



STATE OF WISCONSIN
Legislative Audit Bureau

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Janice Mueller
State Auditor

December 3, 2009

Mr. Sean Dilweg, Commissioner
Office of the Commissioner of Insurance
125 South Webster Street
Madison, Wisconsin 53703

Dear Commissioner Dilweg:

We have completed our audit of the Wisconsin State Life Insurance Fund as of and for the calendar years ending December 31, 2008, 2007, 2006, and 2005. This work was performed to meet our audit requirements under s. 13.94(1)(de), Wis. Stats. Our audit opinion on the Fund's financial statements, which are prepared on the basis of accounting prescribed or permitted by the Commissioner of Insurance, was included in report 09-14.

In this letter, we provide additional detail regarding our concerns related to the need for the Fund to improve its financial reporting process, perform reconciliations between cash balance recorded on the State's central accounting system to cash balance recorded on the Fund's general ledger, and improve its security of computer systems and data. These concerns were summarized in our Internal Control and Compliance Report that was included in report 09-14. In addition, this letter discusses the need to ensure that information provided by policyholders or beneficiaries is consistent with the information recorded in the Fund's computer systems before authorizing payment for claims.

Your office's responses to our recommendations 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 findings in this letter have been resolved.

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

Sincerely,

Janice Mueller
State Auditor

JM/BN/bm

Enclosure

WISCONSIN STATE LIFE INSURANCE FUND

The Wisconsin State Life Insurance Fund, which was created in 1911 to provide low-cost individual life insurance to Wisconsin residents, is administered by the Office of the Commissioner of Insurance (OCI). As part of our audit of the Wisconsin State Life Insurance Fund, we reviewed OCI's internal controls over administration of the Fund and compliance with laws and regulations, and followed up on findings identified in past audits. In this narrative, we describe in more detail the internal control weaknesses that were summarized in our Report on Internal Control over Financial Reporting and Compliance and Other Matters for Financial Statements, which was included in report 09-14. In addition, we discuss concerns related to the process used to approve payment for claims.

Financial Reporting

The financial statements of the Wisconsin State Life Insurance Fund are prepared in accordance with the accounting and financial reporting provisions of the National Association of Insurance Commissioners (NAIC). Wisconsin statutes require the Fund, as well as any company offering life insurance, to annually submit the Annual Statement to OCI. The Annual Statement, which is required to be submitted by March 1, includes the financial statements for the prior calendar year as well as other statutorily required information. The Fund Director prepares the financial statements and notes that we audit based on the financial statements included in the Annual Statement.

Financial reporting for the Fund is challenging because the NAIC accounting and financial reporting requirements are complex. In addition, Fund staff face tight time deadlines to prepare the Annual Statement.

During our prior audit, we identified various accounting and financial reporting errors and made recommendations for improvement. In response, Fund staff took some steps to improve financial reporting, including determining the quality ratings of all bonds held in the bond portfolio at year-end and involving the Fund's actuary in the calculation of the interest maintenance reserve and asset valuation reserve.

However, while Fund staff indicated in their response to our prior audit recommendations that they would consult with OCI Regulation and Enforcement Division staff to ensure accounting and reporting meets regulatory requirements, they have not done so. Staff told us that the strict time deadline to prepare the Annual Statement has prevented them from working with the Regulation and Enforcement Division staff. Because complete corrective actions were not taken, there is an increased risk that the Fund's financial statements contain errors.

During our current audit, we again identified deficiencies in the Fund's accounting and financial reporting procedures. For example, the surplus account on the calendar year balance sheet differed by \$616,572 from the surplus account on the summary of operations. However, while staff indicated they investigated the difference, they were unable to resolve it. Because the difference was unresolved, the correct surplus account balance was unknown. Nevertheless, staff adjusted the surplus account on the balance sheet by \$616,572 so that it equaled the surplus account balance on the summary of operations. In addition, we found formula errors and keying errors in electronic spreadsheets that serve as the basis for the exhibits and schedules in the Annual Statement that

flow into the financial statements. As a result, we again identified significant financial reporting errors that needed to be adjusted to ensure the audited financial statements were fairly presented. For example:

- Investment income was understated by \$146,666 for calendar year 2005 and by \$200,325 for calendar year 2008 because there was an error in the formula used to prepare the exhibit for net investment income.
- The general expenses account for calendar year 2006 was understated by \$53,302 because certain expenses were inadvertently excluded from the electronic spreadsheet used to prepare the exhibit for general expenses.
- The dividends to policyholders account was overstated by \$795,852 for calendar year 2008 because staff entered an incorrect amount into the exhibit included in the Annual Statement for dividends.
- The net realized capital gain (loss) account was understated by \$755,864 in 2008 because staff improperly reported a loss on an investment in General Motors bonds as an unrealized loss. Because these bonds were assigned an NAIC credit rating of “6,” staff should have reported the decline in value as a realized loss.

