Office of the Auditor General

Investigative Audit Report

Southwestern Michigan College's Contributions to the Michigan Public School Employees' Retirement System For Part-Time Student Employees

February 2018

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

917-DTMB-01

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Office of the Auditor General
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February 21, 2018

Mr. Scott Koenigsknecht, Chair
Michigan Public School Employees' Retirement System Board
Stevens T. Mason Building
Lansing, Michigan
and
Mr. David L. DeVries, Director
Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan
and
Ms. Kerrie L. Vanden Bosch, Director
Office of Retirement Services
Stevens T. Mason Building
Lansing, Michigan
and
Mr. Thomas F. Jerdon, Chair
Southwestern Michigan College Board of Trustees
58900 Cherry Grove Road
Dowagiac, Michigan

Dear Mr. Koenigsknecht, Mr. DeVries, Ms. Vanden Bosch, and Mr. Jerdon:

Consistent with our standard practices upon completing an investigative audit, we are issuing our investigative audit report on Southwestern Michigan College's contributions to the Michigan Public School Employees' Retirement System for part-time student employees.

Copies of this report are being forwarded to various relevant entities and legislative committees. Also, the report may be viewed on our public Web site at audgen.michigan.gov.

Sincerely,

Doug Ringler

Doug Ringler
Auditor General

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EXECUTIVE SUMMARY

BACKGROUND

The Office of the Auditor General (OAG) investigated allegations that Southwestern Michigan College (SMC) intentionally excluded part-time student employees from enrollment into the Michigan Public School Employees' Retirement System (MPSERS) and did not report the student employees' wages or remit the associated MPSERS contributions to the Office of Retirement Services (ORS).

INVESTIGATION CONCLUSIONS

1. From July 1, 2010 through April 28, 2017, SMC intentionally excluded approximately 500 part-time student employees from enrollment into MPSERS. As a result, SMC did not report the student employees' wages or remit statutorily-required MPSERS contributions to ORS totaling approximately $388,600. Subject to limitations in the available data and assumptions in our calculation methodology, if held to the full extent of existing statutory provisions, the estimated late fees and interest for the unreported wages and unremitted contributions could be as much as $10.4 million. Late fees and interest on unreported wages and unremitted contributions continue to accrue until paid.

2. The explanations that SMC provided for not complying with MPSERS requirements related to part-time student employees were without merit.

3. Current SMC administrators had not contacted ORS, the U.S. Department of Education (USDOE), or other authorities regarding the validity of the administrators' perceived conflicts between federal student aid (FSA) laws and regulations and MPSERS requirements.

4. SMC falsely certified to ORS on its calendar year 2011 through 2016 Reporting Authorization Certification forms that it was in full compliance with provisions of Public Act 300 of 1980, as amended (i.e., the Public School Employees Retirement Act of 1979, Sections 38.1301 - 38.1437 of the *Michigan Compiled Laws [MCL]*).

Given these conclusions and other observations described in this report, one or more SMC administrators may have violated *MCL* Section 38.1405, which provides that "a person who, with intent to deceive, makes a false statement in a report or record required under this retirement system . . . is guilty of a misdemeanor, punishable by imprisonment for not more than 90 days, or a fine of not more than $500.00, or both." See Appendix #1 for a summary of relevant laws and regulations.

SMC advised us that its most recent (2015) decision to continue excluding part-time student employees from MPSERS was a consensus among several key administrators, including the president, the vice president and chief business officer, the vice president of student services (formerly the director of financial aid), and the director of human resources.

We referred the matters described within this report to ORS for follow-up with and administrative action against SMC, as ORS determines appropriate, pursuant to its statutory responsibility to monitor and audit community colleges' compliance with MPSERS laws and regulations. ORS should ensure that it implements procedures to make sure that all community colleges comply with statutory provisions applicable to part-time student employees. ORS is responsible for calculating any actual contribution shortfalls, late fees, and interest owed by SMC.

In addition, we referred these matters to other relevant entities for consideration of additional investigation and to the OAG's Bureau of Audit Operations for consideration in its ongoing audits concerning ORS and MPSERS.

LEGAL PROCEEDINGS

- On July 7, 2017, before we could share our preliminary conclusions with SMC, lawyers retained by SMC advised us that we could no longer directly contact SMC administrators.

- On August 23, 2017, SMC filed suit in the Court of Claims, seeking injunctive relief from this audit and future OAG audits by challenging the OAG's constitutional authority to audit community colleges.

