

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, 2018

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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.

The auditor general may make investigations pertinent to the conduct of audits.

*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, 2018*

**Report Number:**  
**071-0152-19**

**Released:**  
**April 2019**

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's financial statements dated February 4, 2019.

<b>Findings Related to Internal Control, Compliance, and Other Matters</b>	<b>Material Weakness</b>	<b>Significant Deficiency</b>	<b>Agency Preliminary Response</b>
Lack of internal control resulted in misstatements of certain healthcare-related financial statement line items that were not detected and corrected by Financial Services, Department of Technology, Management, and Budget, prior to audit ( <a href="#">Finding #1</a> ).		X	Agrees

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

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

April 30, 2019

Mr. Scott Koenigs knecht, Chair  
Michigan Public School Employees' Retirement System Board  
Stevens T. Mason Building  
and  
Ms. Tricia L. Foster, 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, Ms. Foster, and Ms. Vanden Bosch:

This is our report on internal control, compliance, and other matters of the Michigan Public School Employees' Retirement System for the fiscal year ended September 30, 2018.

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 to submit it to the State Budget Director upon completion of an audit. Within 30 days of receipt, the Office of Internal Audit Services, State Budget Office, 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 black 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

Mr. Scott Koenigsnecht, Chair  
Michigan Public School Employees' Retirement System Board  
Stevens T. Mason Building  
and  
Ms. Tricia L. Foster, 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. Koenigsnecht, Ms. Foster, 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, 2018 and the related notes to the basic financial statements and have issued our report thereon dated February 4, 2019.

### **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 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 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  
February 4, 2019



FISCAL YEAR 2018  
FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

## FINDING #1

### Improvements needed in internal control over healthcare transactions.

Financial Services (FS), Department of Technology, Management, and Budget (DTMB), did not ensure that sufficient internal control\* existed for the preparation and approval of certain healthcare transactions of the Michigan Public School Employees' Retirement System (MPERS). As a result, misstatements in healthcare-related financial statement line items were not prevented, or detected and corrected, in a timely manner.

Section 18.1485 of the *Michigan Compiled Laws* states that each department shall establish and maintain an internal accounting and administrative control system using generally accepted accounting principles\*. These controls should include a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures; a system of practices to be followed in the performance of duties; qualified personnel that maintain a level of competence; and internal control techniques that are effective and efficient. Each principal department head shall document the system and ensure that the system functions as intended.

Our audit disclosed the following misstatements, which FS corrected prior to the issuance of the MPERS's *Comprehensive Annual Financial Report*:

- a. FS improperly recorded in fiscal year 2018 other governmental contributions for the \$25.3 million Employer Group Waiver Program subsidies earned in fiscal year 2017, but received by MPERS in fiscal year 2018. Because these funds relate to an accrual established in fiscal year 2017, FS should have decreased the health benefits deduction. These misstatements had the following effect (prior to correction):

Financial Statement Line Item	Amount Overstated/ (Understated)
Additions: Other governmental contributions	\$25.3 million
Deductions: Health benefits	\$25.3 million
Net Position Restricted for Pension Benefits and OPEB	\$0

- b. FS improperly decreased health benefits for the \$23.4 million subsidies due from a vendor for the Employer Group Waiver Program. Beginning in fiscal year 2018, MPERS received the subsidy directly from the vendor rather than the vendor applying a credit to future MPERS invoices. This resulted in the need to adjust the recording of the subsidy as other governmental contributions instead of as a reduction in

\* See glossary at end of report for definition.

health benefits. These misstatements had the following effect (prior to correction):

Financial Statement Line Item	Amount Overstated/ (Understated)
Additions: Other governmental contributions	(\$23.4 million)
Deductions: Health benefits	(\$23.4 million)
Net Position Restricted for Pension Benefits and OPEB	\$0

- c. FS did not record a \$39.8 million receivable and the related decrease in health benefits paid for the amount due from vendors for the Centers for Medicare and Medicaid Services program subsidies and various drug manufacturer rebates. These misstatements had the following effect (prior to correction):

Financial Statement Line Item	Amount Overstated/ (Understated)
Receivables: Amounts due from other	(\$39.8 million)
Deductions: Health benefits	\$39.8 million
Net Position Restricted for Pension Benefits and OPEB	(\$39.8 million)

- d. FS did not record a \$5.3 million receivable from a vendor and the corresponding other governmental contributions for the Employer Group Waiver Program. These misstatements had the following effect (prior to correction):

Financial Statement Line Item	Amount Overstated/ (Understated)
Receivables: Amounts due from other	(\$5.3 million)
Additions: Other governmental contributions	(\$5.3 million)
Net Position Restricted for Pension Benefits and OPEB	\$5.3 million

FS informed us that a lack of clear understanding because of staff turnover contributed to each of these errors. In addition, for parts a. and b., FS erred in its determination of the appropriate accounting treatment needed when MPSERS began receiving the subsidies directly from the vendor.

**RECOMMENDATION**

We recommend that FS ensure that sufficient internal control exists for the preparation and approval of certain healthcare transactions for MPSERS.

**AGENCY  
PRELIMINARY  
RESPONSE**

DTMB's FS provided us with the following response:

*Financial Services agrees with the recommendation. Upon notification by the Office of the Auditor General, Financial Services immediately corrected the identified errors and updated the MPSERS and State's Comprehensive Annual Financial Reports. Financial Services has updated and implemented processes that will ensure sufficient internal controls are in place to mitigate the risk of misstatements. Furthermore, Financial Services, in conjunction with the Office of Retirement Services, has prioritized efforts and resources to perform a comprehensive review of the coordination and completion of year-end processes.*

## **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>FS</b>	Financial Services.
<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>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>MPSERS</b>	Michigan Public School Employees' Retirement System.
<b>OPEB</b>	other postemployment benefits.
<b>significant deficiency in internal control over financial reporting</b>	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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