



STATE OF WISCONSIN
Legislative Audit Bureau

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Janice Mueller
State Auditor

December 20, 2007

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, 2005. 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. We note that we completed our audit on April 6, 2007, and the late issuance of the Department's report was a result of delays in its completion by the Department.

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 or continuing concerns related to cash reconciliations, clearing accounts, and the Badger Rx Gold Program that are required to be reported under these standards. We also followed up on concerns noted in the 2004 audit regarding errors in the calculation of accumulated sick leave conversion credits.

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/DA/ss

Enclosure



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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, 2005, and have issued our report thereon dated April 6, 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions relate to cash reconciliations, clearing accounts, and the Badger Rx Gold Program, which are further discussed in the accompanying narrative.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe that the reportable conditions described above are material weaknesses.

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*.

We further noted certain additional matters pertaining to the calculation of accumulated sick leave conversion credits. As noted in the accompanying narrative, we followed up on errors noted in our 2004 audit and found the Department has taken several steps in an effort to educate state agencies and promote accurate calculation of the conversion credits.

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

LEGISLATIVE AUDIT BUREAU

April 6, 2007

by



Diann Allsen
Audit Director

DEPARTMENT OF EMPLOYEE TRUST FUNDS

The Department of Employee Trust Funds (ETF) is responsible for administering the Wisconsin Retirement System 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 ETF's internal controls for the purpose of determining the audit work necessary to express an opinion on its financial statements. During our audit of ETF's 2005 financial statements, we noted new or continuing internal control concerns related to cash reconciliations, the use of clearing accounts, and the administration of the Badger Rx Gold Program. We also followed up on concerns noted in the 2004 audit regarding errors in the calculation of accumulated sick leave conversion credits.

Cash Reconciliations

ETF 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 as prescribed by the Department of Administration (DOA) under s. 16.40, Wis. Stats. As a state agency, ETF 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 ETF's internal financial records and systems. Further, regular reconciliations between the systems better ensure that information reported by ETF in its financial report is complete and accurate.

ETF is not able to fully reconcile its cash balances between the systems. While ETF 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.

For the last several years, we have communicated the unexplained cash variances to ETF. For example, in our 2004 audit, we communicated that the cash balance ETF reported for the Life Insurance Program was 123.2 percent less than that reported on WiSMART. While, to date, we have accepted the cash balances reported by ETF 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, ETF 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 audit that ETF take steps to reconcile the cash balances for each program by the time the State implements a new accounting system, Integrated Business Information System.

In response to our 2004 audit recommendation, ETF agreed that it would be desirable for the State's official accounting system to have the most accurate balances for ETF's programs, although indicated it may not be possible to fully reconcile the systems given the amount of time that has passed since WiSMART was implemented. ETF contacted the State Controller's Office, which agreed to help work on the reconciliation of cash balances between the two systems. Recently, ETF indicated that it has received some information from the State Controller's Office, but it has not been able to commit additional time to the reconciliation effort because of other financial reporting priorities.

Recommendation

We recommend the Department of Employee Trust Funds continue its efforts to fully reconcile the cash balances for each program by the time the State's new Integrated Business Information System is implemented and to 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: We agree with your recommendation and share your concern regarding the incorrect cash balances on the State's central accounting system. We have discussed this with the State Controller's Office and intend to assist the Office in correcting these balances as part of the Integrated Business Information System implementation plan.

Clearing Accounts

ETF uses WiSMART, the State's accounting system, to process financial transactions. It uses reporting category "CL" on WiSMART to temporarily record certain transactions in clearing accounts until proper account coding can be determined. According to ETF, balances in clearing accounts it uses regularly are moved to the appropriate accounts either monthly or annually. The balances in clearing accounts should be zero at year-end to ensure transactions are properly recorded for financial statement purposes.

During our 2004 audit, we identified multiple clearing accounts that have had outstanding balances for several years. The largest balance identified was a negative balance of \$1,683,225 in a clearing account used for the Income Continuation Insurance Program. To ensure its financial transactions are properly reported, ETF should identify and eliminate outstanding balances in its clearing accounts as soon as possible, but no later than by the time the State implements the Integrated Business Information System.