- On September 28, 2017, the OAG filed a motion for summary disposition and dismissal of SMC's lawsuit.

- On January 16, 2018, the Court of Claims granted the OAG's motion and dismissed SMC's lawsuit and affirmed the OAG's authority to conduct this investigative audit.

BACKGROUND FOR OAG INVESTIGATION AND INVESTIGATION CONCLUSIONS

BACKGROUND

On March 4, 2017, the OAG received an anonymous complaint through its Fraud, Waste, and Abuse Hotline alleging that SMC had been intentionally disregarding provisions of the Public School Employees Retirement Act of 1979 that required it to enroll qualified part-time student employees into MPSERS. The complaint alleged that SMC's noncompliance deprived eligible students of the opportunity to participate in MPSERS and resulted in SMC failing to pay potentially hundreds of thousands of dollars into MPSERS over several years.

The complaint contained a detailed account of internal deliberations during the fall 2015 semester among key SMC administrators concerning relevant MPSERS laws, the college's brief efforts to comply with those laws at that time, and its ultimate discontinuation of those efforts. Although the complainant originally filed the complaint anonymously, the complainant later self-identified and indicated a willingness to cooperate in any further proceedings and to testify to the statements that the complainant alleged to have heard firsthand from key SMC administrators concerning these matters.

After reviewing the complaint, we met with ORS to gain an understanding of the relevant MPSERS laws and regulations and inquired about the scope of ORS's payroll audits that it had conducted at the community colleges. We learned that ORS had not obtained student enrollment data and, therefore, could not independently verify SMC's compliance with requirements concerning part-time student employees.

Pursuant to the Auditor General's constitutional and statutory authority to conduct post audits of financial transactions and make investigations pertinent to the conduct of audits, the OAG initiated a limited scope, investigative audit in April 2017 of SMC's compliance with select MPSERS laws and regulations. See Appendix #2 for our investigation activities.

The OAG is responsible for auditing and expressing an opinion on the MPSERS annual financial statements and the schedules of employer allocations and specified column totals included in the schedule of collective pension amounts, which include community colleges' member and employer contributions. If the circumstance alleged at SMC also occurred at other colleges, there would have existed the potential for an erroneous audit opinion and changes to the schedules of allocations that MPSERS participants then use in their individual financial statements.

INVESTIGATION CONCLUSIONS

1. From July 1, 2010 through April 28, 2017, SMC intentionally excluded approximately 500 part-time student employees from enrollment into MPSERS. As a result, SMC did not report the student employees' wages or remit statutorily-required MPSERS contributions to ORS totaling approximately $388,600. Subject to limitations in the available data and assumptions in our calculation methodology, if held to the full extent of existing statutory provisions, the estimated late fees and interest for the unreported wages and unremitted contributions could be as much as $10.4 million. Late fees and interest on unreported wages and unremitted contributions continue to accrue until paid.

According to existing Michigan statute, for the purposes of calculating mandated late fees and interest, intentionally unreported wages and unremitted contributions are treated the same as unintentional, uncorrected errors discovered by ORS.

SMC admitted that it excluded part-time students from enrollment into MPSERS, and we confirmed this by reviewing SMC's student payroll and enrollment data, reports and remittances submitted to ORS, and an affidavit from its former (March 2005 through November 2012) director of human resources (DHR). Our investigation focused on the period beginning July 1, 2010, based on ORS's advisement that it would "look back" to that date because of significant benefit plan changes that were enacted then. We explain the MPSERS benefit plan options in Appendix #3.

E-mail correspondence from fall 2015 showed that current SMC administrators had become aware that SMC was not in compliance with MPSERS requirements related to part-time student employees after hearing ORS discussion on the topic at a Statewide conference of community college human resource administrators. Subsequent to that conference, SMC administrators began evaluating options to comply with the MPSERS requirements and decided to restrict employment to only full-time students beginning with the spring 2016 semester and to limit the students' work schedules to periods when the students were actually enrolled in and attending classes. Although this would have resulted in all of SMC's part-time students losing their jobs, the strategy would have allowed SMC to avoid making MPSERS contributions because enrolled and attending full-time students were statutorily exempt from MPSERS.

The proposed student hiring changes were discussed at three Operation and Processes Committee meetings in November and December 2015, and SMC communicated its planned action to college employees and posted related information on its internal web pages for the spring 2016 semester. SMC e-mail correspondence indicated that some faculty members expressed concerns over losing the ability to employ part-time students.

