

Office of the Auditor General
Report on Internal Control, Compliance, and Other Matters

Michigan State Employees' Retirement System
(A Fiduciary Component Unit of the State of Michigan)

Fiscal Year Ended September 30, 2021

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

The auditor general may make investigations pertinent to the conduct of audits.

Article IV, Section 53 of the Michigan Constitution



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Office of the Auditor General

Report Summary

Report on Internal Control, Compliance, and Other Matters

Michigan State Employees' Retirement System (A Fiduciary Component Unit of the State of Michigan)

Fiscal Year Ended September 30, 2021

Report Number:
071-0151-22

Released:
April 2022

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the Michigan State Employees' Retirement System's financial statements dated February 16, 2022.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Department of Technology, Management, and Budget's Financial Services did not establish sufficient internal control, which necessitated corrections to the financial statements prior to issuance (<u>Finding 1</u>).	X		Agrees

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Doug A. Ringler, CPA, CIA
Auditor General

April 28, 2022

Mr. David A. Berridge, 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 Mr. Berridge, Ms. Lange, and Mr. Estell:

This is our report on internal control, compliance, and other matters of the Michigan State Employees' Retirement System for the fiscal year ended September 30, 2021.

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 the audit. Within 30 days of receipt, the Office of Internal Audit Services, State Budget Office, is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

A handwritten signature in blue ink that reads "Doug Ringler". The signature is written in a cursive, flowing style.

Doug Ringler
Auditor General

TABLE OF CONTENTS

MICHIGAN STATE EMPLOYEES' RETIREMENT SYSTEM

	<u>Page</u>
Report Summary	1
Report Letter	3
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	8
Fiscal Year 2021 Findings, Recommendations, and Agency Preliminary Responses	
1. Improvements needed in internal control over accounting transactions.	12
Glossary of Abbreviations and Terms	14

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



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Auditor General

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

Mr. David A. Berridge, 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 Mr. Berridge, Ms. Lange, and Mr. Estell:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the Michigan State Employees' Retirement System, a fiduciary component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2021 and the related notes to the basic financial statements and have issued our report thereon dated February 16, 2022.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in Finding 1 in the body of our report, we identified deficiencies in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's basic financial statements will not be prevented, or detected and corrected, on a timely basis.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

System's Response to Finding

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 basic 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
Auditor General
February 16, 2022

FISCAL YEAR 2021
FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

FINDING 1

Improvements needed in internal control over accounting transactions.

The Department of Technology, Management, and Budget's (DTMB's) Financial Services (FS) needs to enhance its internal control* to ensure accounting transactions are appropriately recorded and misstatements are prevented, or detected and corrected, in a timely manner.

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

Our audit disclosed the following misstatements which FS corrected prior to the issuance of the *Michigan State Employees' Retirement System Annual Comprehensive Financial Report*:

- a. FS overstated the incurred but not reported healthcare expenditures in its Medicare Advantage accrual. This misstatement had the following effects (prior to correction):

Financial Statement Line Item	Amount Overstated/ (Understated) (In Millions)
OPEB Plan:	
Receivables: Amounts due from federal agencies long term	\$ (5.3)
Payables: Accounts payable and other accrued liabilities	\$ 68.9
Deductions: Health benefits	\$ 51.8
Deductions: Administrative and other expenses	\$ 17.2
Deductions: Uncollectible receivables	\$ 5.3
Net Position Restricted for Pension Benefits and OPEB: End of Year	\$ (74.2)

We noted FS did not appropriately consider the prior year accrual when establishing the fiscal year 2021 accrual, and supervisor review did not detect the error. Also, FS informed us it had not yet completed its year-end variance review.

- b. FS did not properly calculate compensated absences for the fiscal year 2021 pension and other postemployment benefit (OPEB) contributions receivable and the restatement of beginning of year net position restricted

* See glossary at end of report for definition.

for pension benefits and OPEB. This misstatement had the following effects (prior to correction):

Financial Statement Line Item	Amount Overstated/ (Understated) (In Millions)
Pension Plan:	
Receivables: Amounts due from employer	\$ 3.1
Receivables: Amounts due from employer long term	\$(10.9)
Employer contributions	\$ (2.8)
Net Position Restricted for Pension Benefits and OPEB: End of Year	\$ (7.8)
Net Position Restricted for Pension Benefits and OPEB: Beginning of Year	\$ (5.1)
OPEB Plan:	
Receivables: Amounts due from employer	\$ 4.1
Receivables: Amounts due from employer long term	\$(12.4)
Employer contributions	\$ (2.4)
Net Position Restricted for Pension Benefits and OPEB: End of Year	\$ (8.3)
Net Position Restricted for Pension Benefits and OPEB: Beginning of Year	\$ (5.9)

We noted FS did not properly identify the population of employees with compensated absence balances.

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

RECOMMENDATION

We recommend that FS enhance its internal control to ensure accounting transactions are appropriately recorded and misstatements are prevented, or detected and corrected, in a timely manner.

**AGENCY
PRELIMINARY
RESPONSE**

DTMB provided us with the following response:

DTMB Financial Services and Office of Retirement Services agree and will comply with the recommendation. Upon notification by the Office of the Auditor General, Financial Services immediately corrected the identified errors and updated the MSERS Annual Comprehensive Financial Report. Financial Services is working to assess and enhance the current controls in place and implement additional controls to ensure misstatements in accounting transactions will be prevented or detected and corrected.

Related to part b., Financial Services will work to ensure compensated absence accruals are properly calculated for MSERS.

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 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."
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 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.
MSERS	Michigan State Employees' Retirement System.
OPEB	other postemployment benefit.

significant deficiency in internal control over financial reporting

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



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