Office of the Auditor General

Financial and Performance Audit Including Report on Internal Control, Compliance, and Other Matters

Information Technology Fund and IT Billings

Department of Technology, Management, and Budget

Fiscal Year Ended September 30, 2018

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

071-0137-19

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

Report Summary

Financial and Performance Audit Including Report on Internal Control, Compliance, and Other Matters
Information Technology Fund and IT Billings
Department of Technology, Management, and Budget (DTMB)
Fiscal Year Ended September 30, 2018

Report Number:
071-0137-19

Released:
May 2020

The Information Technology Fund is an internal service fund created by administrative decision to provide telecommunication and IT services for State agencies. User agencies are billed for equipment and services based on actual costs or rates established to cover actual costs.

Auditor's Report Issued
UNMODIFIED OPINION ☒ MODIFIED OPINION ☐
We issued an unmodified opinion on the Fund's financial statements to reflect that they were fairly presented, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

Report on Internal Control, Compliance, and Other Matters			
Findings Related to Internal Control, Compliance, and Other Matters	**Material Weakness**	**Significant Deficiency**	**Agency Preliminary Response**
DTMB did not have sufficient internal control in place to evaluate the delivery and service dates when processing payments and identifying accounts payable. Consequently, expenditures were recorded in the wrong fiscal year (Finding #1).		X	Agrees

Performance Audit Objective			**Conclusion**
Objective: To assess the effectiveness of DTMB's efforts to properly apply its billing methodology and allocation of expenses to recoup costs of the Fund.			Effective
Findings Related to This Audit Objective	**Material Condition**	**Reportable Condition**	**Agency Preliminary Response**
None reported.	Not applicable.		

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Lansing, Michigan 48913

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General

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May 8, 2020

Mr. Brom Stibitz, Acting Director
Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Stibitz:

This is our report on the financial and performance audit including the report on internal control, compliance, and other matters on the Information Technology Fund and IT Billings, Department of Technology, Management, and Budget, 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

Doug Ringler
Auditor General

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Office of the Auditor General
Doug A. Ringler, CPA, CIA
Auditor General
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Independent Auditor's Report on the Financial Statements
and Other Reporting Required by *Government Auditing Standards*

Mr. Brom Stibitz, Acting Director
Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Stibitz:

Report on the Financial Statements
We have audited the accompanying financial statements of the Information Technology Fund, Department of Technology, Management, and Budget, as of and for the fiscal year ended September 30, 2018 and the related notes to the financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Information Technology Fund as of September 30, 2018 and the changes in its financial position and its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters
As discussed in Note 1 to the financial statements, the financial statements present only the Information Technology Fund and do not purport to, and do not, present fairly the financial position of the State of Michigan or its internal service funds as of September 30, 2018, the changes in its financial position, or, where applicable, its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the financial statements, the State of Michigan adopted Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, for the fiscal year ended September 30, 2018.

Our opinion is not modified with respect to these matters.

Other Matter
Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the required supplementary information, as listed in the table of contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by GASB who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*
In accordance with *Government Auditing Standards*, we have also issued our report dated April 27, 2020 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

Sincerely,

Doug Ringler

Doug Ringler
Auditor General
April 27, 2020

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INFORMATION TECHNOLOGY FUND
FINANCIAL STATEMENTS

INFORMATION TECHNOLOGY FUND AND IT BILLINGS
Department of Technology, Management, and Budget

Statement of Net Position
Information Technology Fund
As of September 30, 2018
(In Thousands)

ASSETS		
Current Assets:		
Cash	$	3
Equity in common cash		81,612
Amounts due from component units		325
Inventories		54
Other current assets		57,564
Total Current Assets	$	139,558
Capital Assets:		
Land and other non-depreciable assets	$	78,270
Buildings and equipment		1,444,855
Allowance for depreciation		(884,836)
Construction in progress		155
Total Capital Assets	$	638,444
Total Assets	$	778,002
DEFERRED OUTFLOWS OF RESOURCES	$	67,598
LIABILITIES		
Current Liabilities:		
Accounts payable and other liabilities	$	103,946
Amounts due to other funds		30,207
Unearned revenue		78,092
Current portion of other long-term obligations		29,674
Total Current Liabilities	$	241,919
Long-Term Liabilities:		
Unearned revenue	$	385,231
Noncurrent portion of other long-term obligations		779,809
Total Liabilities	$	1,406,959
DEFERRED INFLOWS OF RESOURCES	$	25,969
NET POSITION		
Net investment in capital assets	$	530,010
Unrestricted		(1,117,336)
Total Net Position	$	(587,326)

The accompanying notes are an integral part of the financial statements.

INFORMATION TECHNOLOGY FUND AND IT BILLINGS
Department of Technology, Management, and Budget

Statement of Revenues, Expenses, and Changes in Fund Net Position
Information Technology Fund
For the Fiscal Year Ended September 30, 2018
(In Thousands)

OPERATING REVENUES	
Operating revenues	$ 934,971
Total Operating Revenues	$ 934,971
OPERATING EXPENSES	
Salaries, wages, and other administrative	$ 821,239
Depreciation	124,245
Premiums and claims	1
Total Operating Expenses	$ 945,486
Operating Income (Loss)	$ (10,515)
NONOPERATING REVENUES (EXPENSES)	
Other nonoperating revenues	$ 1,172
Interest expense	(4,630)
Total Nonoperating Revenues (Expenses)	$ (3,458)
Income (Loss) Before Transfers	$ (13,973)
CAPITAL CONTRIBUTIONS AND TRANSFERS	
Transfers to other funds	$ (3,637)
Total Transfers In (Out)	$ (3,637)
Change in net position	$ (17,610)
Total net position - Beginning of fiscal year - Restated	$ (569,716)
Total net position - End of fiscal year	$ (587,326)

The accompanying notes are an integral part of the financial statements.

INFORMATION TECHNOLOGY FUND AND IT BILLINGS
Department of Technology, Management, and Budget

Statement of Cash Flows
Information Technology Fund
For the Fiscal Year Ended September 30, 2018
(In Thousands)

CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$	971,456
Payments to employees		(292,938)
Payments to suppliers		(544,267)
Claims paid		(1)
Other receipts		3,412
Net cash provided (used) by operating activities	$	137,662
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Loans or loan repayments from other funds	$	26,367
Loans or loan repayments to other funds		(22,991)
Transfers to other funds		(3,637)
Net cash provided (used) by noncapital financing activities	$	(261)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	$	(25,445)
Capital lease payments (including imputed interest expense)		(27,550)
Net cash provided (used) by capital and related financing activities	$	(52,995)
CASH FLOWS FROM INVESTING ACTIVITIES	$	0
Net cash provided (used) - all activities	$	84,405
Cash and cash equivalents at beginning of year		(2,790)
Cash and cash equivalents at end of year	$	81,615
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per Statement of Net Position Classifications:		
Cash	$	3
Equity in common cash		81,612
Cash and cash equivalents at end of year	$	81,615
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$	(10,515)
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation expense		124,245
Pension expense		54,185
OPEB expense		34,578
Deferred Outflows - contributions subsequent to measurement date		(65,072)
Other nonoperating revenues		1,172
Other reconciling items		4
Net Changes in Assets and Liabilities:		
Inventories		307
Other assets (net)		(90,629)
Accounts payable and other liabilities		52,567
Unearned revenue		36,819
Net cash provided (used) by operating activities	$	137,662
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Cost of capital assets acquisitions financed by capital leases	$	122,259
Capital lease liabilities entered into during the year		(122,259)
Total noncash investing, capital, and financing activities	$	0

The accompanying notes are an intregral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

a. Reporting Entity
The accompanying financial statements report the financial position, changes in financial position, and cash flows of the Information Technology Fund, a proprietary fund of the State of Michigan, as of and for the fiscal year ended September 30, 2018. They are not intended to present the financial position, changes in financial position, and cash flows of the State of Michigan or its internal service funds in conformity with accounting principles generally accepted in the United States of America. The Fund is reported as an internal service fund in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR).*

The footnotes accompanying these financial statements relate directly to the Fund. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; and common cash.

