

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

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

Fiscal Year Ended September 30, 2020

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



OAG

Office of the Auditor General

Report Summary

*Report on Internal Control Over Financial Reporting
Michigan State Employees' Retirement System
- Schedule of Employer Allocations and Schedules of Pension and Other Postemployment Benefit Amounts by Employer
Fiscal Year Ended September 30, 2020*

Report Number:
071-0165-21

Released:
October 2021

Generally accepted auditing standards require that an auditor report to management and those charged with governance any significant deficiencies or material weaknesses coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report dated September 16, 2021 on the Michigan State Employees' Retirement System's schedule of employer allocations and schedules of pension and other postemployment benefit amounts by employer for the fiscal year ended September 30, 2020.

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

Obtain Audit Reports

Online: audgen.michigan.gov

Phone: (517) 334-8050

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

Doug A. Ringler, CPA, CIA
Auditor General

Laura J. Hirst, CPA
Deputy Auditor General



OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • audgen.michigan.gov

Doug A. Ringler, CPA, CIA
Auditor General

October 29, 2021

Colonel John J. Wojcik, Chair
State of Michigan Retirement Board
Stevens T. Mason Building
and
Ms. Michelle Lange, Acting Director
Department of Technology, Management, and Budget
Elliott-Larsen Building
and
Mr. Anthony J. Estell, Director
Office of Retirement Services
Stevens T. Mason Building
Lansing, Michigan

Dear Colonel Wojcik, Ms. Lange, and Mr. Estell:

This is our report on internal control over financial reporting of the Michigan State Employees' Retirement System Schedule of Employer Allocations and Schedules of Pension and Other Postemployment Benefit Amounts by Employer for the fiscal year ended September 30, 2020.

Your agency provided the preliminary response to the recommendation at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and to submit it to the State Budget Office upon completion of an audit. Within 30 days of receipt, the Office of Internal Audit Services, State Budget Office, is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Doug Ringler
Auditor General

TABLE OF CONTENTS

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

	<u>Page</u>
Report Summary	1
Report Letter	3
Independent Auditor's Report on Internal Control Over Financial Reporting	8
Fiscal Year 2020 Findings, Recommendations, and Agency Preliminary Responses	
1. Improvement in internal control needed to ensure proper allocation of net pension and OPEB liabilities.	12
Fiscal Year 2019 Report on Internal Control Over Financial Reporting Follow-Up	18
Glossary of Abbreviations and Terms	19

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL



Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • audgen.michigan.gov

Doug A. Ringler, CPA, CIA
Auditor General

Independent Auditor's Report on Internal Control Over Financial Reporting

Colonel John J. Wojcik, Chair
State of Michigan Retirement Board
Stevens T. Mason Building
and
Ms. Michelle Lange, Acting Director
Department of Technology, Management, and Budget
Elliott-Larsen Building
and
Mr. Anthony J. Estell, Director
Office of Retirement Services
Stevens T. Mason Building
Lansing, Michigan

Dear Colonel Wojcik, Ms. Lange, and Mr. Estell:

We planned and performed our audit of the Michigan State Employees' Retirement System's schedule of employer allocations and the specified column totals of the schedules of pension and other postemployment benefit amounts by employer as of and for the fiscal year ended September 30, 2020 and the related notes in accordance with auditing standards generally accepted in the United States of America. We considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the schedule of employer allocations and on the specified column totals of the schedules of pension and other postemployment benefit amounts by employer, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, as described in Finding 1, that we consider to be a significant deficiency.

The System's preliminary response to the finding identified in our audit is included in the body of our report. The System's response was not subjected to the auditing procedures applied in the audit of the schedule of employer allocations and the specified column totals of the schedules of pension and other postemployment benefit amounts by employer and, accordingly, we express no opinion on it.

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

Sincerely,

A handwritten signature in black ink that reads "Doug Ringler". The signature is written in a cursive style with a large, prominent "D" and "R".

Doug Ringler
Auditor General
September 16, 2021

FISCAL YEAR 2020
FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

FINDING 1

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

Financial Services (FS), Department of Technology, Management, and Budget (DTMB), did not have sufficient internal control* to ensure the proper allocation of the Michigan State Employees' Retirement System's (MSERS's) net pension and other postemployment benefit (OPEB) liabilities on the schedules of pension and OPEB amounts by employer for the fiscal year ended September 30, 2020. Although FS corrected the misstatements we identified prior to issuing the schedules, without implementing sufficient control improvements, risk exists that other misstatements could occur and not be detected in a timely manner.

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

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

FS calculates the employer's required pension and OPEB contributions using employee wage data confirmed with each reportable employer. FS sends instructions to each employer on how to determine employee wage data and relevant payroll adjustments. The actuaries then calculate net pension and OPEB liabilities amounts based on the required contribution.

* See glossary at end of report for definition.

