



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

REPORT ON INTERNAL CONTROL,
COMPLIANCE, AND OTHER MATTERS

MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Fiscal Year Ended September 30, 2014



Doug A. Ringler, CPA, CIA
AUDITOR GENERAL

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.

– Article IV, Section 53 of the Michigan Constitution

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Report Summary

*Report on Internal Control, Compliance, and
Other Matters
Michigan Public School Employees'
Retirement System
Fiscal Year Ended September 30, 2014*

**Report Number:
071-0152-15M**

**Released:
April 2015**

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the Michigan Public School Employees' Retirement System (MPSERS) financial statements dated January 16, 2015.

Finding Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Office of Retirement Services (ORS), Department of Technology, Management, and Budget (DTMB), did not have an internal control process to verify the census data of participating employers in MPSERS, a cost-sharing pension plan (<u>Finding 1</u>).		X	Agrees

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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



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Office of the Auditor General

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Doug A. Ringler, CPA, CIA
Auditor General

April 21, 2015

Mr. Scott Koenigsknecht, Chair
Michigan Public School Employees' Retirement System Board
General Office Building
and
Mr. David B. Behen, Director
Department of Technology, Management, and Budget
Lewis Cass Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management, and Budget
General Office Building
Lansing, Michigan

Dear Mr. Koenigsknecht, Mr. Behen, and Mr. Stoddard:

We have audited the basic financial statements of the Michigan Public School Employees' Retirement System (MPERS) as of and for the fiscal year ended September 30, 2014 and have issued a separate report thereon dated January 16, 2015. In planning and performing our audit of the financial statements, we considered MPERS's internal control over financial reporting and compliance and other matters. This is our report on internal control, compliance, and other matters of MPERS for the fiscal year ended September 30, 2014.

This report contains our report summary; our independent auditor's report on internal control over financial reporting and on compliance and other matters; our finding, our recommendation, and the agency preliminary response; and a glossary of abbreviations and terms.

The agency preliminary response was taken from the agency's response at the end of our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendation and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

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

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE



Doug A. Ringler, CPA, CIA
Auditor General

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

Mr. Scott Koenigs knecht, Chair
Michigan Public School Employees' Retirement System Board
General Office Building
and
Mr. David B. Behen, Director
Department of Technology, Management, and Budget
Lewis Cass Building
and
Mr. Phillip J. Stoddard, Director
Office of Retirement Services
Department of Technology, Management, and Budget
General Office Building
Lansing, Michigan

Dear Mr. Koenigs knecht, Mr. Behen, and Mr. Stoddard:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the Michigan Public School Employees' Retirement System as of and for the fiscal year ended September 30, 2014 and the related notes to the basic financial statements and have issued our report thereon dated January 16, 2015.

Internal Control Over Financial Reporting

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

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. 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.

Compliance and Other Matters

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

System's Response to 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
January 16, 2015

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FINDING, RECOMMENDATION, AND
AGENCY PRELIMINARY RESPONSE

FINDING

1. **Verifying Census Data**

The Office of Retirement Services (ORS), Department of Technology, Management, and Budget (DTMB), did not have an internal control process to verify the census data of participating employers in the Michigan Public School Employees' Retirement System (MPERS), a cost-sharing pension plan. This deficiency increases the risk of a misstatement in the notes to the financial statements.

Governmental Accounting Standards Board* (GASB) Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*, requires pension plans to report total pension liability in the notes to the financial statements of cost-sharing pension plans. The calculation of the total pension liability for cost-sharing plans is dependent on the completeness and accuracy of the underlying census data of the plans' members.

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

Also, the American Institute of Certified Public Accountants' whitepaper, *Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements*, states that management is responsible for designing, implementing, and maintaining internal control related to the amounts reported in the financial statements. Internal control should include procedures to verify complete and accurate census data. The lack of such procedures constitutes a control deficiency.

Approximately 700 Michigan public schools report census data, such as date of birth, years of service, gender, job classification, and eligible compensation, to ORS. ORS provides this data to the actuary, a third party vendor, to perform calculations to determine the total net pension liability. We performed auditing procedures on the census data for the fiscal year ended September 30, 2013.

* See glossary at end of report for definition.

Although we discovered various errors in the data, we determined that, overall, the errors did not have a material impact on the net pension liability.

ORS relies on MPSERS members to verify the accuracy of the information reported by the schools to ORS by reviewing the information in their personal retirement accounts.

RECOMMENDATION

We recommend that ORS develop an internal control process to verify the census data of participating employers in MPSERS.

AGENCY PRELIMINARY RESPONSE

DTMB provided us with the following response:

Summary and Background

ORS agrees there was no material weakness in the internal controls for census data, and that all participating employers within MPSERS should have internal controls to increase the accuracy of data submitted to the retirement system.

Like most retirement systems around the country, ORS has had a long-term practice that reporting units participating in MPSERS are responsible for the accurate reporting of active member retirement demographic data. While this has been the historical practice, the American Institute of Certified Public Accountants (AICPA) has recently issued a whitepaper titled Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements that calls for a change to this practice. The whitepaper was a result of GASB issuing Statement Nos. 67 and 68, which changed financial reporting standards for defined benefit plans. Though the revised GASB standards were published in final form on August 2, 2012, the AICPA did not publish the whitepaper until February 2014. Lack of an implementation guide and confusion among industry experts have led to many retirement systems nationwide failing to implement the external controls that the paper supports.

Existing Processes

ORS did have internal controls to validate material pieces of census information.

Each year ORS conducts an Annual Wage Review, which audits and tests employer reported census data such as: member reportable compensation, job classification, years in position, and reported hours.

ORS's existing process controls for the correct placement of a member's benefit structure by automatically assigning newly-hired members to the correct structure; ORS sends a confirmation letter to the member. Within the last year, ORS continues to improve this effective process which reduces risk by proactively coordinating reported benefit structures.

In 2010, and again in 2012, ORS implemented a process for schools to confirm active members' first day of employment. During the 2012 reform period, over 186,000 active members logged into miAccount, where they were able to review and edit their demographic information, including compensation, years of service, benefit structure, date of hire, and gender. In addition, ORS continues to send proactive communications which urge members to log into miAccount to review their demographic information.

Before benefits are paid to members, ORS conducts a full review of all retirement information, including demographic information, at the point a member applies for retirement.

Future Actions

ORS will continue to review its audit programs and will implement enhancements to existing processes where necessary.

ORS will convene its employer advisory group – known as the Payroll Advisory Team – to discuss how ORS can assist employers with improving reporting units' internal controls surrounding demographic information.

GLOSSARY

Glossary of Abbreviations and Terms

AICPA	American Institute of Certified Public Accountants.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
DTMB	Department of Technology, Management, and Budget.
financial audit	An audit that is designed to provide reasonable assurance about whether the basic financial statements of an audited entity are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
generally accepted accounting principles (GAAP)	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

material misstatement	A misstatement in the basic financial statements that causes the statements to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the basic financial statements will not be prevented, or detected and corrected, on a timely basis.
MPSERS	Michigan Public School Employees' Retirement System.
ORS	Office of Retirement Services.
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.