In addition, we identified a variety of less significant errors that also required adjustments. As shown in the following table, the audit adjustments reduced the reported net income by approximately \$148,000 for 2005, \$103,000 for 2006, \$10,000 for 2007 and \$575,000 for 2008.

Effect on Net Income Due to Audit Adjustments

Account/Year	Unaudited Balance	Audited Balance	Difference
Net Income (Loss)			
2005	\$1,887,298	\$1,739,669	(\$147,629)
2006	1,230,069	1,127,868	(102,201)
2007	1,365,549	1,356,038	(9,511)
2008	539,548	(35,496)	(575,044)

Due to the unique nature of life insurance financial reporting, only a few of the errors required adjustments to the Fund’s surplus balance. The combined effect of the audit adjustments was to reduce the Fund’s December 31, 2008 surplus balance by \$12,125 from \$6,440,837 to \$6,428,712.

We note that while the majority of these errors appear to relate to Fund staff's incomplete understanding of accounting and financial reporting, the material errors would have been detected through a more thorough review of the Fund's financial statements.

☑ **Recommendation**

We recommend the Wisconsin State Life Insurance Fund take more care in the preparation of the Annual Statement, which includes the annual financial statements; review and identify any amounts that are different than would be expected; and analyze whether such amounts are based on accurate and reliable financial information. We also recommend the Wisconsin State Life Insurance Fund consult with others, such as Regulation and Enforcement Division examiners, with expertise on life insurance financial reporting issues as needed to ensure the Fund's financial statements are accurately prepared.

Agency Response: As noted by the auditors, the Wisconsin State Life Insurance Fund has taken certain steps since the last audit to improve financial reporting, determine the quality ratings of bonds, and request that the Fund's actuaries calculate the interest maintenance reserve and asset valuation reserve. We believe the audit process is very valuable in helping to identify areas where improvements can be made and to allow OCI to better focus its limited staff resources on such areas.

Fund staff will strive to complete the Annual Statement as accurately as possible and will seek to engage staff from the agency's Regulation and Enforcement Division to provide an additional review of the statement. If there is insufficient time to use such staff before the filing deadline, the Fund will seek an extension to the deadline to ensure the additional review can be made. If there is a discrepancy in the balancing of the financial statements, Fund staff will pursue the resolution with the guidance of the Regulation and Enforcement Division examiners. It will be key to involve staff from outside the Fund to secure needed expertise, given the small size of the Fund's own staff and the increasing complexity of financial reporting under statutory accounting requirements.

Reconciliation of the General Ledger to WiSMART

The Wisconsin State Life Insurance Fund staff use several agency-level accounting systems to record the Fund's accounting transactions and to provide the information needed to prepare the Fund's annual financial statements. In addition, staff use WiSMART, the State's central accounting system, to process the payment of checks, such as for dividends and payment claims, as well as other receipts and disbursements of the Fund.

WiSMART is also used by other state agencies responsible for processing accounting transactions for the Fund. For example, the State Controller's Office records on WiSMART premium revenue the Fund receives through a lockbox and the State of Wisconsin Investment Board records on WiSMART investment sales and purchases and investment income. Accounting transactions recorded on WiSMART by these other agencies are downloaded by the Fund's staff and used to update the Fund's general ledger system, as well as other systems as needed. It is important to

reconcile the WiSMART records to the Fund's general ledger and other systems to ensure that all transactions processed by WiSMART are properly reflected in the Fund's accounting systems.

In past audits, we noted concerns related to the lack of adequate reconciliations between the general ledger system and WiSMART and that the Fund's general ledger cash balance had differed from the WiSMART cash balance since at least 1994. In response to our prior audit recommendations, the Fund's staff stated that they successfully reconciled cash for January 2005, and that they would complete monthly reconciliations in subsequent months.

However, apparently because of the difficulty and the time needed to continue monthly reconciliations, staff have not reconciled cash since January 2005. As a result, a variance has again arisen between the cash balance recorded on WiSMART and the cash balance recorded on the Fund's general ledger. As of December 31, 2008, the variance between the two systems reached \$40,937, with the cash balance recorded in WiSMART being less than the cash balance recorded in the Fund's general ledger. Because this variance has not been fully investigated, there is increased risk that unauthorized or inappropriate cash transactions have been processed on WiSMART and remain undetected. In addition, because staff use the general ledger to prepare the Fund's financial statements, the reported cash balance could be misstated.