FS did not properly classify employee wages and required pension and OPEB contributions between employers which impacted pension and OPEB liabilities. Our audit disclosed the following misstatements, which FS corrected prior to the issuance of the schedules:

<u>Employer</u>	<u>Overstatement (Understatement) of September 30, 2020 Net Pension Liability</u>	<u>Percent Impact of Error on Each Employer Net Pension Liability</u>	<u>Overstatement (Understatement) of September 30, 2020 Net OPEB Liability</u>	<u>Percent Impact of Error on Each Employer Net OPEB Liability</u>
State of Michigan	\$ (2,507,798)	(0.0%)	\$ (2,134,375)	(0.0%)
State Building Authority	\$ 9,344	2.0%	\$ 6,401	2.1%
Information Technology Fund	\$ 1,517,479	0.5%	\$ 1,387,741	0.5%
State Lottery Fund	\$ 953,350	3.2%	\$ 838,958	3.2%
Liquor Purchase Revolving Fund	\$ (766,655)	(5.8%)	\$ (714,025)	(6.5%)
Office Services Revolving Fund	\$ 105,205	0.7%	\$ 98,277	0.8%
Correctional Industries Revolving Fund	\$ 187,324	3.0%	\$ 153,885	3.0%
Motor Transport Fund	\$ 20,159	0.4%	\$ 15,179	0.3%
Attorney Discipline System	\$ 41,539	3.6%	\$ 28,751	3.1%
Risk Management Fund	\$ (63,851)	(5.7%)	\$ (46,641)	(4.9%)
Michigan State Housing Development Authority	\$ 82,896	0.2%	\$ 67,762	0.2%
Michigan Strategic Fund	\$ (1,950,166)	(26.1%)	\$ (1,704,788)	(27.7%)

Continued on next page.

<u>Employer</u>	<u>Overstatement (Understatement) of September 30, 2020 Net Pension Liability</u>	<u>Percent Impact of Error on Each Employer Net Pension Liability</u>	<u>Overstatement (Understatement) of September 30, 2020 Net OPEB Liability</u>	<u>Percent Impact of Error on Each Employer Net OPEB Liability</u>
Michigan Economic Development Corporation	\$ 1,999,679	15.8%	\$ 1,746,335	16.1%
Michigan Finance Authority	\$ 29,939	0.3%	\$ 30,043	0.4%
Mackinac Bridge Authority	\$ 149,681	1.8%	\$ 135,192	1.8%
Mackinac Island State Park Commission	\$ 64,046	2.6%	\$ 60,364	2.8%
Michigan Education Trust	\$ 17,019	0.6%	\$ 12,348	0.6%
State Land Bank	\$ (36,904)	(2.5%)	\$ (33,678)	(2.5%)
State Bar of Michigan	\$ 147,714	26.8%	\$ 52,272	3.6%

When determining the wages and contributions by employers, we noted FS did not include the wages and contributions associated with new fiscal year 2020 pay codes and the employers did not always correctly identify their accounting adjustments.

In our report on internal control over financial reporting for the fiscal year ended September 30, 2019, we reported the same significant deficiency that also resulted in misstatements. DTMB indicated that it agreed with the recommendation and developed guidelines and instructions to help ensure the accuracy of reporting. However, we noted that DTMB did not initially detect and correct these misstatements.

RECOMMENDATION

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

**AGENCY
PRELIMINARY
RESPONSE**

DTMB provided us with the following response:

The Department agrees with the recommendation. DTMB Financial Services, with assistance from the State Budget Office's Office of Financial Management, will continue its efforts to update and enhance the guidelines and instructions to

further educate agency personnel regarding summary level payroll adjustments. Furthermore, DTMB Financial Services will continue to expand its efforts to establish more effective controls to mitigate errors during the compilation of employer wage and contribution information. A step will be added into the process to identify if any new pay codes have been created before compiling the wages and contributions by employers each fiscal year.

FISCAL YEAR 2019
REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING
FOLLOW-UP

Following is the status of the reported finding from the fiscal year 2019 Michigan State Employees' Retirement System schedule of employer allocations and schedules of pension and other postemployment benefit amounts by employer report on internal control over financial reporting (071-0165-20):

Prior Audit Finding Number	Topic Area	Current Status	Current Finding Number
1	Improvement in internal control needed to ensure proper allocation of net pension and OPEB liabilities.	Repeated*	1

* See glossary at end of report for definition.

GLOSSARY OF ABBREVIATIONS AND TERMS

deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
DTMB	Department of Technology, Management, and Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules of an audited entity are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
FS	Financial Services.
generally accepted accounting principles (GAAP)	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the financial schedules that causes the schedules to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial schedules will not be prevented, or detected and corrected, on a timely basis.
MSERS	Michigan State Employees' Retirement System.

OPEB other postemployment benefit.

repeated The same problem was noted in the current audit, and the wording of the current recommendation remains essentially the same as the prior audit recommendation.

significant deficiency in internal control over financial reporting A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Report Fraud/Waste/Abuse

Online: audgen.michigan.gov/report-fraud

Hotline: (517) 334-8070