

**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, 2019

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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, 2019*

**Report Number:  
071-0152-20**

**Released:  
April 2020**

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 26, 2020.

<b>Findings Related to Internal Control, Compliance, and Other Matters</b>	<b>Material Weakness</b>	<b>Significant Deficiency</b>	<b>Agency Preliminary Response</b>
The Department of Technology, Management, and Budget's Financial Services did not establish sufficient internal control, which resulted in financial statement line item misstatements prior to audit and contributed to delays in the issuance of the audited financial report ( <u>Finding #1</u> ).	X		Agrees
The Office of Retirement Services did not complete the actions necessary to help validate that the underlying wage and census data sent to the actuary was complete and accurate ( <u>Finding #2</u> ).		X	Agrees

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

**Laura J. Hirst, CPA**  
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**Doug A. Ringler, CPA, CIA**  
Auditor General

April 21, 2020

Mr. Scott Koenigs knecht, Chair  
Michigan Public School Employees' Retirement System Board  
Stevens T. Mason Building  
and  
Mr. Brom Stibitz, Acting Director  
Department of Technology, Management, and Budget  
Lewis Cass Building  
and  
Mr. Anthony J. Estell, Director  
Office of Retirement Services  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Koenigs knecht, Mr. Stibitz, and Mr. Estell:

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, 2019.

Your agency provided preliminary responses to the recommendations 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,

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 Koenigsknecht, Chair  
Michigan Public School Employees' Retirement System Board  
Stevens T. Mason Building  
and  
Mr. Brom Stibitz, Acting Director  
Department of Technology, Management, and Budget  
Lewis Cass Building  
and  
Mr. Anthony J. Estell, Director  
Office of Retirement Services  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Koenigsknecht, Mr. Stibitz, and Mr. Estell:

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, 2019 and the related notes to the basic financial statements and have issued our report thereon dated February 26, 2020.

### **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.

Our consideration of internal control was for the limited purpose described in the preceding 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. However, as described in the body of our report, we identified a deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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. We consider the deficiency described in Finding #1 to be a material weakness.

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. We consider the deficiency described in Finding #2 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 Findings**

The System's preliminary responses to the findings identified in our audit are included in the body of our report. The System's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

### **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 26, 2020



FISCAL YEAR 2019  
FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

**FINDING #1**

**Improvements  
needed in internal  
control over  
accounting  
transactions.**

The Department of Technology, Management, and Budget's (DTMB's) Financial Services (FS) division did not have sufficient internal control\* in place for the Michigan Public School Employees' Retirement System (MPERS) to ensure that misstatements in accounting transactions were prevented, or detected and corrected, in a timely manner. We identified 7 significant financial statement errors that contributed to MPERS's audited financial report being issued 2 months after the statutory deadline of December 29, 2019.

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\*(GAAP). 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.

Lack of sufficient internal control resulted in 7 significant financial statement errors that were not timely detected and corrected.

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

- a. FS did not record a \$50.9 million receivable and the related other governmental contributions for the amount due from vendors for the Centers for Medicare and Medicaid Services (CMS) program reinsurance subsidies. This misstatement had the following effects (prior to correction):

<u>Financial Statement Line Item</u>	<u>Amount Overstated/ (Understated)</u>
Additions: Other governmental contributions	(\$50.9 million)
Receivables: Amounts due from other	(\$38.4 million)
Receivables: Amounts due from other long term	(\$12.5 million)
Net Position Restricted for Pension Benefits and OPEB	(\$50.9 million)

\* See glossary at end of report for definition.

- b. FS improperly increased amounts due from employers instead of amounts due from other for \$44.5 million for the amount due from various healthcare vendors for CMS program subsidies, drug manufacturer rebates, and credits from a vendor for a billing error. This misstatement had the following effects (prior to correction):

<u>Financial Statement Line Item</u>	<u>Amount Overstated/ (Understated)</u>
Receivables: Amounts due from employers	\$44.5 million
Receivables: Amounts due from other	(\$44.5 million)
Net Position Restricted for Pension Benefits and OPEB	\$0

- c. FS improperly increased health benefits for the \$23.4 million Employer Group Waiver Program subsidies earned in fiscal year 2018 and received by MPERS in fiscal year 2019. Because these funds relate to an accrual established in fiscal year 2018, FS should have decreased other governmental contributions. This misstatement had the following effects (prior to correction):

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

- d. FS did not record a \$23.4 million receivable and the related decrease in health benefits paid for the amount due from a vendor for drug manufacturer rebates. This misstatement had the following effects (prior to correction):

<u>Financial Statement Line Item</u>	<u>Amount Overstated/ (Understated)</u>
Receivables: Amounts due from other	(\$23.4 million)
Deductions: Health benefits	\$23.4 million
Net Position Restricted for Pension Benefits and OPEB	(\$23.4 million)

- e. FS improperly decreased other governmental contributions and amounts due from others for \$5.3 million for an Employer Group Waiver Program subsidy. FS recorded the transaction twice in its

accounting records. This misstatement had the following effects (prior to correction):

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

- f. FS's year-end review procedures did not identify two financial transactions related to a \$15.1 million overstatement and a \$10 million understatement that were both recorded twice in the accounting records. Our review noted that in each instance, FS recorded a manual accounting entry duplicating an automatic entry from the Office of Retirement Services' (ORS's) Clarety system. These misstatements had the following effects (prior to correction):

<u>Financial Statement Line Item</u>	Amount Overstated/ (Understated)
Additions: Employer contributions	\$5.1 million
Receivables: Amounts due from employers	\$5.1 million
Net Position Restricted for Pension Benefits and OPEB	\$5.1 million

For part a., FS informed us that it and ORS did not effectively collaborate to ensure that the necessary accounting transactions related to healthcare subsidy credits were properly identified and recorded in the State's accounting system. For parts b. through f., FS did not properly apply its controls that were in place to ensure that the accounting transactions were accurately recorded in the State's accounting system.

