

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

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**Michigan Military Retirement Provisions**

Fiscal Year Ended September 30, 2017

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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 Military Retirement Provisions*

### *Fiscal Year Ended September 30, 2017*

**Report Number:**  
071-0158-18

**Released:**  
September 2018

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 Provisions' (MMRP's) financial statements dated July 20, 2018.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Office of Retirement Services, Department of Technology, Management, and Budget, did not have an internal control process to ensure that member data provided to MMRP's actuary for the total pension liability calculation was complete and accurate. This resulted in MMRP's audited financial statements being issued over 6 months after the statutory deadline of December 30, 2017 ( <a href="#">Finding #1</a> ).		X	Agrees

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

**Laura J. Hirst, CPA**  
Deputy Auditor General





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

September 13, 2018

Ms. Laurie Hill, Chair  
State of Michigan Retirement Board  
Stevens T. Mason Building  
and  
Mr. David L. DeVries, 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. DeVries, and Ms. Vanden Bosch:

This is our report on internal control, compliance, and other matters of the Michigan Military Retirement Provisions for the fiscal year ended September 30, 2017.

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 audit recommendations and to 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 L. DeVries, 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. DeVries, 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 Provisions (MMRP) as of and for the fiscal year ended September 30, 2017 and the related notes to the basic financial statements and have issued our report thereon dated July 20, 2018.

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

In planning and performing our audit of the basic financial statements, we considered MMRP'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 MMRP's internal control. Accordingly, we do not express an opinion on the effectiveness of MMRP'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 have not been 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 MMRP'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*.

**MMRP's Response to Finding**

MMRP's preliminary response to the finding identified in our audit is included in the body of our report. MMRP'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  
July 20, 2018



FISCAL YEAR 2017  
FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

## FINDING #1

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

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The Office of Retirement Services (ORS), Department of Technology, Management, and Budget (DTMB), did not have an internal control\* process to ensure that member data provided to MMRP's actuary for the total pension liability calculation was complete and accurate. This resulted in MMRP's audited financial statements being issued over 6 months after the statutory deadline of December 30, 2017.

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, Section 18.1492 of the *Michigan Compiled Laws* requires MMRP's financial statements to be audited and submitted to DTMB's Office of Financial Management for inclusion in the *State of Michigan Comprehensive Annual Financial Report* within 90 days of the close of the State's fiscal year.

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 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 member census data of the members of the plan.

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 include the Michigan Air and Army National Guard, report census data, such as date of birth, gender, enlistment status, 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.

Our review of the initial fiscal year 2016 member data disclosed errors resulting in a \$15.1 million overstatement of the total pension liability in the actuarial valuation (see parts a. through d. of this finding). After our review, ORS submitted revised member data to its actuary who then recalculated the actuarial valuation for inclusion in MMRP's fiscal year 2017 *Comprehensive Annual Financial Report*. However, our review of the revised actuarial valuation disclosed additional errors resulting in an estimated \$305,000 understatement of the total pension liability (see part e.).

\* See glossary at end of report for definition.

We noted:

- a. Thirteen (65%) of 20 inactive and 5 (25%) of 20 active members sampled had incorrect years of service reported by the participating employer. The inactive and active populations were 17,901 and 10,230, respectively. We noted that both federal service and other states' service were inappropriately included as MMRP service.

ORS informed us that the process used to validate the data provided by the participating employer was in development at the time of the valuation.

- b. Of the retired members, 931 were inappropriately included in the inactive vested data provided to the actuary.

ORS informed us that because of a miscommunication between ORS and its actuary, retired members were inappropriately classified as inactive vested members and ORS's review process did not detect this error.

- c. ORS did not appropriately offset active special duty members' service time for qualifying federal service time.

ORS informed us that this resulted from a miscommunication between ORS and its actuary.

- d. ORS was unable to provide member data for inactive members of the Michigan Air National Guard. As a result, MMRP's actuary estimated the number of and liability for inactive vested members of the Michigan Air National Guard.

ORS informed us that it had not yet fully developed its process to obtain inactive Michigan Air National Guard member data from the Michigan National Guard.

- e. An estimated 95 inactive vested members were not included in the fiscal year 2016 revised actuarial valuation, resulting in an estimated \$305,000 understatement of total pension liability disclosed in the notes to the financial statements.

ORS informed us that because of a miscommunication between ORS and its actuary, vested-deferred members were counted using a 20-year vesting rule instead of the required 19.5-year vesting rule.

In our report on internal control, compliance, and other matters for the nine months ending September 30, 2016, we reported a similar condition. DTMB indicated that it agreed with the recommendation and would work with the Michigan National Guard to explore options for gaining greater access to member data.

## RECOMMENDATION

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

## AGENCY PRELIMINARY RESPONSE

DTMB's ORS provided us with the following response:

*DTMB agrees with the recommendation. Over the past year, many internal controls have been implemented to address control deficiencies noted in the finding. ORS has a process in place to validate the service credit reported by the Michigan National Guard (MiNG) to ensure federal and other state time is not included in the reported service credit.*

*ORS has also established better communication with its actuary to ensure a common understanding of the benefits provisions and the vesting rules are applied appropriately.*

*ORS has worked tirelessly to establish an internal control to obtain demographic and service record data for inactive members of the Michigan Air National Guard. The MiNG has informed ORS that they are prohibited from maintaining this information at their Michigan headquarters. When a member of the MiNG terminates service, the MiNG has a finite amount of time to transfer their service records to the National Personnel Records Center. ORS has taken every step outlined by the MiNG to obtain this data directly from the federal government including filing a legal justification and enlisting the support of senior DTMB officials, however, the federal government has rejected our request at this time. In spite of this setback, ORS continues to work diligently to gain access to this data, and in the absence of actual data the actuary is estimating the number of inactive deferred MiNG members in the calculation of the total pension liability so that it will not be understated.*

NINE MONTHS ENDING SEPTEMBER 30, 2016  
REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS  
FOLLOW-UP

Below is the status of the reported finding from the nine months ending September 30, 2016 Michigan Military Retirement System report on internal control, compliance, and other matters:

<u>Prior Audit Finding Number</u>	<u>Topic Area</u>	<u>Current Status</u>	<u>Current Finding Number</u>
1	Controls necessary to ensure completeness and accuracy of data provided to actuary.	Repeated*	1

\* See glossary at end of report for definition.

## **GLOSSARY OF ABBREVIATIONS AND TERMS**

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<b>deficiency in internal control over financial reporting</b>	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.
<b>DTMB</b>	Department of Technology, Management, and Budget.
<b>financial audit</b>	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.
<b>generally accepted accounting principles (GAAP)</b>	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."
<b>Governmental Accounting Standards Board (GASB)</b>	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.
<b>internal control</b>	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.
<b>material misstatement</b>	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.
<b>material weakness in internal control over financial reporting</b>	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.
<b>MiNG</b>	Michigan National Guard.
<b>MMRP</b>	Michigan Military Retirement Provisions.

**ORS** Office of Retirement Services.

**repeated** The same problem was noted in the current audit, and the wording of the current recommendation remains essentially the same as the prior audit recommendation.

**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.









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