The Fund was created by administrative decision to provide telecommunication and IT services for State agencies. User agencies are billed for the cost of such services. During fiscal year 2002, the use of this Fund was expanded to account for all IT activities of the executive branch as prescribed in Executive Order No. 2001-03.

b. Measurement Focus, Basis of Accounting, and Presentation
The financial statements contained in this report are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the time of cash flows. Other revenues and expenses are reported as nonoperating.

c. Deferred Outflows/Inflows of Resources
In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The Fund has deferred outflows of resources related to pensions that qualify for reporting in this category.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Fund has deferred inflows of resources related to pensions that qualify for reporting in this category.

Note 2 Equity in the State Treasurer's Common Cash

The State Treasurer (Treasurer) manages the State's common cash pool, which is used by most State funds. The pooling of cash allows the Treasurer to invest money not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund's balance is treated as equity in the pool and presented in this report as equity in common cash.

Statute or administrative policy determines whether a particular fund receives or pays interest on its balances in the pool. If a fund does not receive or pay interest, the General Fund receives or absorbs such amounts. The Fund does not have investment authority, and the Fund does not receive common cash interest. For the total amount of deposits and investments in the State Treasurer's common cash pool and their specific risks, please refer to the *SOMCAFR.*

a. Common Cash Deposits

Custodial Credit Risk
Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

- Uncollateralized.
- Collateralized with securities held by the pledging financial institution.
- Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

The Treasurer's policy requires the following criteria to lessen custodial credit risk: all financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits to secure the State's funds; a bank, savings and loan association, or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the

State of Michigan; and no deposit in any financial organization may be in excess of 50.0% of the net worth of the organization.

Foreign Currency Risk
Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Section 487.714 of the *Michigan Compiled Laws* requires State deposits be held in a financial institution which maintains a principal office or branch office located in the State. The State had no common cash deposits subject to foreign currency risk at September 30, 2018.

b. Common Cash Investments

Types of Investments
Common cash investments include prime commercial paper, certificates of deposit, and emergency municipal loans.

Risk
In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, investments also require certain disclosures regarding policies and practices with respect to the risk associated with them. Custodial credit risk, credit risk, and interest rate risk are discussed in the following paragraphs.

Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of a failure by a counterparty, the Fund will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent but not in the government's name.

The Treasurer does not have an investment policy for managing custodial credit risk. At September 30, 2018, common cash investments were not exposed to custodial credit risk.

Credit Risk
Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

Prime commercial paper investments must be rated within one of the two highest ratings classifications (1 or 2) at the time of purchase from not less than two of the nationally recognized ratings organizations specified in Public Act 314 of 1965, as amended. Borrowers must have at least

$400 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10.0% of a borrower's outstanding debt.

Emergency municipal loans are evidenced by unrated notes held by the State in the State's name. At September 30, 2018, prime commercial paper investments were rated at A-1 or P-1.

Interest Rate Risk
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The Treasurer's policy states that cash equivalents are invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

Note 3 Change in Accounting/Restatements

The beginning net position of the Fund, as of September 30, 2018, was reduced by $31,309,809 primarily because of the implementation of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The effects of applying this standard are disclosed in Note 5 and Note 6.

Note 4 General Information On Employee Pension Plans

a. Plan Description
The Michigan State Employees' Retirement System (System) is a single-employer, Statewide, defined benefit public employee retirement plan governed by the State of Michigan and created under Public Act 240 of 1943, as amended. The System is overseen by the State of Michigan Retirement Board. The System's pension plan was established by the State to provide retirement, survivor, and disability benefits to the State's government employees.

The System is accounted for in a separate pension trust fund and also issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by visiting www.michigan.gov/ors or by calling the Customer Contact Center at (517) 284-4400 or 1-800-381-5111.

b. Benefits Provided
Introduction
Benefit provisions of the defined benefit (DB) pension plan are established by State statute, which may be amended.

Public Act 240 of 1943, State Employees' Retirement Act, as amended, establishes eligibility and benefit provisions for the DB pension plan. Retirement benefits are determined by final average compensation (FAC) and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability, and survivor benefits.

A member who has separated from employment may request a refund of his or her member contribution account. A refund may cancel a former member's rights to future benefits. However, former members who return to employment and who previously received a refund of their contributions may reinstate their service through repayment of the refund upon satisfaction of certain requirements.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new entrants. All new employees become members of the defined contribution (DC) plan. The Public Act allows returning employees and members who left State employment on or before March 31, 1997 to elect the DB plan instead of the DC plan.

<u>Pension Reform of 2012</u>
On December 15, 2011, the Governor signed Public Act 264 of 2011 into law. The legislation granted members a choice regarding their future retirement plan. They had the following options:

- Option 1: DB Classified. Members voluntarily elected to remain in the DB plan for future service and contribute 4% of their annual compensation to the pension fund until they terminate State employment. The 4% contribution began on April 1, 2012.

- Option 2: DB 30. Members voluntarily elected to remain in the DB plan for future service and contribute 4% of pay until they reach 30 years of service. When they reach 30 years of service, they will switch to the State's DC plan. The 4% contribution began April 1, 2012 and continues until they switch to the DC plan or terminate State employment, whichever comes first.

- Option 3: DB/DC Blend. Members voluntarily elected not to pay the 4% and therefore became participants in the DC plan for future service beginning April 1, 2012. As DC plan participants, they receive a 4% employer contribution to their 401(k) account and are eligible for an additional dollar-for-dollar employer match of up to 3% of pay to the plan.

Deferred members of the DB plan (with 10 or more years of service) who are reemployed by the State on or after January 1, 2012 become participants in the DC plan. Their pension calculation is determined by their FAC and years of service as of March 31, 2012. They retain their eligibility for the retiree health insurance premium subsidy offered by the State.

Former non-vested members of the DB plan (with less than 10 years of service) who are reemployed by the State on or after January 1, 2012 and before January 1, 2014 become participants in the DC plan. When they have earned sufficient service credit for vesting (10 years), they would be eligible for a pension based on their FAC and years of service in the DB plan as of March 31, 2012. They retain their eligibility for the retiree health insurance premium subsidy offered by the State.

Former non-vested members (with less than 10 years of service) of the DB plan who are reemployed by the State on or after January 1, 2014 become members of the DC plan. Any service credit previously earned would count toward vesting for the DC plan. They will not be eligible for any pension or retiree health insurance coverage premium but will become a participant in the Personal Healthcare Fund where they will contribute up to 2% of their compensation to a 401(k) or 457 account, earning a matching 2% employer contribution. They will also receive a credit into a health reimbursement account (HRA) at termination if they terminate employment with at least 10 years of service. The credit will be $2,000 for participants who are at least 60 years old or $1,000 for participants who are less than 60 years old at termination.

