

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

Michigan Military Retirement System

Nine Months Ending 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 Military Retirement System

Nine Months Ending September 30, 2016

Report Number:
071-0158-17

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 Military Retirement System's (MMRS's) financial statements dated January 30, 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 that member data provided to MMRS's actuary for the net pension liability calculation was complete and accurate. We estimated that the net pension liability was understated by \$1.8 million (<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

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Office of the 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 Military Retirement System (MMRS) as of and for the nine months ending September 30, 2016 and have issued a separate report thereon dated January 30, 2017. In planning and performing our audit of the financial statements, we considered MMRS's internal control over financial reporting and compliance and other matters. This is our report on internal control, compliance, and other matters of MMRS for the nine months ending 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,

A handwritten signature in dark ink that reads "Doug Ringler". The signature is written in a cursive, slightly slanted style.

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 Military Retirement System as of and for the nine months ending September 30, 2016 and the related notes to the basic financial statements and have issued our report thereon dated January 30, 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 30, 2017

FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

FINDING #1

Controls necessary to ensure completeness and accuracy of data provided to actuary.

The Office of Retirement Services (ORS) did not have an internal control* process to ensure that member data provided to MMRS's actuary for the net pension liability calculation was complete and accurate. We estimated that the net pension liability, which is disclosed in the notes to the financial statements, was understated by \$1.8 million.

Governmental Accounting Standards Board* Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*, requires pension plans to report total pension liability in the notes to the financial statements of pension plans. The calculation of the total pension 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.

Also, the American Institute of Certified Public Accountants Audit & Accounting Guide entitled *State and Local Governments*, sections 13.49 through 13.52, states that the system's management is responsible for designing, implementing, and maintaining a system of internal control related to the amounts reported in the financial statements, which should include procedures to verify the underlying census data to ensure the completeness and accuracy of the data. The lack of such procedures constitutes a control deficiency.

Participating employers, which consist of the Michigan Air and Army National Guard, report census data, such as date of birth, gender, and service credit, to ORS. ORS provides this data to the actuary, a third-party vendor, to perform calculations to determine the total pension liability. ORS did not complete procedures to ensure that the data provided by participating employers was complete and accurate.

Our review of the fiscal year 2015 member data provided to the actuary disclosed:

- a. ORS did not provide the actuary with member data for an estimated 140 inactive vested members. We determined that, as a result, the net pension liability was understated by an estimated \$0.9 million in the notes to the financial statements.
- b. Participating employers underreported total earned service credit for 18 (20.5%) of 88 members reviewed. We determined that, as a result, the net pension liability was understated by an estimated \$0.9 million in the notes to the financial statements.

* See glossary at end of report for definition.

RECOMMENDATION

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

**AGENCY
PRELIMINARY
RESPONSE**

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

DTMB agrees with the recommendation. However, Federal law currently prohibits ORS from having access to active military demographic and service records that are maintained by the Michigan Department of Military and Veterans Affairs (DMVA) on databases owned by the U.S. Department of Defense. ORS having access to DMVA records would significantly improve ORS's ability to ensure the accuracy of the net pension liability.

Each year, ORS provides member data to the actuary to perform calculations to determine the total pension liability. The actuary compares the current year's demographic and service data to the previous year to determine any discrepancies. ORS relies on DMVA for accurate reporting; any discrepancies are sent back to the DMVA to review and correct. In addition, before any benefits are paid to members, ORS conducts a full review of all retirement information, including demographic information at the point a member applies for retirement. During these reviews, ORS re-analyzes all service credit calculations to ensure that benefits are correctly paid to eligible members.

To help ensure that the member data provided to the actuary for the MMRS net pension liability calculation is as complete and accurate as possible, ORS will identify points of contact from DMVA Air and Army National Guard; explore options for gaining greater access to member data; and host regular meetings with DMVA.

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.
DMVA	Department of Military and Veterans Affairs.
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.
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.
MMRS	Michigan Military 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.

