



STATE OF WISCONSIN
Legislative Audit Bureau

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Janice Mueller
State Auditor

November 18, 2009

Mr. David Stella, Secretary
Department of Employee Trust Funds
801 West Badger Road
Madison, Wisconsin 53702

Dear Mr. Stella:

We have completed the financial audit of the State of Wisconsin Department of Employee Trust Funds as of and for the year ended December 31, 2007. We have issued an unqualified auditor's report on the fair presentation of the Department's financial statements. The financial statements and related opinion are included in the Department's Comprehensive Annual Financial Report.

As required by *Government Auditing Standards*, we also are furnishing you with the auditor's report on internal control over financial reporting, compliance with laws and regulations, and other matters. We identified new and continuing concerns related to oversight of the financial reporting process, cash reconciliations, and controls over employee access to certain computer systems. We are pleased to note that the Department has adequately addressed our past concern with its compliance with a provision of federal tax law.

The Department's responses and corrective action plans to implement recommended improvements are included in the text so that readers may see your intended resolution of the matters discussed. In future audits, the Audit Bureau will determine the extent to which the concerns discussed in this letter have been resolved.

We appreciate the courtesy and cooperation extended to us by the Department's staff during the audit.

Sincerely,

Janice Mueller
State Auditor

JM/BB/ss

Enclosures



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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of the State of Wisconsin Department of Employee Trust Funds as of and for the year ended December 31, 2007, and have issued our report thereon dated November 11, 2009. The financial statements and related auditor's opinion have been included in the Department's Comprehensive Annual Financial Report for 2007. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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 Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department'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 significant deficiencies or material weaknesses, and therefore there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the following paragraphs, we identified a certain deficiency in internal control that we consider to be a material weakness, and another deficiency that we consider to be a significant deficiency.

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 to 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 Department's financial statements will not be prevented or will not be detected and corrected on a timely basis. We consider the deficiency pertaining to oversight of the financial reporting process, which is further discussed in the accompanying narrative, to be a material weakness.

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. We consider the deficiency pertaining to cash reconciliations, which is further discussed in the accompanying narrative, to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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*. As discussed in the accompanying narrative, we followed up on the concern noted in our 2006 audit and found that the Department has taken additional steps to ensure its compliance with a provision of federal tax law.

We noted a certain additional matter pertaining to controls over employee access to certain computer systems that is discussed in the accompanying narrative. We also communicated issues concerning the accuracy of local employer income continuation insurance premium calculations in a separate communication with the Department dated June 25, 2009.

The Department's written response to the findings identified in our audit is described in the accompanying narrative. We did not audit the Department's response and, accordingly, express no opinion on it.

This independent auditor's report is intended solely for the information and use of the Department's management and governing boards, and the Wisconsin Legislature. This report is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Department's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

November 11, 2009

by



Diann Allsen
Audit Director

DEPARTMENT OF EMPLOYEE TRUST FUNDS

The Department of Employee Trust Funds is responsible for administering the Wisconsin Retirement System (WRS) and several other programs that provide retirement, disability, health, and other benefits to participants who are current and retired employees of state and local government employers.

As part of our annual financial audits, we review and consider the Department's internal controls and compliance issues for the purpose of determining the audit work necessary to express an opinion on its financial statements. During our audit of the Department's 2007 financial statements, we noted new and continuing concerns related to oversight of the financial reporting process, cash reconciliations, and controls over employee access to certain computer systems.

We also note that the Department has adequately addressed our past audit concern with its compliance with a provision of federal tax law pertaining to annual compensation limits for the WRS. The Department is now generating a semiannual report to identify and correct situations in which reported earnings for participants exceed allowable limits.

Lack of Adequate Oversight of the Financial Reporting Process

During our audit of the Department's financial statements for 2006, we reported on concerns that the Department did not have adequate procedures and did not provide sufficient attention and oversight to ensure the accuracy of its financial reporting process.

The Department agreed with our concerns and indicated that it would continue to assess the procedures and resources associated with the presentation of its financial statements. One step it has taken to improve this process is to use its Office of Internal Audit to provide a quality assurance review of the financial information before it is made available for audit. In addition, after assessing internal resources dedicated to the financial reporting process, the Department requested an additional accountant position to assist with financial reporting and other accounting activities. This request was granted and the position filled in June 2009 through an internal transfer. However, the Department has not yet realized the full benefit of this new position because the vacancy created from this transfer is in the accounting area. Once this vacancy is also filled, the Department anticipates further improvements to its financial reporting process.