<u>Regular Retirement</u>
The retirement benefit is based on a member's years of credited service (employment) and FAC. The normal benefit equals 1.5% of a member's FAC multiplied by the years and partial year of credited service and is payable monthly over the member's lifetime.

Under Public Act 264 of 2011, FAC is initially determined as the annual average of the highest three years of compensation (including overtime paid before January 1, 2012 but excluding overtime paid after December 31, 2011). If the end date for the initial FAC calculation is between January 1, 2012 and January 1, 2015, then a prorated amount of post-2008 average overtime will be added to the initial FAC calculation. If the end date for the initial FAC calculation is January 1, 2015 or later, then an annual average of overtime – for the six-year period ending on the FAC calculation date – will be added to that initial FAC calculation to get the final FAC number.

For members who switch to the DC plan for future service, the pension calculation (FAC times 1.5% times years of service) will be determined as of the point the member switches to the DC plan. If the FAC period includes the date of the switch to the DC plan, then the FAC will include up to 240 hours of accrued annual leave multiplied by the rate of pay as of the date of the switch. The hours will be paid at separation.

A member may retire and receive a monthly benefit after attaining:

- Age 60 with 10 or more years of credited service.

- Age 55 with 30 or more years of credited service.

- Age 55 with at least 15 but less than 30 years of credited service. The benefit allowance is permanently reduced 0.5% for each month from the member's age on the effective date of retirement to the date the member will attain age 60.

Employees in covered positions are eligible for supplemental benefits and may retire after attaining:

- Age 51 with 25 or more years in a covered position.

- Age 56 with 10 or more years in a covered position.

In either case, the three years immediately preceding retirement must have been in a covered position. Employees in covered positions are responsible for the custody and supervision of inmates.

Deferred Retirement
Any member with 10 or more years of credited service who terminates employment but has not reached the age of retirement is a deferred member and is entitled to receive a monthly pension upon reaching age 60, provided the member's accumulated contributions have not been refunded. Deferred retirement is available after five years of service for State employees occupying unclassified positions in the executive and legislative branches and certain Michigan Department of Health and Human Services employees subject to reduction in force lay-offs by reason of deinstitutionalization.

Non-Duty Disability Benefit
A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as a State employee is eligible for a non-duty disability pension. The non-duty disability

benefit is computed in the same manner as an age and service allowance based upon service and salary at the time of disability.

Duty Disability Benefit
A member who becomes totally and permanently disabled from performing duties as a State employee as a direct result of State employment, and who has not met the age and service requirement for a regular pension, is eligible for a duty disability pension. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of the pension benefit and increase the minimum annual payment. If the member is under age 60, the duty disability allowance is now a minimum of $6,000 payable annually. At age 60, the benefit is recomputed under service retirement.

Survivor Benefit
Upon the death of a member who was vested, the surviving spouse shall receive a benefit calculated as if the member had retired the day before the date of death and selected a survivor pension. Certain designated beneficiaries can be named to receive a survivor benefit. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of duty death benefits and redefines eligibility for deceased member's survivors. The new minimum duty-related death benefit has been increased to $6,000.

Pension Payment Options
When applying for retirement, an employee may name a person other than his or her spouse as a beneficiary if the spouse waives this right. If a beneficiary is named, the employee must choose whether the beneficiary will receive 100%, 75%, or 50% of the retiree's pension benefit after the retiree's death. The decision is irrevocable. A description of the options follows.

Regular Pension - The pension benefit is computed with no beneficiary rights. If the retiree made contributions while an employee and has not received the total accumulated contributions before death, a refund of the balance of the contributions is made to the beneficiary of record. If the retiree did not make any contributions, there will not be payments to beneficiaries.

100% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

75% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 75% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is lower than the factor used in the 100% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

50% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is lower than the factor used in the 100% or 75% options previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Equated Pension - An equated pension may be chosen by any member under age 65 except a disability retiree and an early supplemental retiree. Equated pensions provide an additional amount until age 65 and may be combined with Regular, 100%, 75%, or 50% option. At age 65 the monthly amount is permanently reduced. The initial and reduced amounts are based on an estimate of social security benefits at age 65, provided by the U.S. Social Security Administration. In order to calculate this benefit, members choosing this option must provide Office of Retirement Services with an estimate from the U.S. Social Security Administration. The actual amount received from social security may vary from the estimate.

Post Retirement Adjustments

One-time upward benefit adjustments were made in 1972, 1974, 1976, 1977, and 1987. Beginning October 1, 1988, a 3% non-compounding increase, up to a maximum of $25 monthly, is paid each October to recipients who have been retired 12 full months. Beginning in 1983, eligible benefit recipients share in a distribution of investment income earned in excess of 8% annually. This distribution is known as the supplemental payment. The supplemental payment is offset by one year's cumulative increases received after the implementation of the annual 3% increase in benefits. These adjustment payments were not issued during fiscal years 1991 through 1994. Members who retired on or after October 1, 1987 are not eligible for the supplemental payment.

Member Contributions

Under Public Act 264 of 2011, members who voluntarily elected to remain in the DB plan contribute 4% of compensation to the retirement system. In addition, members may voluntarily contribute to the System for the purchase of creditable service, such as military service or maternity leave, or a universal buy-in. If a member terminates employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Employer Contributions
The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-dollar value funding principles so that the contribution rates do not have to increase over time. For the fiscal year ended 2018, the Fund's contribution rate was 24.6% of the DB employee wages and 19.7% of the DC employee wages. The Fund's contribution to the System for the fiscal year ended September 30, 2018 was $30,873,569.

Banked Leave Time
Public Act 33 of 2004 amended the State Employees' Retirement Act to include banked leave time (BLT) for members. BLT is an extension of the State's current annual leave program, which banks a predetermined number of hours per pay period. However, BLT will not have an effect on a member's FAC calculation.

c. Actuarial Assumptions
The Fund's net pension liability was measured as of September 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2016 and rolled-forward using generally accepted actuarial procedures. The total pension liability was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Wage inflation rate	3.5%
Projected salary increases	3.5% to 12.5%, including wage inflation at 3.5%
Investment rate of return	7.5%
Cost-of-Living pension adjustment	3% annual non-compounded with maximum annual increase of $300 for those eligible

Mortality rates were based on RP-2000 Combined Healthy Life Mortality Table, adjusted for mortality improvements to 2015 using projection scale BB. For active members, 50% of the table rates were used for males and females.

