial audit of the Michigan Public School Employees' Retirement System (MPSERS).

Financial Statements:

Auditor's Report Issued

We have audited MPSERS's financial statements as of and for the fiscal years ended September 30, 2010 and September 30, 2009 and have issued a separate report thereon dated December 30, 2010. We issued an unqualified opinion on MPSERS's financial statements.

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Internal Control Over Financial Reporting

We identified a significant deficiency in internal control over financial reporting (Finding 1). We do not consider this significant deficiency to be a material weakness.

The Office of Retirement Services (ORS) and Financial Services, within the Department of Technology, Management & Budget (DTMB), did not have sufficient controls to ensure that they properly classified MPSERS's financial activity (Finding 1).

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Noncompliance and Other Matters Material to the Financial Statements

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

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Agency Response:

Our management letter includes 1 finding and 1 corresponding recommendation. DTMB's preliminary response indicates that ORS and Financial Services agree with the recommendation.

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

Background:

MPSERS is a cost-sharing, multiple-employer, Statewide, defined benefit public employee retirement plan governed by the State and operating under the provisions of Act 300, P.A. 1980, as amended. MPSERS's pension plan was established by the State to provide retirement, survivor, and disability benefits to public school employees. In addition, MPSERS's health plan provides all retirees with the option of receiving health, dental, and vision coverage under the Michigan Public School Employees' Retirement Act. There are 724 participating employers. By statute, employees of K-12 public school districts, public school academies, district libraries, tax-supported community colleges, and seven universities may be members.

~ ~ ~ ~ ~ ~ ~ ~ ~ ~

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

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

March 9, 2011

Ms. Diana Osborn, Chair
Michigan Public School Employees' Retirement System Board
General Office Building
and
John E. Nixon, C.P.A., Director
Department of Technology, Management & Budget
George W. Romney Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management & Budget
General Office Building
Lansing, Michigan

Dear Ms. Osborn, Mr. Nixon, and Mr. Stoddard:

We have audited the financial statements of the Michigan Public School Employees' Retirement System (MPSERS) as of and for the fiscal years ended September 30, 2010 and September 30, 2009 and have issued a separate report thereon dated December 30, 2010. In planning and performing our audit of the financial statements of MPSERS, we considered MPSERS's internal control over financial reporting and compliance and other matters. This is our management letter on the internal control over financial reporting and on compliance and other matters of the Michigan Public School Employees' Retirement System for the period October 1, 2008 through September 30, 2010.

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

The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to address 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.

Auditor General

This Page Left Intentionally Blank

TABLE OF CONTENTS

MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

This Page Left Intentionally Blank

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

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

Ms. Diana Osborn, Chair
Michigan Public School Employees' Retirement System Board
General Office Building
and
John E. Nixon, C.P.A., Director
Department of Technology, Management & Budget
George W. Romney Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management & Budget
General Office Building
Lansing, Michigan

Dear Ms. Osborn, Mr. Nixon, and Mr. Stoddard:

We have audited the basic financial statements of the Michigan Public School Employees' Retirement System as of and for the fiscal years ended September 30, 2010 and September 30, 2009 and have issued our report thereon dated December 30, 2010. We conducted our audit in accordance with 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Public School Employees' Retirement System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan Public School Employees' Retirement System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Michigan Public School Employees' Retirement System's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph. However, we identified a deficiency in internal control over financial reporting, as described in Finding 1, that we consider to be a significant deficiency in internal control over financial reporting. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Public School Employees' Retirement System's financial statements are free of 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*.

The agency preliminary response to the finding identified in our audit is included in the body of our report. We did not audit the agency preliminary response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Governor, the Legislature, the Michigan Public School Employees' Retirement System Board, management, and others within the Department of Technology, Management & Budget and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

December 30, 2010

FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

FINDING

1. Controls Over Financial Reporting

The Office of Retirement Services (ORS) and Financial Services, within the Department of Technology, Management & Budget, did not have sufficient controls to ensure that they properly classified Michigan Public School Employees' Retirement System's (MPSERS's) financial activity. As a result, the amounts due from employer in MPSERS's pension plan were overstated by $111 million and the amounts due from other and the amounts due from employer in MPSERS's other postemployment benefits (OPEB) plan were understated by $107 million and $4 million, respectively.

Governmental Accounting Standards Board* (GASB) Statement No. 25 requires pension plans to report the financial activities of OPEB separate from pensions to provide more complete, reliable, and decision-useful financial reporting regarding the costs and financial obligations that governments incur when they provide postemployment benefits other than pensions. Our review disclosed:

a. Financial Services did not allocate a portion of its estimate of amounts due from employer to MPSERS's OPEB plan. As a result, for fiscal year 2009-10, the amounts due from employer in the pension plan were overstated and the amounts due from employer in the OPEB plan were understated by $4 million. Effective July 1, 2010, Act 75, P.A. 2010 (Section 38.1343e of the *Michigan Compiled Laws*), required each public school employee to contribute 1.5% or 3.0%, depending on the employee's salary from the prior school fiscal year, to MPSERS's OPEB plan. Financial Services estimated the amounts due from employer as of September 30, 2010 using preliminary wage and contribution totals reported by employers in ORS's Employer Reporting Web site. However, ORS's Employer Reporting Web site did not provide for allocation of the preliminary contribution amounts between pension benefits and the amounts withheld from the employees' wages for OPEB.

b. ORS and Financial Services did not properly classify the amount due from a vendor related to the Medicare Advantage Program. In fiscal year 2009-10, ORS entered into a settlement agreement with the vendor that resulted in additional reimbursement to MPSERS under the Medicare Advantage

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

Program. When Financial Services recorded the receivable at September 30, 2010, it recorded the receivable in the pension plan as an amount due from employer rather than an amount due from other. In addition, because the reimbursement was related to health care benefits, it should have been recorded in the OPEB plan. As a result, for fiscal year 2009-10, the amounts due from employer in the pension plan were overstated and the amounts due from other in the OPEB plan were understated by $107 million.

Prior to publishing MPSERS's *Comprehensive Annual Financial Report (CAFR)*, ORS and Financial Services corrected the accounting records and made appropriate revisions to MPSERS's *CAFR* for the fiscal year ended September 30, 2010 with comparative information for the fiscal year ended September 30, 2009.

RECOMMENDATION

We recommend that ORS and Financial Services implement sufficient controls to ensure that they properly classify MPSERS's financial activity.

AGENCY PRELIMINARY RESPONSE

ORS and Financial Services agree with the recommendation but note that the initial $111 million misclassification was corrected in the State's accounting records and the published financial statements were accurate. ORS and Financial Services will, however, revise existing financial statement preparation and review processes to enhance existing controls for calculating and recording revenue related to new programs and incentives. Financial Services will update relevant procedures for review and approval processes by August 30, 2011.

GLOSSARY

CAFR	*Comprehensive Annual Financial Report.*
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 & Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are presented fairly in all material respects in conformity with the disclosed basis of accounting.
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 schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

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 schedules and/or financial statements will not be prevented, or detected and corrected, on a timely basis.
MPSERS	Michigan Public School Employees' Retirement System.
OPEB	other postemployment benefits.
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.
unqualified opinion	An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.

This Page Left Intentionally Blank

This Page Left Intentionally Blank

STATE OF MICHIGAN

OFFICE of the AUDITOR GENERAL