



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL



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**

## *Management Letter*

### *Michigan Public School Employees' Retirement System*

*Fiscal Years Ended September 30, 2012 and September 30, 2011*

Report Number:  
071-0152-13M

Released:  
March 2013

*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 (MPERS).*

#### **Financial Statements:**

##### **Auditor's Report Issued**

We have audited MPERS's basic financial statements as of and for the fiscal years ended September 30, 2012 and September 30, 2011 and have issued a separate report thereon dated December 29, 2012. We issued an unqualified opinion on MPERS's financial statements.

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##### **Internal Control Over Financial Reporting**

We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, we did identify a significant deficiency (Finding 1).

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

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#### **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*.

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#### **Agency Response:**

Our management letter includes 1 finding and 1 corresponding recommendation. DTMB's preliminary response indicates that it agrees with the recommendation.

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#### **Background:**

MPERS 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. MPERS's pension plan was established by the State to provide retirement, survivor, and disability benefits to public school employees.

In addition, MPSERS's other postemployment benefits plan provides all retirees with the option of receiving health, dental, and vision coverage under the Michigan Public School Employees' Retirement Act. There are 711 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.

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obtained by calling 517.334.8050  
or by visiting our Web site at:  
<http://audgen.michigan.gov>



Michigan Office of the Auditor General  
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**Thomas H. McTavish, C.P.A.**  
Auditor General

**Scott M. Strong, C.P.A., C.I.A.**  
Deputy Auditor General



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

March 8, 2013

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, and Budget  
George W. Romney Building  
and  
Mr. Phillip J. Stoddard, Director  
Office of Retirement Services  
Department of Technology, Management, and Budget  
General Office Building  
Lansing, Michigan

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

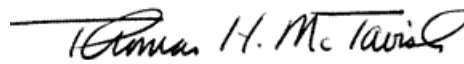
We have audited the basic financial statements of the Michigan Public School Employees' Retirement System (MPERS) as of and for the fiscal years ended September 30, 2012 and September 30, 2011 and have issued a separate report thereon dated December 29, 2012. In planning and performing our audit of the financial statements, we considered MPERS'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 fiscal years ended September 30, 2012 and September 30, 2011.

This management letter 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 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 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,

  
Thomas H. McTavish, C.P.A.  
Auditor General



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# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



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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, and Budget  
George W. Romney Building  
and  
Mr. Phillip J. Stoddard, Director  
Office of Retirement Services  
Department of Technology, Management, and 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, 2012 and September 30, 2011 and have issued our report thereon dated December 29, 2012. 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

Management of the Michigan Public School Employees' Retirement System is responsible for establishing and maintaining effective 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.

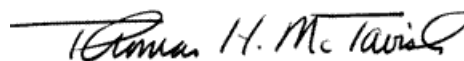
#### Compliance and Other Matters

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 management letter. 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, and 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.

Sincerely,



Thomas H. McTavish, C.P.A.

Auditor General

December 29, 2012

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, and Budget (DTMB), did not have sufficient controls to ensure that they properly recorded Michigan Public School Employees' Retirement System's (MPERS's) financial activity. As a result, they could not ensure the accurate and timely preparation of MPERS's financial statements.

Governmental Accounting Standards Board\* (GASB) Statement No. 25, as amended, establishes financial reporting standards for defined benefit pension plans; GASB Statement No. 43, as amended, establishes financial reporting standards for other postemployment benefits (OPEB) plans. In accordance with these standards, ORS and Financial Services are required to account for and report the MPERS pension plan separate from its OPEB plan. Also, Section 18.1492 of the *Michigan Compiled Laws* requires MPERS's financial statements to be audited and submitted to DTMB's Office of Financial Management (OFM) for inclusion in the *State of Michigan Comprehensive Annual Financial Report* within 90 days of the close of the State's fiscal year. Our review disclosed:

- a. Financial Services did not properly classify \$19.5 million of contributions received from school districts. As a result, the contributions in the OPEB plan were overstated and the contributions in the pension plan were understated by \$19.5 million as of September 30, 2012. Prior to publishing MPERS's *Comprehensive Annual Financial Report (CAFR)*, Financial Services corrected the accounting records and made the appropriate revisions to MPERS's *CAFR*.
- b. Financial Services did not record the financial activity for MPERS in a timely manner. ORS and Financial Services agreed to a time line by which all accounting entries would be finalized in the State's accounting system; however, Financial Services did not finalize MPERS's standard accounting entries until 32 days past the agreed-upon deadline, 79 days after the fiscal year-end. Although MPERS's *CAFR* was submitted to OFM timely,

\* See glossary at end of report for definition.

significant delays such as this impose a risk that the audited *CAFR* may not be submitted by the deadline required by State law.

We noted a similar condition in our prior audit. Financial Services indicated that it would revise existing financial statement preparation and review processes to enhance existing controls for calculating and recording activity related to programs and incentives. We noted that Financial Services modified its preparation and review processes; however, our review disclosed that its modifications were not sufficient to prevent the deficiency identified in this finding.

### **RECOMMENDATION**

We again recommend that ORS and Financial Services, within DTMB, implement sufficient controls to ensure that they properly record MPSERS's financial activity.

### **AGENCY PRELIMINARY RESPONSE**

DTMB agrees with the recommendation but notes that the initial \$19.5 million misclassification in the draft financial statements was corrected in the State's accounting records and the published financial statements were accurate. DTMB informed us that, during the fiscal year, Financial Services implemented a significant change to how pension and OPEB plans were reported. As a result, significant additional staff effort was required to ensure that the activity was properly reflected in the financial statements. Financial Services will, however, revisit existing financial statement preparation and review processes to enhance existing controls and update MPSERS's *CAFR* time lines to ensure that the audited *CAFR* will be submitted by the deadline required by State law.

# GLOSSARY

## Glossary of Acronyms and Terms

<i>CAFR</i>	<i>Comprehensive Annual Financial Report.</i>
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 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 statements that causes the 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 statements will not be prevented, or detected and corrected, on a timely basis.
MPSERS	Michigan Public School Employees' Retirement System.
OFM	Office of Financial Management.
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 statements presenting the basic financial information of the audited entity are fairly presented in conformity with the disclosed basis of accounting.