Actuarial assumptions used in the September 30, 2017 valuation were based on the results of an actuarial experience study covering October 1, 2007 through September 30, 2012.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense, and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of September 30, 2017 is summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return*
Domestic equity pools	28.0%	5.6%
International equity pools	16.0%	7.2%
Private equity pools	18.0%	8.7%
Real estate and infrastructure pools	10.0%	4.2%
Fixed income pools	10.5%	(0.1)%
Absolute return pools	15.5%	5.0%
Short-term investment pools	2.0%	(0.9)%
Total	100.0%	

*Long-term expected real rates of return are net of administrative expenses and 2.3% inflation.

d. Discount Rate
A discount rate of 7.5% was used to measure the total pension liability. The discount rate was based on the long-term expected rate of return on pension plan investments of 7.5%. The projection of cash flows used to determine this discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

e. Net Pension Liability
At September 30, 2018, the Fund reported a liability of $239,415,089 for its proportionate share of the System's net pension liability. The net pension liability was measured as of September 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2016 and rolled-forward using generally accepted actuarial procedures. The Fund's proportion of the net pension liability was based on the Fund's required pension contributions received by the System during the measurement period October 1, 2016 through September 30, 2017, relative to the total required employer contributions from all of the System's participating employers. At September 30, 2017, the Fund's proportion was 4.61%.

f. Pension Liability Sensitivity
The following presents the Fund's proportionate share of the net pension liability calculated using the discount rate of 7.5% as well as what the proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current discount rate:

	1% Decrease 6.5%	Current Discount 7.5%	1% Increase 8.5%
Fund's proportionate share of the net pension liability	$312,784,137	$239,415,089	$176,181,795

g. Pension Plan Fiduciary Net Position
Detailed information about the pension plan's fiduciary net position is available in the System's Comprehensive Annual Financial Report that may be obtained by visiting www.michigan.gov/ors.

h. Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions
For the fiscal year ended September 30, 2018, the Fund's recognized pension expense was $54,185,090. At September 30, 2018, the Fund reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes in experiences	$ 54,905	$ 0
Changes of assumptions	1,970,791	0
Changes in proportions	451,672	0
Net difference between projected and actual earnings on investments	0	14,365,579
Fund's contributions subsequent to the measurement date	30,715,869	0
Total	$33,193,237	$14,365,579

Amounts reported as deferred outflows of resources related to pensions resulting from the Fund's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended September 30, 2019. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ended September 30	Pension Expense Amount
2019	$(3,314,890)
2020	$1,166,298
2021	$(4,611,776)
2022	$(5,127,843)

Currently, deferred outflows and inflows of resources related to pensions that will be recognized in pension expense do not extend beyond the four years identified in the previous table.

i. DC Plan
The Fund participates in the State of Michigan's DC plan. The Fund is required to contribute to the DC plan 4.0% of payroll with an additional match of up to 3.0%. The contribution requirements of plan members and the Fund are established and may be amended by the State Legislature. The State Legislature established the extent to which employer and employees are required to make contributions and established the benefit provisions for the plan. The Fund's contributions to the plan were $7,613,223 for the fiscal year ended September 30, 2018 and are recorded in salaries and benefits expense.

Note 5 Other Postemployment Benefits (OPEB) – Healthcare Plan

a. Plan Description
The System is a single-employer, Statewide, defined benefit public employee retirement plan governed by the State and created under Public Act 240 of 1943, as amended. Section 2 of this Act established the Board's authority to promulgate or amend the provisions of the System. Executive Order No. 2015-13 signed by the Governor on October 27, 2015 established the State of Michigan Retirement Board. The Board consists of nine members:

- Five members appointed by the Governor, which consist of:
    - Two members of the State Employees' Retirement System at least one of whom is a retirant
    - One member of the Michigan Judges' Retirement System
    - One current or former officer or enlisted person in the Michigan military establishment who is a member or retirant under the Michigan Military Retirement Provisions
    - One member of the general public
- Attorney General
- State Treasurer
- Legislative Auditor General
- State Personnel Director, who serves as an ex-officio member

The System's OPEB plan provides all retirees with the option of receiving health, dental, and vision coverage under the Michigan State Employees' Retirement Act.

The System is accounted for in a separate OPEB trust fund and also issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by visiting www.michigan.gov/ors or by calling the Customer Contact Center at (517) 284-4400 or 1-800-381-5111.

b. Benefits Provided

Benefit provisions of the OPEB plan are established by State statute, which may be amended. Public Act 240 of 1943, as amended, establishes eligibility and benefit provisions for the OPEB plan.

DB (Tier 1) members are eligible to receive health, prescription drug, dental, and vision coverage on the first day they start receiving pension benefits. DC (Tier 2) participants who elected to retain the graded premium subsidy benefit under the reform elections of Public Act 264 of 2011 are also eligible to receive subsidized health, prescription drug, dental, and vision coverage after terminating employment if they meet eligibility requirements. Retirees with the premium subsidy benefit contribute 20% of the monthly premium amount for the health (including prescription coverage), dental, and vision coverage. Retirees with a graded premium subsidy benefit accrue credit toward insurance premiums in retirement, earning a 30% subsidy with 10 years of service with an additional 3% subsidy for each year of service thereafter, not to exceed the maximum allowed by statute or 80%. There is no provision for ad hoc or automatic increases. The State Employees' Retirement Act requires joint authorization by the Department of Technology, Management, and Budget (DTMB) and the Michigan Civil Service Commission to make changes to retiree medical benefit plans. DC (Tier 2) participants who elected the Personal Healthcare Fund under Public Act 264 of 2011, and those hired on or after January 1, 2012, are not eligible for any subsidized health, prescription drug, dental, or vision coverage in retirement but may purchase it at their own expense (certain conditions apply).

Former non-vested members of the DB plan who are reemployed by the State on or after January 1, 2014 are not eligible for retiree health insurance coverage premium subsidy but will become a participant in the Personal Healthcare Fund.

The plan is closed to new hires.

c. Contributions

The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-percent of payroll value funding principles so that the contribution rates do not have to increase over time. For fiscal year 2018, the Fund's contribution rate was 22.1% of the DB employee wages and 22.1% of the DC employee wages. The Fund's contribution to the System for the fiscal year ended September 30, 2018 was $32,934,576. Active employees are not required to contribute to the System's OPEB.

d. Actuarial Assumptions

The Fund's net OPEB liability was measured as of September 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of September 30, 2016 and rolled-forward using generally accepted actuarial procedures. The total OPEB liability was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Wage inflation rate	3.5%
Projected salary increases	3.5% to 12.5%, including wage inflation at 3.5%
Investment rate of return	7.5%
Health care cost trend rate	9.0% Year 1 graded to 3.5% Year 10
Mortality	RP-2000 Combined Healthy Life Mortality Table, adjusted for mortality improvements to 2015 using projection scale BB. For active members, 50% of the table rates were used for males and females.

The actuarial assumptions were based upon the results of an experience study covering the period October 1, 2007 through September 30, 2012.

The long-term expected rate of return on OPEB plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense, and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the OPEB plan's target asset allocation as of September 30, 2017 are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return*
Domestic equity pools	28.0%	5.6%
International equity pools	16.0%	7.2%
Private equity pools	18.0%	8.7%
Real estate and infrastructure pools	10.0%	4.2%
Fixed income pools	10.5%	(0.1)%
Absolute return pools	15.5%	5.0%
Short-term investment pools	2.0%	(0.9)%
Total	100.0%	

*Long-term expected real rates of return are net of administrative expenses and 2.3% inflation.

For the fiscal year ended September 30, 2017, the annual money-weighted rate of return on OPEB plan investment, net of OPEB plan investment expense, was 13.30%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

e. Discount Rate

A discount rate of 7.5% was used to measure the total OPEB liability. This discount rate was based on the long-term expected rate of return on OPEB plan investments of 7.5%. The projection of cash flows used to determine this discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member (retiree) rate. Based on these assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

f. Net OPEB Liability

At September 30, 2018, the Fund reported a liability of $383,971,404 for its proportionate share of participating employers' net OPEB liability. The net OPEB liability was measured as of September 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of September 30, 2016 and rolled-forward using generally accepted actuarial procedures. The Fund's proportion of the net OPEB liability was based on the Fund's required OPEB contributions received by the System during the measurement period October 1, 2016 through September 30, 2017, relative to the total required employer contributions from all of the System's participating employers. At September 30, 2017, the Fund's proportion was 4.66%.

