

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

Michigan State Employees' Retirement System

Fiscal Year Ended September 30, 2016

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 State Employees' Retirement
System
Fiscal Year Ended September 30, 2016*

Report Number:
071-0151-17

Released:
March 2017

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 State Employees' Retirement System's (MSERS's) financial statements dated January 18, 2017.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Office of Retirement Services did not have an internal control process to ensure the completeness of the defined contribution member data provided to MSERS's actuary. We estimated that the other postemployment benefits accrued liability was understated by \$143 million (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
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Auditor General

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Doug A. Ringler, CPA, CIA
Auditor General

March 24, 2017

Ms. Laurie Hill, Chair
State of Michigan Retirement 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 Ms. Hill, Mr. Behen, and Ms. Vanden Bosch:

We have audited the basic financial statements of the Michigan State Employees' Retirement System (MSERS) as of and for the fiscal year ended September 30, 2016 and have issued a separate report thereon dated January 18, 2017. In planning and performing our audit of the financial statements, we considered MSERS's internal control over financial reporting and compliance and other matters. This is our report on internal control, compliance, and other matters of MSERS for the fiscal year ended September 30, 2016.

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 ON INTERNAL CONTROL AND COMPLIANCE



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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

Ms. Laurie Hill, Chair
State of Michigan Retirement 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 Ms. Hill, 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 State Employees' Retirement System as of and for the fiscal year ended September 30, 2016 and the related notes to the basic financial statements and have issued our report thereon dated January 18, 2017.

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
January 18, 2017

**FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES**

FINDING #1

Controls necessary to ensure completeness of data provided to actuary.

Incomplete member data resulted in an estimated understatement of \$143 million for the MSERS other postemployment benefits accrued liability.

The Office of Retirement Services (ORS) did not have an internal control* process to ensure the completeness of the defined contribution member data provided to MSERS's actuary. We estimated that the accrued liability for other postemployment benefits, which is disclosed in the notes to the financial statements, was understated by \$143 million as of the September 30, 2015 actuarial valuation.

Governmental Accounting Standards Board* Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, requires other postemployment benefit plans to report the actuarial accrued liability in the notes to the financial statements of other postemployment benefit plans. The calculation of the actuarial accrued liability is dependent on the completeness and accuracy of the underlying plan census data.

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* and including recordkeeping procedures and internal control techniques that are effective and efficient.

Annually, ORS queries the Human Resources Management Network* for MSERS's defined contribution member data. ORS provides the member data to its actuary, who uses it to determine plan enrollment, actuarial accrued liability, and annual required contributions for other postemployment benefits.

Our audit procedures noted that the ORS query did not contain the coding needed to identify approximately 1,100 defined contribution inactive vested members and, therefore, they were not included in the fiscal year 2015 other postemployment benefit actuarial valuation.

RECOMMENDATION

We recommend that ORS develop an internal control process to ensure the completeness of the defined contribution member data provided to MSERS's actuary.

AGENCY PRELIMINARY RESPONSE

The Department of Technology, Management, and Budget's (DTMB's) ORS provided us with the following response:

DTMB agrees and has complied with the recommendation. ORS will continue to work with the Office of the Auditor General on a standard definition for the term "inactive member" and which retirement status codes will be used in the query. ORS has updated the query and has provided the query's results to the actuary for use in the creation of the fiscal year 2016 valuations, which will be used in the fiscal year 2017 CAFR, and the determination of the actuarial accrued liability for other postemployment benefits.

* See glossary at end of report for definition.

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.
DTMB	Department of Technology, Management, and Budget.
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 (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.
Human Resources Management Network (HRMN)	The State's integrated human resources system that processes personnel, payroll, and employee benefits data.
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.

MSERS

Michigan State 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.

