

**Office of the Auditor General**  
Report on Internal Control, Compliance, and Other Matters

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**Michigan Public School Employees'  
Retirement System**

Fiscal Year Ended September 30, 2015

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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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Office of the Auditor General

## Report Summary

*Report on Internal Control, Compliance, and  
Other Matters  
Michigan Public School Employees'  
Retirement System  
Fiscal Year Ended September 30, 2015*

**Report Number:  
071-0152-16**

**Released:  
February 2016**

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the Michigan Public School Employees' Retirement System (MPERS) financial statements dated December 30, 2015.

<b>Findings Related to Internal Control, Compliance, and Other Matters</b>	<b>Material Weakness</b>	<b>Significant Deficiency</b>	<b>Agency Preliminary Response</b>
The Office of Retirement Services, Department of Technology, Management, and Budget, did not have an internal control process in place to ensure that data forwarded to the actuary for the MPERS net pension liability calculation was complete and accurate ( <u>Finding #1</u> ).		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](http://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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Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • [www.audgen.michigan.gov](http://www.audgen.michigan.gov)

**Doug A. Ringler, CPA, CIA**  
Auditor General

February 25, 2016

Mr. Scott Koenigs knecht, 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, Director  
Office of Retirement Services  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Koenigs knecht, Mr. Behen, and Ms. Vanden Bosch:

We have audited the basic financial statements of the Michigan Public School Employees' Retirement System (MPERS) as of and for the fiscal year ended September 30, 2015 and have issued a separate report thereon dated December 30, 2015. 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 report on internal control, compliance, and other matters of MPERS for the fiscal year ended September 30, 2015.

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  
Auditor General



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# INDEPENDENT AUDITOR'S REPORT



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**Doug A. Ringler, CPA, CIA**  
Auditor General

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

Mr. Scott Koenigs knecht, 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, Director  
Office of Retirement Services  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Koenigs knecht, Mr. Behen, and Ms. Vanden Bosch:

We have audited, in accordance with the 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, the basic financial statements of the Michigan Public School Employees' Retirement System as of and for the fiscal year ended September 30, 2015 and the related notes to the basic financial statements and have issued our report thereon dated December 30, 2015.

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

In planning and performing our audit of the basic financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the basic financial statements, 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 basic 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 of this section 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.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the System's basic financial statements are free from 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*.

### **System's Response to Finding**

The System's preliminary response to the finding identified in our audit is included in the body of our report. The System's response was not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

### **Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sincerely,



Doug Ringler  
Auditor General  
December 30, 2015



# FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

## FINDING #1

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**Development of controls is necessary to verify completeness and accuracy of actuary data.**

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The Office of Retirement Services (ORS), Department of Technology, Management, and Budget, did not have an internal control\* process in place to ensure that data forwarded to the actuary for the MPSERS net pension liability calculation was complete and accurate. This deficiency increases the risk of a misstatement in the notes to the financial statements.

Governmental Accounting Standards Board\* (GASB) Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*, requires pension plans to report the total pension liability in the notes to the financial statements of cost-sharing pension plans. The calculation of the total pension liability for cost-sharing plans is dependent on the completeness and accuracy of the underlying wage and census data of the plans' members. Also, the American Institute of Certified Public Accountants Audit and Accounting Guide entitled *State and Local Governments* states that the absence of effective controls by the plan to verify underlying payroll and personnel records of participating employer census data in a cost-sharing plan is a deficiency in internal control over financial reporting.

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.

Our review of the fiscal year 2014 data forwarded to the actuary disclosed:

- ORS did not have an internal control process in place to verify the census data of MPSERS participating employers. ORS relied on the MPSERS members to verify the accuracy of the information reported by MPSERS employers to ORS by reviewing the information in their personal retirement accounts. Although we discovered various errors in the data, we determined that, overall, the errors did not have a material impact on the net pension liability.
- ORS did not have an internal control process in place to ensure the accuracy of wage data prior to submitting the data to the actuary. In our review of 56 MPSERS employers, with wages totaling \$1.2 billion, we noted that 3 (5%) MPSERS employers underreported wages to ORS by \$24.1 million (2%). Subsequently, ORS reported this understated wage data to the actuary.

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MPSERS employers understated wages by \$24.1 million; ORS forwarded inaccurate wage data to the actuary for the net pension liability calculation.

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## RECOMMENDATION

We recommend that ORS develop an internal control process to ensure that data forwarded to the actuary for the net pension liability calculation is complete and accurate.

\* See glossary at end of report for definition.

**AGENCY  
PRELIMINARY  
RESPONSE**

ORS provided us with the following response:

*ORS agrees with the Office of the Auditor General's recommendation and agrees that the errors located do not have a material impact on the net pension liability.*

*ORS is continuously working with all MPSERS employers/reporting units to ensure that they are educated and adequately trained to prevent inaccurate reporting. ORS conducts routine monthly data analysis, as well as annual wage reviews. During these internal checks, members' reportable compensation, job classification, years in position, and reportable hours are evaluated to confirm accuracy. ORS also conducts full assessments of all members' demographic data upon retirement. During the retirement review process, the members' eligibility and pension calculation are revisited for accuracy. These methods help ensure that benefits are paid correctly to eligible members.*

*A payroll audit of all MPSERS employers/reporting units is scheduled to take place and will be completed by September 30, 2016. This audit will compare Unemployment Insurance Agency (UIA) wage data against MPSERS reported wage data. This study will look to correct wages erroneously reported to ORS.*

*Like most retirement systems around the country, ORS has had a long-term practice that employers/reporting units participating in MPSERS are responsible for the accurate reporting of active members' retirement demographic data. While this has been the historical practice, the American Institute of Certified Public Accountants (AICPA) had issued a whitepaper titled Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements. The whitepaper was a result of GASB issuing Statements No. 67 and No. 68, which changed financial reporting standards for defined benefit plans. The whitepaper included guidance that the auditors working with the employers/reporting units should perform testing on the same demographic data. Although the revised GASB standards were published in final form in June 2012, the AICPA did not publish this whitepaper until February 2014.*

## **GLOSSARY OF ABBREVIATIONS AND TERMS**

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AICPA	American Institute of Certified Public Accountants.
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 basic 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	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 basic 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 basic 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.