While these changes have begun to improve the financial reporting process, we again identified several errors in the financial statements and notes during our 2007 audit, including the following:

- The Wisconsin Retirement System Reserves at Funding Value presented in Note 1 differed by \$4 billion from the financial statements because of an apparent keying error.
- The Accumulated Sick Leave Conversion Credit Long-Term Liability presented in Note 1 differed by \$116 million from the financial statements because the Investment in Core Fund amount was used instead of the Total Liabilities amount.

- An adjustment of over \$11 million was identified and made to the Active Health Insurance Statement of Net Assets by the Department. However, the necessary corresponding adjustment was not also made to the Statement of Cash Flows.
- Drafts of the Statement of Cash Flows treated investment income as an operating activity in the Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities section, even though the Department began presenting investment income as a nonoperating activity in its 2006 statements.
- As directed by s. 40.875, Wis. Stats., the Department assesses and collects fees from the employer agencies for administrative costs incurred by the Commuter Benefits program. However, due to an error in the calculation used to determine these fees, employers were under-billed for more than \$30,000 in administrative expenses incurred in 2007, which will need to be recouped in future billings.

In addition, a prior-period adjustment was necessary to ensure that the Department's 2007 CAFR was prepared in compliance with Government Accounting Standards Board (GASB) Statement 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. While Statement 43 was first implemented for the 2006 CAFR, audit adjustments to the 2007 beginning Net Assets account and to several other accounts were necessary to correctly reflect the division of assets among and the claims incurred by the Active Health Insurance and Retiree Health Insurance plans. These adjustments were not material for the Active Health Insurance plan but were material for both of the Retiree Health Insurance plans. The prior-period adjustment included a \$14.4 million transfer from the Active Health Insurance plan's beginning Net Assets to the balances of the State Retiree Health and Local Retiree Health Insurance plans in the amounts of \$13.1 million and \$1.3 million, respectively. These adjustments were necessary because the Department was provided inaccurate data by a third-party administrator of the Health Insurance program, and the Department did not fully review the data to ensure accuracy.

☑ Recommendation

We recommend the Department of Employee Trust Funds continue to take steps to improve the attention and oversight given to its financial reporting process, including reconciling key balances between the financial statements, notes, and required supplemental information, and increasing the overall level of care applied to completing its financial information.

Department Response and Corrective Action Plan: While we were pleased that actions taken since the 2006 audit findings have produced favorable results, we understand that the issues you raised in your 2006 audit findings will not be eliminated overnight. We agree that additional progress is required in eliminating the clerical and other errors you identified as part of your 2007 findings. To that end, the Department will continue to utilize staff assistance from the Office of Internal Audit for review, identify opportunities to reallocate staff to assist in various aspects of the financial reporting process, provide training pending available resources, review the process used to produce the financial statements and, in general, continue to increase the overall level of care applied to the completion of the financial information. We believe that the effective improvements we have already made will continue to improve the overall process and outcomes in the future.

As you noted, the Department was able to add one full-time equivalent advanced accountant position to assist with various aspects of the financial reporting process. The position was filled with an internal candidate, and the Department is in the process of recruiting for a replacement. We anticipate the position will be filled within the near future. In addition, a new electronic health insurance system is scheduled for implementation this fall. It is anticipated that additional staff time will be made available due to increased efficiencies associated with the new system. These resources will allow the Department to dedicate more staff time to minimizing the types of errors noted by your staff.

Cash Reconciliations

The Department uses WiSMART, the State's official accounting system, to process financial transactions and Helmsman, a financial reporting software package, to create financial statements for its programs. Section 16.41, Wis. Stats., requires all agencies to keep their accounts and other financial records in the form prescribed by the Department of Administration (DOA) under s. 16.40, Wis. Stats. As a state agency, the Department is responsible for ensuring its information on WiSMART is complete and accurate. An important step in ensuring the accuracy of the financial information on WiSMART is to reconcile it to the Department's internal financial records and systems. Further, regular reconciliations between the systems better ensure that information reported by the Department in its financial reports is complete and accurate.

