

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

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

Fiscal Year Ended September 30, 2022

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

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

Article IV, Section 53 of the Michigan Constitution



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Report Summary

Report on Internal Control, Compliance, and Other Matters

Michigan Legislative Retirement System (A Fiduciary Component Unit of the State of Michigan) Fiscal Year Ended September 30, 2022

Report Number:
900-0140-23

Released:
February 2023

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 Legislative Retirement System's financial statements dated January 12, 2023.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Michigan Legislative Retirement System did not document compliance with the investment limitations specified in the Public Employee Retirement System Investment Act of 1965, as amended (Finding 1).		X	Partially agrees

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Doug A. Ringler, CPA, CIA
Auditor General

February 28, 2023

The Honorable R. Robert Geake, Chair
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Anderson House Office Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

This is our report on internal control, compliance, and other matters of the Michigan Legislative Retirement System for the fiscal year ended September 30, 2022.

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

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

Sincerely,

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



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Doug A. Ringler, CPA, CIA
Auditor General

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

The Honorable R. Robert Geake, Chair
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Anderson House Office Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

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 Michigan Legislative Retirement System, a fiduciary component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2022 and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated January 12, 2023.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the 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 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.

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 were not 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.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System'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 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

Government Auditing Standards require the auditor to perform limited procedures on the System's preliminary response to the finding identified in our audit. The response is included after the finding. The response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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
January 12, 2023

FISCAL YEAR 2022
FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

FINDING 1

Improvements needed in internal control* over monitoring compliance.

The Michigan Legislative Retirement System (MLRS) did not document compliance with the investment limitations specified in the Public Employee Retirement System Investment Act of 1965 (the Act), as amended, during its quarterly monitoring of investment performance.

In its September 30, 2022 *Annual Comprehensive Financial Report*, MLRS disclosed \$45.9 million of investments (38.4% of MLRS's assets) were classified as having foreign currency risk because the investments were either direct equity holdings of a foreign company or holdings in mutual funds targeting emerging market or international corporations.

Section 38.1133 of the *Michigan Compiled Laws* requires an investment fiduciary to monitor the investments of the system's assets with regard to the limitations established in the Act.

The Act establishes limitations on investments in various asset classes for public employee retirement systems, including MLRS. These limits include:

- An investment fiduciary shall not invest more than 70% of a system's assets in stock or specific global security.
- Notwithstanding a percentage of total assets limitation for an investment provided in any other section of this Act, an investment fiduciary of a system that has assets of less than \$2.0 billion and who is not the State Treasurer may invest not more than 20% of a system's assets in global securities.

MLRS assets as of September 30, 2022 were \$119.6 million and had not exceeded \$2.0 billion during fiscal year 2022.

The Act defines a global security as:

- A fixed income security issued by a government, a governmental agency, or a public or private company that is traded outside of the United States (U.S.) and may be issued in a currency other than the U.S. dollar.
- An equity position in a company traded on an exchange outside of the U.S. or a security that may be issued in a currency other than the U.S. dollar or an unregistered American depository receipt.
- An equity or fixed income derivative that derives its value from an investment described above or a global security or bond index traded on an exchange outside of the U.S.

MLRS holding 38.4% of investments subject to foreign currency risk is an indicator that MLRS likely exceeded the 20% limitation

* See glossary at end of report for definition.

of global security holdings specified in the Act. Based on MLRS's interpretation of the Act, MLRS maintains it can invest up to 90% in global securities. We continue to believe an authoritative interpretation related to the investment limitations and their application is needed before MLRS can reach a conclusion regarding its compliance with this provision of the Act.

RECOMMENDATIONS

We again recommend that MLRS document compliance with the investment limitations specified in the Act.

We also again recommend that MLRS seek clarification regarding the definition of global security and the allowable legal limit of such investments and seek amendatory legislation as needed.

AGENCY PRELIMINARY RESPONSE

MLRS provided us with the following response:

The Michigan Legislative Retirement System (MLRS) partially agrees with the recommendations and will continue to seek appropriate legal guidance, statutory interpretation, and subsequent action on the matter.

The MLRS understands the OAG concern regarding the MLRS compliance with MCLA 38.1133, the Public Employee Retirement System Investment Act (Act 314 of 1965), that addresses global investment limitations that may exist under the statute.

While the MLRS has obtained authoritative legal guidance regarding global investment limitation and strongly disagrees with the 20% limitation that the OAG believes is applicable, the MLRS will continue to seek additional clarification of the legal limitations that may exist.

To the extent possible, the MLRS will seek statutory amendment(s) to clarify the definition of global security, if needed. In addition, to the extent possible, the MLRS will also seek to establish a policy and/or process that will document the MLRS's compliance with Act 314.

FISCAL YEAR 2021
REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS
FOLLOW-UP

Below is the status of the reported finding from the fiscal year 2021 Michigan Legislative Retirement System report on internal control, compliance, and other matters (900-0140-22):

<u>Prior Audit Finding Number</u>	<u>Topic Area</u>	<u>Current Status</u>	<u>Current Finding Number</u>
1	Improvements needed in internal control over monitoring compliance.	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.
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.
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.
MLRS	Michigan Legislative Retirement System.
repeated	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.
U.S.	United States.



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