The investment return assumption was updated beginning with the September 30, 2016 valuation to reflect reductions in capital market assumptions for the asset classes in which the System invests. The investment return assumption was updated again beginning with the September 30, 2017 valuation in accordance with the Dedicated Gains Policy adopted by the Board of Trustees. This assumption change will increase the computed liabilities.

g. Sensitivity of the Net OPEB Liability to Changes in the Discount Rate

The following table presents the Fund's net OPEB liability, calculated using a single discount rate of 7.5%, as well as what the Fund's net OPEB liability would be if it were calculated using a single discount rate that is 1% lower or 1% higher.

	1% Decrease 6.5%	Rate Discount 7.5%	1% Increase 8.5%
Fund's proportionate share of the net OPEB liability	$437,142,203	$383,971,404	$338,915,791

h. Sensitivity of the Net OPEB Liability to Changes in the Healthcare Trend Rates

The following table presents the Fund's net OPEB liability, calculated using the assumed trend rates as well as what the Fund's net OPEB liability would be if it were calculated using a trend rate that is 1% lower or 1% higher.

	1% Decrease	Trend Rate	1% Increase
Fund's proportionate share of the net OPEB liability	$336,294,500	$383,971,404	$438,650,704

i. OPEB Plan Fiduciary Net Position

Detailed information about the OPEB plan's fiduciary net position is available in the System's *Comprehensive Annual Financial Report* that may be obtained by visiting www.michigan.gov/ors.

j. <u>OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB</u>
For the fiscal year ended September 30, 2018, the Fund recognized OPEB expense of $31,454,734. At September 30, 2018, the Fund reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes in experiences	$ 0	$2,785,333
Changes of assumptions	0	0
Changes in proportions	0	2,343,289
Net difference between projected and actual earnings on investments	0	3,325,545
Fund's contributions subsequent to the measurement date	32,934,576	0
Total	$32,934,576	$8,454,167

Amounts reported as deferred outflows of resources related to OPEB resulting from the Fund's contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the fiscal year ended September 30, 2019. Other amounts reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Fiscal Year Ended September 30	OPEB Expense Amount
2019	$(1,860,073)
2020	$(1,860,073)
2021	$(1,860,073)
2022	$(1,860,073)
2023	$(1,013,875)

Currently, deferred outflows and inflows of resources related to OPEB that will be recognized in OPEB expense do not extend beyond the five years identified in the table above.

Note 6 <u>OPEB - Life Insurance Plan</u>

a. <u>PELIB Description</u>
The State of Michigan provides postemployment life insurance benefits (PELIB) to eligible individuals upon retirement from State employment. Members of the

System may receive a life insurance benefit if they meet the benefit eligibility requirements. PELIB is a single-employer, Statewide, DB OPEB plan. The State contracts with Minnesota Life to administer the payout of life insurance benefits. PELIB is administered by the Michigan Civil Service Commission under Article XI, Section 5 of the Michigan Constitution of 1963 and Michigan Civil Service Commission Rule 5-11.

Activity of PELIB is accounted for in the State Sponsored Group Insurance Fund (SSGIF), an internal service fund in the *SOMCAFR*. SSGIF was administratively established to account for employee insurance benefit programs, which are largely self-funded. Five group insurance programs are offered to State employees: health, dental, vision, long-term disability, and life.

PELIB is not a trust and has no assets.

b. Benefits Provided

The State's group policy with Minnesota Life includes any active employee in the category of classified State service with an appointment of at least 720 hours duration but excluding employees with non-career appointments and those working less than 40% of full time; any active official or active unclassified employee of the State who has been approved for coverage by the Michigan Civil Service Commission; any retired employee or official who was insured under this policy or the prior policies it replaced prior to entry into a State retirement system; and Wayne County employees who a) were State Judicial Council employees on October 1, 1996 and whose employment was transferred to the Recorder's Court on October 1, 1996 and b) whose employer subsequently became the Wayne County Clerk's Office.

Eligible retirees are provided with life insurance coverage equal to 25% of the active life insurance coverage (which amount is rounded to the next higher $100 provided the retiree retired after July 1, 1974), $1,000 for spouse, and $1,000 for each dependent under age 23. The active life insurance amount is either a) two times the employee's basic annual salary, the result rounded to the next higher $1,000 if not already a multiple thereof, with a minimum of $10,000 and a maximum of $200,000 or b) one times the employee's basic annual salary, the result rounded to the next higher $1,000 if not already a multiple thereof, with a minimum of $10,000 and a maximum of $50,000.

c. Contributions

The State contributes 100% of the premiums for employee and retiree life insurance coverage. The premium rate for fiscal year 2018 was $.28 for each $1,000 of coverage. The employee contributes 100% of the premiums for dependent life coverage, and an employee must have been enrolled in dependent life insurance to maintain eligibility for dependent coverage as a retiree. The State is liable for benefit payments that exceed premiums paid. The Michigan Civil Service Commission is responsible for establishing and amending funding policies.

More specific information concerning eligibility requirements, benefit level, and funding policies is included in employee collective bargaining agreements, benefit plan booklets, and rules and regulations issued by the Michigan Civil Service Commission.

d. Actuarial Valuations and Assumptions

The Fund's total OPEB liability for PELIB as of September 30, 2018 was measured as of September 30, 2017 and is based on an actuarial valuation performed as of that date.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculations.

The normal cost and the allocation of benefit values between service rendered before and after the valuation date were determined using an Individual Entry-Age Actuarial Cost Method with these characteristics: a) the annual normal cost for each individual active member, payable from the date of employment to the date of retirement, is sufficient to accumulate the value of the member's benefit at the time of retirement and b) each annual normal cost is a constant percentage of the members' year-by-year projected covered pay.

The total OPEB liability for PELIB was measured using the following actuarial assumptions:

Wage inflation rate	3.5%
Investment rate of return (discount rate)	3.5% per year
Mortality	Healthy life and disabled life mortality, with 115% of the male rates and 121% of the female rates used in the pension valuations for the System's plan members.

IBNR: A liability equal to 25% of expected first year cash flow was held for PELIB benefits claims incurred but not reported (IBNR).

Spouse Benefits for Future Retirees: The liabilities for active members were loaded to account for potential PELIB payable to spouses of future retirees at 3% for the System's retirees.

Spouse Benefits for Current Retirees: Data regarding PELIB coverage for spouses of current retirees was not available. Liabilities for retired members were loaded to account for PELIB payable to the spouses of current retirees at 4% for the System's retirees.

Compensation: For some System retirees, FAC was not reported. The FAC for these members was assumed to be $51,045 (the average of all System retiree records reported with FAC).

For purposes of valuing the PELIB policies for retirees, base wage at retirement was not available and was approximated by applying a factor to the reported FAC at retirement. The factor used to convert an FAC to a base wage is based on the length of the FAC period for each group. The factor used for the System was 0.983092 (2-year FAC) for Conservation and 0.966565 (3-year FAC) for Michigan Department of Corrections and all others.

