

Office of the Auditor General
Report on Internal Control Over Financial Reporting

**Michigan Public School Employees'
Retirement System**

Schedules of Employer Pension and Other Postemployment Benefit
Allocations and Schedules of Collective Pension and
Other Postemployment Benefit Amounts

Fiscal Year Ended September 30, 2018

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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Report Summary

*Report on Internal Control Over Financial Reporting
Michigan Public School Employees' Retirement System - Schedules of Employer Pension and Other Postemployment Benefit Allocations and Schedules of Collective Pension and Other Postemployment Benefit Amounts
Fiscal Year Ended September 30, 2018*

Report Number:
071-0164-19

Released:
September 2019

Generally accepted auditing standards require that an auditor report to management and those charged with governance any significant deficiencies or material weaknesses 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 dated July 26, 2019 on the Michigan Public School Employees' Retirement System's schedules of employer pension and other postemployment benefit allocations and schedules of collective pension and other postemployment benefit amounts for the fiscal year ended September 30, 2018.

Findings Related to Internal Control Over Financial Reporting	Material Weakness	Significant Deficiency	Agency Preliminary Response
Lack of internal control resulted in an improper allocation of net pension and other postemployment benefit liabilities between non-university employers and university employers that was not detected and corrected by the Office of Retirement Services, Department of Technology, Management, and Budget, prior to audit (<u>Finding #1</u>).		X	Agrees

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Doug A. Ringler, CPA, CIA
Auditor General

September 27, 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 over financial reporting of the Michigan Public School Employees' Retirement System Schedules of Employer Pension and Other Postemployment Benefit Allocations and Schedules of Collective Pension and Other Postemployment Benefit Amounts for the fiscal year ended September 30, 2018.

Your agency provided the 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 Office 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,

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL



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Doug A. Ringler, CPA, CIA
Auditor General

Independent Auditor's Report on Internal Control Over Financial Reporting

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:

We planned and performed our audit of the Michigan Public School Employees' Retirement System's schedules of employer allocations for non-university employers and university employers and the specified column totals of the schedules of collective pension and other postemployment benefit amounts as of and for the fiscal year ended September 30, 2018 and the related notes in accordance with auditing standards generally accepted in the United States of America. We considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the schedules of employer allocations for non-university employers and university employers and on the specified column totals of the schedules of collective pension and other postemployment benefit amounts, 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 financial schedules 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 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.

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 schedules of employer allocations for non-university employers and university employers and the specified column totals of the schedules of collective pension and other postemployment benefit amounts and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the Michigan Public School Employees' Retirement System Board, the Department of Technology, Management, and Budget, and the Office of Retirement Services and is not intended to be, and should not be, used by anyone other than these specified parties.

Sincerely,

A handwritten signature in cursive script that reads "Doug Ringler".

Doug Ringler
Auditor General
July 26, 2019

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

FINDING #1

Improvement in internal control needed to ensure proper allocation of pension and OPEB liabilities.

The Office of Retirement Services (ORS), Department of Technology, Management, and Budget (DTMB), did not have sufficient internal control* to ensure the proper allocation of the Michigan Public School Employees' Retirement System's (MPERS's) net pension and other postemployment benefit (OPEB) liabilities between non-university employers and university employers on the schedules of collective pension and OPEB amounts for the fiscal year ended September 30, 2018. As a result, financial errors of \$8.3 million affecting the net pension and net OPEB liabilities for non-university employers and university employers were not prevented, or detected and corrected, in a timely manner.

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*. 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.

In addition, Governmental Accounting Standards Board* (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, require employers participating in a cost-sharing pension plan to recognize in their financial statements the proportionate share of the collective net pension and OPEB liabilities, deferred inflows and outflows of resources, and pension and OPEB expenses. The calculation of these amounts for non-universities and universities is dependent on the completeness and accuracy of the underlying financial activity. Also, the proportionate share of the net pension and OPEB liabilities is determined based on each employer's required contributions.

Our audit disclosed the following misstatements, which ORS corrected prior to the issuance of the schedules:

- a. ORS did not properly allocate \$6.5 million (97.0%) of the \$6.7 million unfunded actuarially accrued liability rate stabilization funding to 6 of 7 participating universities as required by Section 236(4), Public Act 108 of 2017.

* See glossary at end of report for definition.

This resulted in these universities receiving an incorrect allocation of the net pension liability:

University	Overstatement (Understatement) of September 30, 2018 Net Pension Liability	Percent Impact of Error on Each University's Net Pension Liability
Central Michigan University	\$ (5,503,235)	(3.6%)
Eastern Michigan University	\$ (2,190,711)	(2.8%)
Michigan Technological University	\$ 6,441,393	8.2%
Northern Michigan University	\$ 4,357,700	6.8%
Western Michigan University	\$ 1,076,316	0.7%
Ferris State University	\$ (4,181,451)	(4.1%)
Lake Superior State University	\$ 0	0.0%

The error did not affect the total September 30, 2018 net pension liability.

ORS informed us that the misstatement was because of a clerical error that was not detected during the supervisory review.

- b. ORS overstated the non-universities' share of retiree prescription drug claims by \$1.7 million and understated the universities' share by \$1.7 million. The misstatement resulted in an overstatement of the non-universities' share of the September 30, 2018 net OPEB liability by \$1.8 million and an understatement of the universities' share by \$1.8 million. (The \$100,000 difference between these amounts is because of the reallocation of investment earnings.)

ORS informed us that the misstatement occurred because its third-party database vendor incorrectly loaded data after a significant ORS database system redesign, which impacted ORS's queries. Also, ORS informed us that it did not identify these errors during its initial validation of the updated third-party database prior to sending data to the actuary.

RECOMMENDATION

We recommend that ORS implement sufficient internal control to ensure the proper allocation of MPERS's net pension and OPEB liabilities between non-university employers and university employers on the schedules of collective pension and OPEB amounts.

**AGENCY
PRELIMINARY
RESPONSE**

DTMB provided us with the following response:

DTMB agrees with the recommendation. ORS has corrected both issues related to this finding and will implement controls to ensure that the university and non-university unfunded actuarial accrued liability rate stabilization is accurately allocated among the participating employers and to work with our third-party database vendor to ensure that data is loaded correctly for calculating the university share of retiree healthcare expenses.

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 financial schedules 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 financial schedules that causes the schedules 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 financial schedules will not be prevented, or detected and corrected, on a timely basis.
MPSERS	Michigan Public School Employees' Retirement System.
OPEB	other postemployment benefit.

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.



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