The Department is not able to fully reconcile its cash balances between the systems. While the Department has made some attempts to reconcile cash balances at a fund level, varying amounts of unreconciled differences exist at the end of each year. Further, it has made only limited attempts to reconcile cash balances on a program level, which is the level on which it reports and on which we opine on the financial statements in its annual financial report.

While we have, to date, accepted the cash balances reported by the Department in its financial reports as materially correct, larger unreconciled variances could affect our ability to issue unqualified auditor's opinions in the future. Further, as a state agency, the Department has a responsibility to ensure the accuracy of its information on the State's official accounting system and records. Consequently, we had recommended in our 2004, 2005, and 2006 audits that the Department take steps to reconcile the cash balances for each program.

In response to our past audit recommendations, the Department agreed that it would be desirable for the State's official accounting system to have the most accurate balances for the Department's programs, although it indicated that fully reconciling the systems may not be possible given the amount of time that has passed since WiSMART was implemented. The Department contacted the State Controller's Office, which agreed to help work on the reconciliation of cash balances between the two systems.

As previously noted, the Department filled an accounting position in June 2009 through an internal transfer that is intended, among other things, to provide the needed analysis for the reconciliation of these cash balances. The Department plans to have this position work with DOA and the State of Wisconsin Investment Board to fully understand cash processing at those two agencies and the effect on the Department's statements. The Department has indicated a commitment to completing

this task. However, as noted, the Department has not yet realized the full benefit of the new position because the vacancy created from this transfer is in the accounting area. Once this vacancy is also filled, the Department anticipates further progress in its cash reconciliations.

☑ Recommendation

We recommend the Department of Employee Trust Funds continue its efforts to reconcile the cash balances for each program and take steps to correct any inaccuracies identified in the beginning cash balances on the State's official accounting system or Helmsman through the reconciliation process.

Department Response and Corrective Action Plan: The Department has dedicated resources to try to reconcile cash balances at the program level. During FY 2009, a limited-term position was created with a primary responsibility to research and to try to resolve differences between the Department's and DOA's balances. Due to various resource restrictions, the Department was unable to continue this project when the limited-term employee reached the statutory maximum of 1,040 hours. In August of 2009, the Department was able to hire another limited-term position to continue this project. The Department continues to make the completion of this project a priority. However, external factors beyond the Department's control, such as the hiring freeze, turnover, and the availability of DOA personnel, may present challenges in completing this task in a timely fashion.

Access to Certain Computer Systems

During our 2007 audit, we identified concerns with controls over access to the Wisconsin Employee Benefit System (WEBS) and WiSMART. We believe the Department needs to be more diligent in ensuring that needed changes to access are made in a timely manner.

WEBS Access

WEBS was implemented by the Department in 1992 to administer WRS data and serve as a central repository for the Department's benefit data. Access to the system is controlled through various security packages and programs. Maintaining proper access to WEBS and its various subsystems and screens is an essential control for preventing unauthorized access to, processing of, and changes to critical data. Participant account data that is maintained on WEBS becomes exposed to increased risk of data manipulation, fraud, and errors if staff have unnecessary and inappropriate access. Further, unnecessary access exposes the Department to the risk that personal and confidential information could be compromised.

According to Department policy, a systems user access request form containing the authorizing signatures of the employee's immediate supervisor, the employee's bureau director or division administrator, and the security administrator must be submitted to the Department's Computer Science Bureau in order to obtain or change access to the Department's computer systems and applications. Based on the instructions provided in a systems user access request form, the Department security administrator adds, changes, or deletes staff access to critical Local Area

Network (LAN) and mainframe applications, including WEBS. However, we found that the systems user access request form is not always provided to a security administrator in a timely fashion when these changes to access needs occur, leading to potentially excessive staff access.

For our 2007 and 2008 audits, we obtained and reviewed listings from the Department of all staff with critical WEBS access and found 24 instances of inappropriate access to WEBS, including:

- 14 employees who transferred to different positions during the year or experienced some other change in responsibilities had excessive access inconsistent with their current job duties; and
- 10 employees of third-party contractors who had access that was not needed for their responsibilities.