During our current audit, we performed additional but limited procedures to identify potential reconciling items. We found:

- the Department of Administration processed on WiSMART a \$1,200 required transfer from the Fund to the General Fund in May 2005, which was not recorded in the Fund's general ledger;
- the Department of Administration issued a \$303 payment in February 2006 for a previously cancelled draft that was not recorded on the Fund's general ledger; and
- Fund staff issued a \$500 policy loan in July 2008 that was properly recorded on WiSMART but was not recorded on the Fund's general ledger.

These three transactions identified during our limited review account for \$2,003 of the \$40,937 cash variance that existed as of December 31, 2008. It is important that Fund staff take steps to investigate the remaining variance of \$38,934 to ensure transactions were properly recorded on both WiSMART and the Fund's general ledger. We provided suggested procedures for the Fund's staff to follow to identify variances arising during the month. In addition, we contacted staff within the State Controller's Office who indicated that they would be available to assist Fund staff in their reconciliation efforts. Fund staff informed us that they intend to perform monthly reconciliations, beginning with a reconciliation of January 2009 transactions. After Fund staff have completed several monthly reconciliations, staff may become aware of possible causes for the variance that accumulated prior to December 31, 2008, that should be investigated.

☑ Recommendation

We recommend the Wisconsin State Life Insurance Fund work with the Department of Administration to reconcile the cash balance recorded in WiSMART to the cash balance recorded in the Fund's general ledger to ensure all transactions are properly recorded.

Agency Response: The Fund's staff will perform the suggested procedures to reconcile the cash activity in the Fund to the change in cash as recorded by the Department of Administration. Fund staff have worked with the audit team to gain a more complete understanding of the nature of the cash variances and strategies for analyzing them. Fund staff are committed to moving forward on this much-needed reconciliation. Reconciliations will be done on a monthly basis commencing January 2009. It should be noted that the Insurance Program Manager immediately began working to reconcile the Fund's cash balance when it was brought to her attention during this audit and that she has already reconciled through the month of July 2009.

Security over Computer Systems

Controlling access to computer systems is important to ensure that computer programs and data are protected from improper access and use. If access is not limited to appropriate staff, computer programs and data may be intentionally or unintentionally damaged or manipulated. We continue to note concerns over security and access to OCI systems, including increased risk of unauthorized access to the Flexible Insurance, Marketing, Management, and Administration System (FIMMAS). Because of the sensitivity of the security issues, we are reporting our detailed findings to OCI only.

Agency Response: The Office of the Commissioner of Insurance is in the process of addressing these issues.

Claims Payments

The Wisconsin State Life Insurance Fund pays benefits to policyholders in the event of death, maturity of policy, upon surrender of the policy, or, under certain circumstances, in the event the covered individual becomes disabled. FIMMAS is used to account for and manage all of the Fund's insurance policies, including determining the cash surrender value of the policies. The Fund also uses an imaging system to store documentation for each policy, such as the application, change of beneficiary form, and contract.

To request a benefit payment, a policyholder or beneficiary is required to submit specific documentation to OCI. For example, for a death claim, OCI requires the beneficiary to submit a certified copy of the death certificate, the Selection of Settlement Option Form, IRS W-9 form, and, if available, the policy contract. The Fund's staff review the available information and, if approved, initiate payment based on the information previously entered into FIMMAS. However, the Fund's written procedures for processing claims do not require staff to verify that the information recorded in FIMMAS is consistent with the information included in the documentation provided by the policyholder or beneficiary. For example, staff do not verify that the face value of the insurance policy agrees with the amount included in FIMMAS. As a result, it is possible for a benefit payment calculated by FIMMAS to be in error or issued to an inappropriate individual. We note that this risk is increased because of the previously discussed concerns related to security over computerized data and applications.

We note that we did not identify any erroneous claims payments during our audit. However, we discussed our concerns with Fund staff, who agreed that it would be reasonable to require that

the information included in FIMMAS is consistent with the documentation provided by the policyholder or beneficiary.

Recommendation

We recommend the Wisconsin State Life Insurance Fund adjust its procedures for processing claims to require verification between the information provided by the policyholder or beneficiary and information included in FIMMAS prior to authorizing the claim.

Agency Response: Fund procedures currently require checking several pieces of documentation before paying benefit claims. While the auditors note that no erroneous claim payments were identified during the audit, the Fund will adjust its written and operating procedures to also specifically verify that information contained in FIMMAS is consistent with policyholder information at the time a claim is submitted.