In the midst of implementing these changes, SMC e-mails indicated that the administrators learned that Federal Work-Study Program (FWS) rules required that FWS awards be made available to both full-time and part-time student employees.

Because SMC paid the wages of some student employees in whole or in part with FWS funds and wanted to remain compliant with FWS rules, the administrators abandoned their planned student employment and work scheduling changes altogether. Although SMC administrators had considered the option of enrolling part-time student employees and making the MPSERS contributions as an alternative plan, SMC did not take any subsequent actions to comply with the MPSERS requirements.

SMC sent an e-mail to college faculty and administrators on January 8, 2016 stating:

> After more in-depth research, the College has determined that it cannot have a policy that excludes part-time students from employment. Therefore, we are going back to what we had done in the past and students only have to be enrolled in 6 credits to be eligible to be a student worker.

This essentially retracted SMC's previous communication to faculty and administrators on the topic. SMC also communicated the policy reversal on some of its social media sites.

2. **The explanations that SMC provided for not complying with MPSERS requirements related to part-time student employees were without merit.**

   The explanations that SMC administrators provided to us evolved between our April and June 2017 visits to the college. In April 2017, SMC administrators initially seemed to struggle to remember that discussions had occurred or that any particular direction had been given concerning this matter in fall 2015. SMC administrators first provided us with vague references to perceived conflicts between MPSERS requirements and FWS and/or the more general FSA-related laws, Federal Insurance Contributions Act (FICA) exclusions for students, and the definitions of full-time and part-time students as they pertain to MPSERS eligibility. These considerations did not negate SMC's responsibility to comply with the MPSERS requirements.

Also in April 2017, some of the SMC administrators informed us, and e-mail correspondence supported, that the consensus decision reached in late 2015 was influenced by other community colleges allegedly not complying with the MPSERS requirements and the anticipated logistical difficulties and unbudgeted costs to SMC associated with compliance. In addition, some of the administrators argued that it did not make sense to enroll part-time student employees in MPSERS when full-time student employees were excluded.

However, during our June 2017 visit, SMC's explanation focused on its contention that conflicts existed between the MPSERS requirements and FWS/FSA-related laws and regulations that prevented SMC from simultaneously complying with both MPSERS and FWS/FSA-related laws and regulations.

Essentially, SMC asserted that because student employees not paid with FWS funds would be eligible for participation in MPSERS whereas students paid with FWS funds would not be eligible, it was SMC's interpretation that treating the two groups of student employees differently was prohibited by FWS or more general FSA requirements that barred discrimination between the groups of students. Despite numerous requests, SMC could not provide us with any FSA rules or regulations to support this explanation.

We contacted the USDOE's Policy Liaison and Implementation (PLI) and Postsecondary Education organizational units, and both dispelled SMC's discrimination explanation.

The USDOE PLI informed us, explicitly, that colleges are permitted to create financial aid packaging priorities and philosophies and that not allowing FWS students to participate in MPSERS would not be discriminatory as long as students were treated fairly in the colleges' packaging priorities and philosophies.

The USDOE PLI also informed us that Section 421(a)(2) of the Higher Education Act bans discrimination on the basis of only race, national origin, religion, sex, marital status, age or handicapped status.

Although we concur with SMC that FWS rules prohibit SMC from limiting FWS awards to only full-time students, the rules do not preclude SMC from employing full-time and part-time students and enrolling into MPSERS the qualified part-time students not paid with FWS funds.

Part-time student employees are effectively excluded from MPSERS to the extent that they are paid with FWS funds because FWS requirements prohibit using FWS funds to pay for employee fringe benefits (e.g., retirement benefits).

Also, the Public School Employees Retirement Act of 1979 requires employee contributions to come from the same source that funded the students' wages. According to the data provided by SMC, the amounts that SMC paid with FWS funds to part-time student employees accounted for only 14% of SMC's total payroll for part-time student employees from July 1, 2010 through April 28, 2017.

Also during our June 2017 visit, SMC stated that its former DHR had spoken with ORS in 2011 and that, at that time, ORS had led the former DHR to believe that SMC's interpretation was in compliance with MPSERS requirements. However, according to the affidavit provided by the former DHR subsequent to our June visit, ORS's alleged guidance was related to excluding employees who were "students first" from MPSERS membership. This explanation was inconsistent with others provided to us during April and June 2017. Further, we determined that neither the existing statute nor the Michigan ORS's Reporting Instruction Manual (RIM) for Public School Reporting Units made provisions for excluding part-time student employees from MPSERS who were "students first."