While appropriate corrective action has been taken to remove the access in these instances, they demonstrate that additional controls and procedures are necessary to ensure WEBS access is appropriate on a consistent basis. For example, the Division of Management Services distributes an e-mail when employees terminate employment at the Department. Rather than waiting for supervisor notification, the security administrator could use this e-mail to determine if access needs to be changed or deleted and initiate discussions with Department staff as appropriate.

In response to past concerns that we had communicated, the Department began performing annual supervisor WEBS access reviews in 2003. Each year, in April or May, the security administrator generates and distributes a report to division administrators and bureau or office directors that lists each employee's access. These administrators and directors are asked to review the report, note any necessary changes, and return the report to the security administrator. However, these reviews do not consistently receive the priority that they need to ensure that WEBS access is thoroughly reviewed in a timely manner. For example, we found that some of the annual reviews printed on May 1, 2008, were not completed until October 2008. While these annual reviews can be an effective control to ensure the continuing appropriateness of WEBS access for all staff, we believe the Department needs to emphasize the importance of completing these reviews in a timely manner.

WiSMART Access

WiSMART security administrators have been designated at the agencies and centrally at DOA. It is the responsibility of the agency WiSMART security administrator to evaluate the access needs of their agency's employees and to submit this information to the WiSMART central security administrators via a Security Maintenance Form. The names of individuals authorized to sign this change request for each agency have been provided to DOA and the central WiSMART security administrators will only accept requests from these individuals. The central WiSMART security administrators make the requested changes to the security profiles within the WiSMART system and verify these changes with the agency via e-mail, screen prints, or a phone call.

The central security administrators review and evaluate the requested access before making any changes, to minimize cases in which an individual is granted all levels of approval and the ability

to enter or correct a WiSMART transaction. However, DOA does not provide assurances of access review; therefore, the primary control remains the evaluation and authorization provided by the agency. Consequently, it is paramount that the Department regularly review WiSMART access and ensure that it is adjusted or removed as staff transfer positions or terminate employment.

WiSMART access is added, changed, and deleted at the Department in the same manner and with the same form that is used to modify WEBS access. As is the case with WEBS access, we have noted some instances in which WiSMART access has not been adjusted in a timely manner. For example, in our testing performed in 2008, we found that an employee of one of the Department's third-party administrators had WiSMART access even though she was no longer employed by the third-party administrator. Additionally, in 2009 we found a Department employee had WiSMART access that was inconsistent with his current job duties, even though he had transferred positions within the Department several months earlier. These instances were brought to the attention of the Department, which took appropriate corrective action to remove the access.

☑ Recommendation

We recommend the Department of Employee Trust Funds:

- review its WEBS and WiSMART access procedures to determine if any additional controls can be implemented that would improve its process, such as using e-mails from the Division of Management Services to identify necessary employee deletions;
- emphasize to supervisors the importance of completing a system user access request form in a timely manner, to ensure access is removed for employee transfers and terminations; and
- ensure the annual supervisor access reviews are completed in a timely manner.

Department Response and Corrective Action Plan: The Department agrees that a review of the access procedures would be valuable to determine whether additional controls are needed to better ensure that staff access to these critical systems is appropriate. The review will include but not necessarily be limited to using mechanisms such as the e-mail notification of staff terminations and transfers provided by the Department's Division of Management Services (DMS) to flag information technology security personnel that access for a particular employee should be modified or terminated.

For employees who are transferred to different positions within the agency, the Department will explore a slight modification to our current procedures. Instead of terminating access associated with the prior position on receipt of a system user access form from the previous supervisor, security personnel will automatically terminate this access based on the transfer date listed in the DMS-generated e-mail. Note that in some cases, it is desirable for a staff member to maintain access associated with a prior position (training, staff shortages, and transition). However we will explore having this transitional access proactively requested for a set term by supervisory staff. The Department will explore implementing similar procedures for staff employed by third-party administrators.

The Department will use forums such as monthly meetings of managers to emphasize both the importance of completing system user access request forms in a timely manner and completing the annual access reviews in a timely manner. In addition, the Department will continue utilizing compensating controls such as supervision, privacy training provided by the Department's Office of Policy, Privacy, and Compliance, and the periodic distribution of a computer security newsletter.

Assuming there are no unexpected increases in workload, the Department intends on completing this review by the end of the current calendar year.
