

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

Michigan State Employees' Retirement System
Schedule of Employer Allocations and Schedules of Pension and
Other Postemployment Benefit Amounts by Employer

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 State Employees' Retirement System
- Schedule of Employer Allocations and Schedules of Pension and Other Postemployment Benefit Amounts by Employer
Fiscal Year Ended September 30, 2018*

Report Number:
071-0165-19

Released:
November 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 September 27, 2019 on the Michigan State Employees' Retirement System's schedule of employer allocations and schedules of pension and other postemployment benefit amounts by employer for the fiscal year ended September 30, 2018.

Findings Related to Internal Control, Compliance, and Other Matters	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 employers that was not detected and corrected by Financial Services, Department of Technology, Management, and Budget, prior to audit (Finding #1).		X	Agrees

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Office of the Auditor General
201 N. Washington Square, Sixth Floor
Lansing, Michigan 48913

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

November 26, 2019

Colonel John J. Wojcik, Chair
State of Michigan Retirement 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 Colonel Wojcik, Ms. Foster, and Ms. Vanden Bosch:

This is our report on internal control over financial reporting of the Michigan State Employees' Retirement System Schedule of Employer Allocations and Schedules of Pension and Other Postemployment Benefit Amounts by Employer 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

TABLE OF CONTENTS

MICHIGAN STATE EMPLOYEES' RETIREMENT SYSTEM Schedule of Employer Allocations and Schedules of Pension and Other Postemployment Benefit Amounts by Employer

	<u>Page</u>
Report Summary	1
Report Letter	3
Independent Auditor's Report on Internal Control Over Financial Reporting	8
Findings, Recommendations, and Agency Preliminary Responses	
1. Improvement in internal control needed to ensure proper allocation of net pension and OPEB liabilities.	12
Glossary of Abbreviations and Terms	15

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

Colonel John J. Wojcik, Chair
State of Michigan Retirement 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 Colonel Wojcik, Ms. Foster, and Ms. Vanden Bosch:

We planned and performed our audit of the Michigan State Employees' Retirement System's schedule of employer allocations and the specified column totals of the schedules of pension and other postemployment benefit amounts by employer 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 schedule of employer allocations and on the specified column totals of the schedules of pension and other postemployment benefit amounts by employer, 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 schedule of employer allocations and the specified column totals of the schedules of pension and other postemployment benefit amounts by employer and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the State of Michigan Retirement 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
September 27, 2019

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

FINDING #1

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

Financial Services (FS), Department of Technology, Management, and Budget (DTMB), did not have sufficient internal control* to ensure the proper allocation of the Michigan State Employees' Retirement System's (MSERS's) net pension and other postemployment benefit (OPEB) liabilities on the schedules of pension and OPEB amounts by employer for the fiscal year ended September 30, 2018. As a result, errors affecting the allocation of the net pension and OPEB liabilities by employers 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.

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 proportionate share of the net pension and OPEB liabilities is determined based on each employer's required contributions.

FS calculates the employer's required pension and OPEB contributions using employee wage data confirmed with each reportable employer. The actuaries then calculate net pension and OPEB liabilities amounts based on the required contributions.

* See glossary at end of report for definition.

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

- a. FS did not properly classify employee wages and required pension and OPEB contributions between employers, which impacted net pension and OPEB liabilities:

<u>Employer</u>	<u>Overstatement (Understatement) of September 30, 2018 Net Pension Liability</u>	<u>Percent Impact of Error on Each Employer Net Pension Liability</u>	<u>Overstatement (Understatement) of September 30, 2018 Net OPEB Liability</u>	<u>Percent Impact of Error on Each Employer Net OPEB Liability</u>
State of Michigan	\$ 12,837,743	0.2%	\$ 16,475,527	0.2%
State Building Authority	\$ (21,585)	(3.6%)	\$ (28,592)	(4.3%)
Information Technology Fund	\$ (208,376)	(0.1%)	\$ (290,118)	(0.1%)
Liquor Purchase Revolving Fund	\$ 3,080,666	19.9%	\$ 3,846,338	19.5%
Office Services Revolving Fund	\$ 1,520,535	10.9%	\$ 2,005,576	11.1%
Motor Transport Fund	\$ (308,323)	(7.6%)	\$ (369,849)	(7.0%)
Michigan State Housing Development Authority	\$ (17,486,660)	(80.6%)	\$ (22,683,447)	(80.0%)
Michigan Strategic Fund	\$ (1,302,438)	(25.8%)	\$ (1,813,358)	(28.0%)
Michigan Economic Development Corporation	\$ 2,490,585	18.1%	\$ 3,674,102	20.7%
Michigan Finance Authority	\$ (44,251)	(0.6%)	\$ (219,680)	(2.2%)
Michigan Education Trust	\$ (175,026)	(7.5%)	\$ (234,942)	(8.1%)
Mackinac Island State Park Commission	\$ (121,628)	(5.1%)	\$ (169,340)	(5.3%)
Land Bank Fast Track Authority	\$ (169,761)	(17.1%)	\$ (236,355)	(17.1%)

When determining the wages and contributions by employers, we noted that FS did not confirm the Statewide Integrated Governmental Management

Applications* (SIGMA) coding with employers and did not provide sufficient instructions when requesting employers to validate employee wages and contributions. In addition, FS, in conjunction with MSERS employers, had not fully developed a process to identify, analyze, and communicate accounting adjustments transferring wages and required pension and OPEB contributions between employers.

- b. For two employers, FS did not properly calculate the employers' OPEB contributions based on the required method of actual fiscal year 2018 OPEB claims incurred on behalf of retirees:

Employer	Overstatement (Understatement) of September 30, 2018 Net OPEB Liability	Percent Impact of Error on Each Employer Net OPEB Liability
Attorney Discipline System	\$ 31,653	2.6%
State Bar of Michigan	\$(1,512,317)	(1,664.3%)

FS inadvertently did not use the required method and its departure from this method was not detected during the supervisory review.

RECOMMENDATION

We recommend that FS implement sufficient internal control to ensure the proper allocation of MSERS's net pension and OPEB liabilities on the schedules of pension and OPEB amounts by employer.

AGENCY PRELIMINARY RESPONSE

DTMB provided us with the following response:

DTMB agrees with the recommendation. DTMB Financial Services has begun work with the employers included in the allocation process, with assistance from the Office of Financial Management, to establish controls that ensure proper wage and contribution information is provided to the actuary. New processes will include establishing standardized instructions that will provide employers with detailed steps to properly validate their wage and contribution information.

* See glossary at end of report for definition.

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.
FS	Financial Services.
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.
MSERS	Michigan State Employees' Retirement System.

OPEB

other postemployment benefit.

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.

Statewide Integrated Governmental Management Applications (SIGMA)

The State's enterprise resource planning business process and software implementation that support budgeting, accounting, purchasing, human resource management, and other financial management activities.



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