For System DC plan retirees, compensation at retirement and other information was not provided to the actuary. The PELIB policies for this group were assumed to have the same average value as the policies for retirees in the System DB plan.

Other: The face values of PELIB policies currently in force were requested by the actuary but were not available for use in this valuation.

The actuary estimated the value of the PELIB policies for retirees as follows:

> Individuals retired after July 1974: 50% x compensation at retirement (compensation reported for the 2017 retirement system valuations)
>
> Spousal benefits: $1,000
>
> Individuals retired on or before July 1974: $3,000
>
> Spousal benefits: $1,000

Data for current retiree members of PELIB was not available for use in this valuation. All current retiree members of the retirement plans deemed eligible for PELIB and reported in connection with the 2017 retirement valuations were included in this valuation.

e. Discount Rate
A discount rate of 3.50% was used to measure the ending total OPEB liability for PELIB as of September 30, 2017. This discount rate was based on the tax-exempt municipal bond rate based on an index of 20-year general obligation bonds with an average AA credit rating as of the measurement date because PELIB has no assets. The municipal bond rate of 3.1% was used for determining the beginning total OPEB liability for PELIB as of September 30, 2016. For the prior valuation, dated September 30, 2015, the discount rate used was 4.0%. A decrease in the discount rate used affects the measurement of total OPEB liability for PELIB by increasing its total OPEB liability.

f. Total OPEB Liability for PELIB
As of September 30, 2018, the Fund reported a liability of $58,091,081 for its proportionate share of the State's PELIB total OPEB liability. The total OPEB liability was measured as of September 30, 2017 based on an actuarial valuation as of that date. The Fund's proportion of the total OPEB liability was determined by dividing the Fund's actual contributions to PELIB during the measurement period of October 1, 2016 through September 30, 2017 by the percent of OPEB actual contributions received from all applicable employers. At September 30, 2017, the Fund's proportion was 4.5%.

g. Sensitivity of the Total OPEB Liability for PELIB
The following table presents the Fund's total OPEB liability for PELIB, calculated using a single discount rate of 3.50%, as well as what the Fund's total OPEB liability would be if it were calculated using a single discount rate that is 1% lower or 1% higher:

	1% Decrease 2.5%	Rate Discount 3.5%	1% Increase 4.5%
Fund's proportionate share of the PELIB total OPEB liability	$68,280,237	$58,091,081	$49,968,878

h. OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Life Insurance OPEB

For the year ended September 30, 2018, the Fund recognized OPEB expense of $3,123,439. At September 30, 2018, the Fund reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 48,754	$ 0
Changes of assumptions	0	3,149,449
Contributions subsequent to the measurement date	1,421,907	0
Total	$1,470,661	$3,149,449

Amounts reported as deferred outflows of resources related to OPEB will be recognized in OPEB expense as follows:

Fiscal Year Ended September 30	OPEB Expense Amount
2019	$(636,301)
2020	$(636,301)
2021	$(636,301)
2022	$(636,301)
2023	$(555,491)

Currently, deferred outflows and inflows of resources related to PELIB that will be recognized in OPEB expense do not extend beyond the five years identified in the table above.

Note 7 Risk Management

The Fund participates in the State of Michigan's (primary government) risk management program. The State is self-insured for most general liability and property losses; portions of its employee insurance benefit and bonding programs; and automobile liability, workers' compensation, and unemployment claims. The State Sponsored Group Insurance Fund and Risk Management Fund (internal service funds) have been established by the State to account for these self-insured risk management programs. As a participant, the Fund recognizes expenses for payments made to the State in a manner similar to purchasing commercial insurance. Charges to finance the self-insured programs are based on estimates of amounts needed to pay prior and current year claims as determined annually by the Department of Technology, Management, and Budget. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

Note 8 Other Transfers

Includes transfers to the Michigan Civil Service Commission as authorized by Article XI, Section 5 of the Michigan Constitution. These transfers represent not less than 1% of the aggregate payroll of the classified service for the preceding fiscal year.

Note 9 Fund Deficit

The Fund had a fund balance deficit of $587,326,000 primarily caused by the recording of compensated absences and the implementation of GASB Statement No. 68 and Statement No. 75. The centralization of Statewide IT personnel into a single agency, which resulted from Executive Order No. 2001-3, meant the recording of a compensated absences liability because the Fund's internal service fund activity is reported on a full accrual basis. The statement of net position includes a portion of the net pension liability and net OPEB liability related to the State Employees' Retirement System that was allocated to the Fund in accordance with GASB standards.

Note 10 Capital Assets

a. Summary of Significant Accounting Policies

Methods Used to Value Capital Assets: Capital assets, which include land, buildings, equipment, and intangible items (computer software), are recorded at historical cost or estimated historical cost if purchased or constructed. Land consists primarily of parcels housing radio towers for the State's emergency radio system.

Capitalization Policies: All land and non-depreciable land improvements are capitalized, regardless of cost. Equipment is capitalized when the cost of individual items exceeds $5,000, computer software is capitalized when the cost exceeds $5 million, and all other capital assets are capitalized when the cost of individual items or projects exceeds $100,000.

Depreciation and Useful Lives: Applicable capital assets are depreciated using the straight-line method. Capital assets that were put into service prior to October 1, 2017 had a half-year's depreciation charged in the year of acquisition. Depreciation expense for capital assets put into service after September 30, 2017 is calculated on a daily basis. Estimated useful lives generally were assigned as follows:

Asset	Years
Buildings	5 - 50
Equipment	2 - 25
Intangibles	6 - 12
Land improvements	5 - 40

Capital asset activities for the fiscal year ended September 30 were as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital assets not being depreciated:				
Land	$ 9,169,548			$ 9,169,548
Computer software (projects in process)		$ 70,434,308	$ (1,333,773)	69,100,535
Total capital assets not being depreciated	$ 9,169,548	$ 70,434,308	$ (1,333,773)	$ 78,270,083
Capital assets being depreciated:				
Equipment	$ 554,681,574	$ 252,994,878	$(228,719,823)	$ 578,956,629
Computer software	729,751,893	27,687,514	(31,136,282)	726,303,125
Buildings	135,285,910	4,322,179	(12,416)	139,595,673
Total capital assets being depreciated	$1,419,719,377	$ 285,004,571	$(259,868,522)	$1,444,855,427
Less accumulated depreciation for:				
Equipment	$ (396,529,762)	$ (71,914,664)	$ 33,753,172	$(434,691,254)
Computer software	(279,717,910)	(57,893,117)		(337,611,027)
Buildings	(106,184,700)	(6,348,925)		(112,533,625)
Total accumulated depreciation	$ (782,432,372)	$(136,156,705)	$ 33,753,172	$(884,835,906)
Total capital assets being depreciated, net	$ 637,287,005	$ 148,847,866	$(226,115,350)	$ 560,019,521
Fund capital assets, net	$ 646,456,554	$ 219,282,173	$(227,449,122)	$ 638,289,605

Note 11 Leases

a. Accounting Policy

The State leases various assets under non-cancelable leasing arrangements. Leases that constitute rental agreements are classified as operating leases; the resulting expenditures are recognized as incurred over the lease term. Leases that are comparable to purchases are classified as capital leases.

In the Fund financial statements, assets and liabilities resulting from capital leases are recorded at lease inception. The principal portion of lease payments reduces the liability; the interest portion is expenses. Lease payments are reported as expenditures only when paid.