The combination of deficiencies identified in this finding increases the possibility that a material misstatement\* of the basic financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the combination of these deficiencies to be a material weakness in FS's internal control.

## RECOMMENDATION

We again recommend that FS implement sufficient internal control for MPSERS to ensure that misstatements in accounting transactions are prevented, or detected and corrected, in a timely manner.

\* See glossary at end of report for definition.



**AGENCY  
PRELIMINARY  
RESPONSE**

DTMB provided us with the following response:

*ORS and Financial Services agree with this recommendation. Upon notification by the Office of the Auditor General, Financial Services immediately corrected the identified errors and updated the financial reports. As a result, these errors did not result in misstatements in the MPSERS Comprehensive Annual Financial Report.*

*Financial Services is working to assess and enhance the current controls in place and implement additional controls to ensure misstatements in accounting transactions will be prevented or detected and corrected.*

*Related to parts a. through d., Financial Services, in partnership with ORS, will be working to better understand the services and benefits provided by the healthcare vendors to ensure the financial transactions resulting from the vendor's contractual obligations are accurately identified, reconciled, and posted to the general ledger.*

## FINDING #2

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### Improvements needed to ensure the completeness and accuracy of actuary data.

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DTMB's ORS should improve its internal control to help ensure the accuracy and completeness of member data forwarded to the actuary for use in the calculation of the MPSERS total pension and other postemployment benefits (OPEB) liabilities. This deficiency increases the risk of a misstatement in the notes to the financial statements and could delay issuance of MPSERS's *Comprehensive Annual Financial Report* beyond the statutory deadline.

Governmental Accounting Standards Board\* (GASB) Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25* and GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, require pension and OPEB plans to report the total pension and OPEB liabilities in the notes to the financial statements of cost-sharing plans. The calculation of the total pension and OPEB liabilities is dependent on the completeness and accuracy of the underlying wage and census data.

Section 18.1485 of the *Michigan Compiled Laws* requires each department to establish and maintain an internal accounting and administrative control system using GAAP, including recordkeeping procedures and internal control techniques that are effective and efficient.

ORS's internal control to ensure the completeness and accuracy of the underlying wage and census data includes verifying a sample of participating employers' employee wage and census data reported to ORS. To ensure the timely issuance of MPSERS's audited financial report, ORS estimated that its review would need to be completed by August 1st. This would provide time for participating employers to make corrections, ORS to provide updated data files to the actuary, and the actuary to issue updated actuarial valuations.

ORS's actuary has identified member data elements that are critical in the calculation of the total pension and OPEB liabilities, including eligible wages, years of service, job class, date of birth, gender, benefit structure, and employment status.

We reviewed ORS's verification of its fiscal year 2018 wage and census sample and noted:

- As of November 14, 2019, ORS had not completed its review for 99 (71.2%) of 139 sampled participating employers.
- ORS did not verify the service credit earned for 92.0% of the sampled employees.
- ORS did not verify the employees' job class code.

\* See glossary at end of report for definition.

Our review of the fiscal year 2018 data forwarded to the actuary disclosed various errors in the data. We determined that, overall, the errors did not have a material impact on the calculation of total pension and OPEB liabilities.

ORS informed us that its 2018 review was delayed because it had not finalized its process to verify the completeness and accuracy of participating employers' employee wage data reported to ORS. In addition, ORS did not consider developing a review process for all critical member data elements identified by its actuary.

**RECOMMENDATION**

We recommend that ORS improve its internal control to help ensure the accuracy and completeness of member data forwarded to the actuary.

**AGENCY  
PRELIMINARY  
RESPONSE**

DTMB provided us with the following response:

*DTMB agrees with the recommendation. ORS agrees that its internal control to verify member data forwarded to the actuary was not completed in sufficient time to allow the actuary to revise the actuarial valuation in time for the CAFR publication. ORS will complete its member data review by August 1, annually.*

*ORS agrees that its current internal control to verify the accuracy and completeness of the member data provided to its actuary does not include a review of service credit accumulation or job class codes. ORS will explore methods for conducting a review of critical data fields.*

FISCAL YEAR 2018  
REPORT ON INTERNAL CONTROL,  
COMPLIANCE, AND OTHER MATTERS  
FOLLOW-UP

Below is the status of the reported finding from the fiscal year 2018 Michigan Public School Employees' Retirement System report on internal control, compliance, and other matters (071-0152-19):

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
1	Improvements needed in internal control over healthcare transactions.	Repeated*	1

\* See glossary at end of report for definition.

## **GLOSSARY OF ABBREVIATIONS AND TERMS**

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CMS	Centers for Medicare and Medicaid Services.
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 basic financial statements 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 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.

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 basic financial statements will not be prevented, or detected and corrected, on a timely basis.
MPSERS	Michigan Public School Employees' Retirement System.
OPEB	other postemployment benefits.
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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