Among the cryptic notes allegedly taken by the former DHR and included with the affidavit as evidence of the spring 2011 conversation were several passages that could indicate awareness of the requirements, such as "Fall & Winter No Summer - must report," "Do report in Summer, not attending over 19," and "19 or older, enroll in Fall/Spring but not Summer, must report."

It was unclear from the former DHR's notes the specific questions asked or the context of ORS's alleged responses.

3. **Current SMC administrators had not contacted ORS, the USDOE, or other authorities regarding the validity of the administrators' perceived conflicts between FSA laws and regulations and MPSERS requirements.**

   Despite several SMC administrators lamenting the complexity of the federal regulations and their belief that conflicts existed with MPSERS laws, the current administrators informed us that they had not contacted ORS, the USDOE, their corporate counsel, or other authorities to determine the validity of their concerns and/or interpretations. These authorities could have provided SMC with appropriate, actionable information.

   In addition, we reviewed e-mail correspondence in which another community college had advised SMC in December 2015 that it had discussed this issue with ORS and the USDOE and that it planned to start paying into MPSERS for its part-time student employees.

Subsequent to SMC's decision to continue its practice of excluding part-time student employees from enrollment into MPSERS, some SMC administrators expressed concerns in e-mails. Those concerns involved whether ORS would include SMC in the payroll audits that ORS was conducting in other community colleges at that time, what that could mean to SMC, and whether those other community colleges were following ORS guidelines for enrolling part-time students.

4. **SMC falsely certified to ORS on its calendar year 2011 through 2016 Reporting Authorization Certification forms that it was in full compliance with provisions of Public Act 300 of 1980, as amended (i.e., the Public School Employees Retirement Act of 1979, *MCL* Sections 38.1301 - 38.1437).**

SMC steadfastly provided a variety of reasons why it could not comply with the MPSERS enrollment requirements for part-time student employees. However, SMC submitted annually required ORS Reporting Authorization Certification forms between 2011 and 2016, signed by SMC's president in his position as superintendent, which contained the following assertion:

> By my signature below I certify I am responsible for the retirement reporting activities of my reporting unit. It is my explicit expectation that the wages and contributions listed on the reports submitted by my reporting unit comply with the provisions of 1980 P.A. 300, as amended, as set forth in the Reporting Instruction Manual (RIM) or otherwise required. Reports will include information on all members or retirees for retirement purposes, including wages, hours, and contributions as required. To my knowledge, no violations of law or official policy occur in the reports submitted to the retirement system by designees of my reporting unit.

The president informed us that because previous discussions with ORS would have been the exclusive domain of SMC's Human Resources unit and Business Office, he did not know that SMC had looked into the issue prior to 2015 and only became aware of the former DHR's 2011 inquiry because of our April 2017 requests for information from his administrators. However, in the affidavit, the former DHR stated that in spring 2011 she had to advise college leadership as to whether part-time student workers age 19 and over and actively attending classes were subject to MPSERS withholding.

We reviewed e-mail correspondence that unequivocally demonstrated that current administrators communicated the college's noncompliance to the president in fall 2015. In addition, current administrators advised us that they had internal conversations that would not have been documented in e-mails regarding their perceived conflicts between the MPSERS and FSA rules and regulations.

Notwithstanding, the president remained fully responsible for ensuring SMC's compliance with MPSERS requirements as the ORS-designated superintendent for SMC.

APPENDIX #1

Summary of Relevant Laws and Regulations

Michigan Compiled Laws (MCL) and Michigan Office of Retirement Services' (ORS's) Reporting Instruction Manual (RIM) for Public School Reporting Units

The Public School Employees Retirement Act of 1979, being *MCL* Sections 38.1301 - 38.1437, established the Michigan Public School Employees' Retirement System (MPSERS). Southwestern Michigan College (SMC) is a State tax-funded community college and, consequently, is a reporting unit within MPSERS. SMC received approximately $6.7 million in State appropriations in fiscal year 2017.

MCL Section 388.1807 states that a community college shall pay the employer's contributions to MPSERS as a condition of receiving appropriated funds.

MCL Section 38.1305(1) defines a MPSERS "member" as a public school employee, unless specifically excluded. The specifically excluded individuals include, among others, a person employed by a reporting unit while enrolled as a full-time student in the same reporting unit. The Section does not exclude part-time students age 19 or older.

RIM Sections 3.02.09 and 3.03.02 provide additional clarification regarding the reporting of part-time student employees:

- RIM Section 3.02.09, Students Over the Age of 19, states: "If you have a student who is 19 years old or older who is not enrolled in and *attending* classes as a full-time student at your reporting unit where the student is working, he or she is a member."