Most leases have cancellation clauses with one- to six-month notice requirements in the event that funding is not available. For reporting purposes, such cancellation clauses are not considered in the determination of whether a lease is cancelable because the likelihood that they will be exercised is considered remote. Some lease agreements include renewal or purchase options. The effect of such options is reflected in the minimum lease payments only if it is considered reasonably assured that an option will be exercised. Some lease agreements include escalation clauses or other contingent rentals.

Rental expenditures incurred under operating leases totaled $2.0 million during the fiscal year. Payments for capital lease principal, interest, and executory costs totaled $143.2 million, $4.6 million, and $.2 million, respectively, during the fiscal year.

A summary of the operating lease and non-cancelable capital lease commitments to maturity follows:

		Capital Leases			
Year Ended September 30	Operating Leases Expense	Principal	Interest	Executory Cost	Total
2019	$ 955,728	$ 20,590,418	$ 3,654,575	$ 372,838	$ 24,617,831
2020	871,255	17,562,157	2,897,358	356,819	20,816,334
2021	815,295	14,098,971	2,489,335	356,819	16,945,126
2022	590,288	13,623,766	2,101,576	356,819	16,082,161
2023	174,000	12,414,928	1,725,177	350,969	14,491,074
2024	87,000	12,762,299	1,343,761	321,719	14,427,779
2025		13,170,843	942,089	321,719	14,434,651
2026 -2038		3,142,664	3,557,578	2,390,677	9,090,919
Total	$3,493,566	$107,366,046	$18,711,449	$4,828,379	$130,905,874

The historical cost of assets acquired under capital leases, which are included in capital assets at September 30, follows:

Buildings	$139,595,673
Equipment	578,956,629
Total	$718,552,302
Accumulated depreciation	(547,224,879)
Net buildings and equipment	$171,327,423

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REQUIRED SUPPLEMENTARY INFORMATION

INFORMATION TECHNOLOGY FUND AND IT BILLINGS
Schedules of Required Supplementary Information – Pension Liability
Fiscal Years 2016 Through 2018

Schedule of the Fund's Proportionate Share of Net Pension Liability
Michigan State Employees' Retirement System
(In Thousands)

	2018	2017	2016
Proportion of the net pension liability	4.61%	4.47%	4.33%
Proportionate share of the net pension liability	$239,415	$236,540	$238,031
Covered payroll	$142,285	$135,094	unavailable
Fund's proportionate share of the net pension liability as a percentage of its covered payroll	168.26%	175.09%	unavailable
Plan fiduciary net position as a percentage of the total pension liability	69.45%	67.48%	66.11%

The amounts presented for each fiscal year were determined as of the measurement date of September 30 of the previous year.

This schedule is built prospectively upon implementation of GASB Statement No. 68 and will show 10 years of data once it becomes available.

Schedule of the Fund's Contributions
Michigan State Employees' Retirement System
(In Thousands)

	2018	2017	2016
Statutorily required contribution	$30,716	$32,669	$31,943
Contributions in relation to the statutorily required contribution	$30,716	$32,669	$31,943
Contribution deficiency (excess)	0	0	0
Covered payroll	$149,381	142,285	$135,094
Contributions as a percentage of covered payroll	20.56%	22.96%	23.65%

This schedule is built prospectively upon implementation of GASB Statement No. 68 and will show 10 years of data once it becomes available.

See accompanying note to required supplementary information – pension liability.

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION - PENSION LIABILITY

Note 1

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use pension obligations as a factor.

The schedule of the proportionate share of the net pension liability and schedule of contributions are schedules that are required in implementing GASB Statement No. 68. The schedule of the proportionate share of the net pension liability represents, in actuarial terms, the accrued liability less the market value of assets. The schedule of contributions is a comparison of the employer's contributions with the actuarially determined contributions.

The schedule of contributions is presented to show the responsibility of the employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

The information presented in the schedule of contributions was used in the actuarial valuation for purposes of determining the actuarially determined contribution rate. Additional information as of the latest actuarial valuation for the pension plan follows.

Valuation Date:
Actuarially determined contribution amounts are calculated as of September 30, 2016.

Methods and Assumptions Used to Determine Contributions for the Fiscal Year Ended September 30, 2018:

Actuarial cost method	Entry age, normal
Amortization method	Level dollar, closed
Remaining amortization period	19 years as of October 1, 2017
Asset valuation method	Five-year smoothed fair value
Inflation	2.5%
Salary increases	3.5% to 12.5%, including wage inflation at 3.5%
Investment rate of return	7.5% net of investment and administrative expenses
Retirement age	Experience-based table of rates that are specific to the type of eligibility condition

Mortality	RP-2000 Combined Healthy Life Mortality Table, adjusted for mortality improvements to 2015 using projection scale BB. For active members, 50% of the table rates were used for males and females.

INFORMATION TECHNOLOGY FUND AND IT BILLINGS
Schedules of Required Supplementary Information – OPEB Liability
Fiscal Year 2018

Schedule of the Fund's Proportionate Share of OPEB Liability
Michigan State Employees' Retirement System - Healthcare
(In Thousands)

	2018
Proportion of the total OPEB liability	4.66%
Proportionate share of the total OPEB liability	$383,971
Covered payroll	$142,285
Fund's proportionate share of the total OPEB liability as a percentage of its covered payroll	269.86%
Plan fiduciary net position as a percentage of the total OPEB liability	19.89%

The amounts presented were determined as of the measurement date of September 30, 2017.

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the Fund presents information for those years for which information is available.

Schedule of the Fund's Contributions for OPEB Liability
Michigan State Employees' Retirement System
(In Thousands)

	2018
Statutorily required contribution	$ 32,935
Contributions in relation to the statutorily required contribution	$ 32,935
Contribution deficiency (excess)	
Fund's covered payroll	$149,381
Contributions as a percentage of covered-employee payroll	22.05%

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the Fund presents information for those years for which information is available.

See accompanying note to required supplementary information – OPEB liability.

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION – OPEB LIABILITY

Note 1

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use OPEB obligations as a factor.

The schedule of the proportionate share of the net OPEB liability and schedule of contributions for OPEB are schedules that are required in implementing GASB Statement No. 75. The schedule of contributions is a comparison of the employer's contributions with the actuarially determined contributions.

The schedule of contributions is presented to show the responsibility of the employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

The information presented in the schedule of contributions was used in the actuarial valuation for purposes of determining actuarially determined contribution rate. Additional information as of the latest actuarial valuation for the OPEB plan follows.

<u>Valuation Date:</u>
Actuarially determined contribution amounts are calculated as of September 30, 2016.

<u>Methods and Assumptions Used to Determine Contributions for the Fiscal Year Ended September 30, 2018:</u>

Actuarial cost method	Entry age, normal
Amortization method	Level-Percent of payroll, closed
Remaining amortization period	19 years as of October 1, 2017
Asset valuation method	Fair value
Inflation	2.5%
Salary increases	3.5% to 12.5%, including wage inflation at 3.5%
Investment rate of return	7.5% net of investment and administrative expenses
Retirement age	Experience-based table of rates that are specific to the type of eligibility condition

Healthcare cost trend rate	9.0% trend, gradually decreasing to 3.5% in year 10
Mortality	RP-2000 Combined Healthy Life Mortality Table, adjusted for mortality improvements to 2015 using projection scale BB. For active members, 50% of the table rates were used for males and females.
Aging factors	Based on the 2013 Society of Actuaries study "Health Care Costs - From Birth to Death"

INFORMATION TECHNOLOGY FUND AND IT BILLINGS
Schedule of the Fund's Proportionate Share of PELIB OPEB Liability
Fiscal Year 2018
(In Thousands)

	2018
Proportion of the total OPEB liability	4.54%
Proportionate share of the total OPEB liability	$58,091
Covered payroll	$142,285
Fund's proportionate share of the total OPEB liability as a percentage of its covered payroll	40.83%

The amounts presented were determined as of the measurement date of September 30, 2017.