- RIM Section 3.03.02, Full-Time Student or Employee Under 19, further clarifies that reporting units are to report an employee age 19 or over who is working for the reporting unit any time of the year outside of "enrolled and attending" status, including summer and winter breaks.

MCL Section 38.1342 requires employers to submit various payroll information to ORS along with member, qualified participant, and employer contributions on a schedule and in a manner determined by the retirement system (biweekly for SMC). If an employer fails to submit a report or contributions according to the required schedule, the employer must pay a late fee. If the remittance of contributions is late, the late fee must include interest for each day the contributions are late.

If an employer fails to correct errors on a report before the errors are discovered by the retirement system, or if such errors are intentional, the employer shall pay the late fee and interest charges for each day that the report is in error, unless reasonable cause is shown to the retirement system.

RIM Section 1.03.00 further delineates SMC's responsibility for reporting wages and remitting contributions for each MPSERS member.

RIM Section 1.07.00 requires each designated superintendent to annually sign and return a Reporting Authorization Certification form certifying that no violations of law or official policy occur in the retirement detail reports submitted to ORS by the identified reporting users. This Section of the RIM further stipulates that it is the superintendent's responsibility to make certain that accurate information is reported to the retirement system and that the associated funds are paid in a timely manner. In addition, this Section specifies that the superintendent is responsible for what gets reported by the reporting unit.

MCL Section 38.1405 provides that a person who, with intent to deceive, makes a false statement in a required report or record is guilty of a misdemeanor, punishable by imprisonment for not more than 90 days, or a fine of not more than $500, or both.

APPENDIX #2

OAG Investigation Activities

Our investigation activities consisted primarily of inquiries and the examination of selected financial records and other documentation. This report does not constitute an audit or attestation engagement conducted in accordance with generally accepted government auditing standards.

We visited SMC on April 27 and 28, 2017 and again on June 8, 2017.

During our initial two-day visit, SMC provided us with student enrollment data and minutes from SMC leadership team meetings. Also, we interviewed several key administrators within the college and requested all e-mails and other written correspondence and documentation related to SMC's initial efforts to comply with MPSERS requirements and its ultimate decision to continue to employ part-time student employees without enrolling them in MPSERS. We made multiple requests of several SMC administrators to provide us with the specific authoritative references for potentially conflicting federal laws and/or regulations mentioned by the administrators.

On June 8, 2017, we conducted follow-up interviews with some of the key administrators to obtain additional information and to address inconsistencies between statements they made during our first interviews and the e-mail correspondence that they had provided to us. In addition, we interviewed key administrators we had not previously interviewed.

We had periodic communications with ORS and the USDOE throughout the investigation.

APPENDIX #3

MPSERS Benefit Plan Options

MPSERS members hired on or after July 1, 2010 belong to the Pension Plus (PP) plan. The PP plan has a defined benefit (DB) component with mandatory member contributions ranging from 3% to 6.4% of members' compensation (e.g., 3% for members earning between $0 and $5,000); a defined contribution (DC) component with a 2% member contribution; and a healthcare component whose rate varied but, as of June 30, 2011, had a 3% member health care contribution (HCC). SMC, as the employer, must provide a 50% match to members' DC contributions up to 2% of the members' compensation. PP plan members may decrease their DC contributions to $0 or increase their contributions.

Effective September 4, 2012, new PP members contribute 2% of their gross earnings into a Personal Healthcare Fund (PHF), which is matched by a 2% employer (SMC) contribution, instead of the HCC. Also, existing MPSERS members could elect to discontinue their HCC and establish a PHF. The DB and DC components of PP remained unchanged for new members and SMC.

Also effective September 4, 2012, all new and existing members could elect to enroll in a DC-only plan with either PHF or HCC. DC-only plan members contribute 6% of their compensation, which is matched 50% by SMC. All plan members may decrease their DC and/or PHF contributions to $0 or increase their contributions.

In addition to the matching contributions noted above, SMC was required to make DB contributions that, since July 1, 2010, ranged from 15.44% to 24.19% of members' compensation.

Members' DB contributions are refundable to them when they terminate their employment without sufficient service time to earn monthly pension benefits. Members' DC and PHF contributions and vested employer matching DC and PHF contributions are also refundable to terminating employees. Conversely, SMC's DB and matching but unvested DC and PHF contributions remain in MPSERS.

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