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the Fund presents information for those years for which information is available.

PELIB is not a trust and has no assets.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE

OAG
Office of the Auditor General
Doug A. Ringler, CPA, CIA
Auditor General
201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • audgen.michigan.gov

Independent Auditor's Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters

Mr. Brom Stibitz, Acting Director
Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Stibitz:

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 financial statements of the Information Technology Fund, Department of Technology, Management, and Budget, as of and for the fiscal year ended September 30, 2018 and the related notes to the financial statements and have issued our report thereon dated April 27, 2020.

Internal Control Over Financial Reporting
In planning and performing our audit of the financial statements, we considered the Fund'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 financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund'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 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 Fund's 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*.

Information Technology Fund's Response to Finding
The Fund's preliminary response to the finding identified in our audit is included in the body of our report. The Fund's response was not subjected to the auditing procedures applied in the audit of the 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

Doug Ringler
Auditor General
April 27, 2020

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FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

FINDING #1

Improvements needed to internal control over accounts payable.

DTMB did not have sufficient internal control* in place to evaluate the delivery and service dates when processing payments and identifying accounts payable. Consequently, expenditures were recorded in the wrong fiscal year.

The State of Michigan Financial Management Guide (Part II, Chapter 14, Section 100) requires agencies to record payables for goods or services received by September 30.

We reviewed selected payments totaling $44.3 million made early in fiscal year 2019 for 8 vendors and identified $5.3 million for goods and services provided prior to September 30, 2018 without a corresponding accounts payable in fiscal year 2018.

RECOMMENDATION

We recommend that DTMB improve internal control to help ensure the evaluation of delivery and service dates when processing payments and identifying accounts payable.

AGENCY PRELIMINARY RESPONSE

DTMB provided us with the following response:

DTMB agrees. DTMB Financial Services (FS) addressed the accounts payable estimation process for information technology vendors in advance of the fiscal year end 2019 closing. FS worked with vendors prior to year-end to address the timeliness of receiving invoices to ensure proper classification of expenses/payables in the correct fiscal year. FS also implemented a new payables estimation for the fiscal year 2019 closing cycle that leverages the processes and functionality of SIGMA, the statewide accounting system that was implemented in October of 2017. FS reviews all purchase orders on the agency open purchase order report/query and establishes payables for all applicable transactions.

FS will continue to review and improve the year-end closing payables estimation process for information technology vendors.

** See glossary at end of report for definition.*

PERFORMANCE AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

EFFORTS TO PROPERLY RECOUP COSTS OF THE FUND

PERFORMANCE AUDIT OBJECTIVE

To assess the effectiveness* of DTMB's efforts to properly apply its billing methodology and allocation of expenses to recoup costs of the Fund.

PERFORMANCE AUDIT CONCLUSION

Effective.

FACTORS IMPACTING PERFORMANCE AUDIT CONCLUSION

- DTMB consistently applied appropriate methodologies to create IT billings.
- DTMB used approved IT billing rates or other appropriate sources of information to charge agencies for IT related costs.

** See glossary at end of report for definition.*

DESCRIPTION

The Fund was created by administrative decision to provide telecommunication and IT services for State agencies. User agencies are billed for the cost of such services. During fiscal year 2002, the use of this Fund was expanded to account for all IT activities of the executive branch as prescribed in Executive Order No. 2001-03.

PERFORMANCE AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

PERFORMANCE AUDIT SCOPE

To examine the records and processes related to DTMB's billing processes for the Fund. We conducted this performance audit* in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

PERFORMANCE AUDIT PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered October 1, 2017 through September 30, 2018.

PERFORMANCE AUDIT METHODOLOGY

We conducted a preliminary survey to obtain an understanding of DTMB's billing processes for the Fund and billing procedures to establish our audit objectives and methodology. During our preliminary survey, we:

- Reviewed Executive Order No. 2001-03 creating the Fund and applicable legislation.

- Interviewed DTMB staff to obtain an understanding of the organizational structures, operational responsibilities, and activities related to the billing processes for the Fund.

- Reviewed Fund policies and procedures.

- Obtained an understanding of the various IT systems used for recording and depreciating capital assets and allocating costs for IT billings.

- Analyzed Fund expenses, revenues, assets, and liabilities to gain an understanding of the types of transactions processed through the Fund.

- Performed a cursory review of transactions processed using procurement cards.

- Obtained an understanding of the rate review committee and its responsibilities.

- Performed initial reviews of selected manual and interface agency billings.

** See glossary at end of report for definition.*

PERFORMANCE AUDIT OBJECTIVE

To assess the effectiveness of DTMB's efforts to properly apply its billing methodology and allocation of expenses to recoup costs of the Fund.

To accomplish this objective, we:

- Interviewed DTMB staff to gain an understanding of the billing process for the Fund.

- Judgmentally selected a monthly IT billing from 3 State agencies to determine whether DTMB staff consistently applied methodologies and used approved IT rates or other appropriate sources of information to charge State agencies for IT related costs.

  We judgmentally selected our sample based on the size of the State agency. Therefore, we could not project the results to the entire population.

- Randomly selected 13 of 79,206 transactions for services charged directly to State agencies to determine if DTMB used approved IT rates or other appropriate sources of information for IT related costs.

  Our random sample was selected to eliminate bias and enable us to project the results to the respective population.

- Reviewed the revenue receipted in fiscal year 2018 from 3 judgmentally selected State agencies to ensure that DTMB was sufficiently recouping IT costs.

  We judgmentally selected our sample based on the size of the State agency. Therefore, we could not project the results to the entire population.

PERFORMANCE AUDIT CONCLUSIONS

We base our performance audit conclusions on our audit efforts and any resulting material conditions* or reportable conditions*.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

** See glossary at end of report for definition.*

GLOSSARY OF ABBREVIATIONS AND TERMS

BLT	banked leave time.
DB	defined benefit.
DC	defined contribution.
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.
effectiveness	Success in achieving mission and goals.
FAC	final average compensation.
financial audit	An audit that is designed to provide reasonable assurance about whether the 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.
HRA	health reimbursement account.
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.
IT	information technology.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program. Our assessment of materiality is in relation to the respective audit objective.
material misstatement	A misstatement in the 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 financial statements will not be prevented, or detected and corrected, on a timely basis.
modified opinion	A qualified opinion, an adverse opinion, or a disclaimer of opinion.
observation	A commentary that highlights certain details or events that may be of interest to users of the report. An observation may not include all of the attributes (condition, effect, criteria, cause, and recommendation) that are presented in an audit finding.
OPEB	other postemployment benefits.
PELIB	postemployment life insurance benefits.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.
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.
SOMCAFR	*State of Michigan Comprehensive Annual Financial Report.*
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.
unmodified opinion	The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

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