☑ Recommendation

We recommend the Department of Employee Trust Funds develop a plan to fully review and eliminate balances in its clearing accounts before the State's implementation of the Integrated Business Information System.

Department Response and Corrective Action Plan: We agree with your recommendation and have addressed the findings of the audit by implementing steps to eliminate the outstanding balances in the clearing accounts. In addition, the process involving the use of clearing accounts has been amended so that the accounts are more closely monitored in the future.

Badger RX Gold Program

According to s. 40.53, Wis. Stats., the Group Insurance Board is responsible for establishing a purchasing pool for pharmacy benefits. In response, the Badger Rx Gold Program was implemented in 2005 to allow qualifying Wisconsin residents the opportunity to take advantage of the consolidated bargaining power that the State's group health insurance program for public employees has established as a result of its relationship with pharmaceutical companies. As of December 2005, there were over 7,000 participants in the Badger Rx Gold Program. ETF uses Navitus Health Solutions, LLC, the pharmacy benefit manager for the State's group health insurance program, to administer the daily activity of the program.

During our review of the Badger Rx Gold Program, we identified two areas needing attention. First, ETF was unable to provide us with a signed written agreement with Navitus that establishes each party's responsibilities and other pertinent details, such as the various program and administrative fees and how they are assessed. ETF found a draft agreement, but neither ETF nor Navitus could locate a finalized, signed version of the agreement.

Second, ETF accepts and pays invoices from Navitus for the Badger RX Gold Program without review. Participants in the program pay various fees that fund the administrative costs incurred by ETF and Navitus. The process to ensure that all involved parties have paid and received the proper fee amounts is complex, which increases the risk for errors in the invoices. During our review of the program for the 2005 audit, we were provided conflicting information related to the program and, in particular, the invoices submitted to ETF by Navitus. While the conflicting information resulted in additional audit time to understand and review the invoices, it also demonstrated a lack of understanding by ETF staff of key line items included on the invoices.

Specifically, during our review of the invoices submitted for 2005, Navitus was able to provide us with support for \$132,135 of the \$159,247 that it invoiced ETF. However, neither ETF nor Navitus were able to provide documentation to support the additional \$27,112 invoiced and paid. Only after we completed a detailed review of the invoice and the program's billing procedures, were we able to conclude that the additional amount appeared reasonable.

Subsequent to our inquiry about the 2005 program invoices, ETF staff worked with Navitus staff to gain an understanding of the complex billing procedures associated with the Badger Rx Gold Program. At this time, we believe that ETF staff have developed a sufficient understanding to appropriately monitor the program. However, we believe ETF needs to implement procedures to ensure these invoices are reasonable and appropriate.

☑ Recommendation

We recommend the Department of Employee Trust Funds finalize a written, signed agreement with Navitus to establish each party's responsibilities and other important details related to the administration of the Badger Rx Gold Program, including documentation required to support program invoices. Further, we recommend the Department of Employee Trust Funds staff perform reviews of Badger Rx Gold invoices to ensure the accuracy and reasonableness of the billings in accordance with this agreement.

Department Response and Corrective Action Plan: As is the case with any new program, administrative procedures continue to be assessed and adjusted as needed to ensure the program objectives are met. Your first recommendation deals with the formal contract between ETF and Navitus. We agree with your recommendation, and are in the process of replacing the lost agreement.

Your second recommendation deals with staff review of Badger Rx Gold invoices. Our current policy is not to perform detail audit procedures on each invoice, but to rely on periodic compliance audits to confirm the accuracy of the payments. Invoices are subject only to reasonableness reviews prior to payment. This approach was implemented because detail information is not available from Navitus. However, it should be noted that the compliance audits have revealed the accuracy of the payments; therefore we feel this process is effective and reliable at this time. The recommended detail review of invoices would require additional staff to complete the highly labor-intensive processes.

Determination of Accumulated Sick Leave Conversion Credits

ETF administers the Accumulated Sick Leave Conversion Program and the Supplemental Health Insurance Conversion Credit Program. Both programs provide credits to eligible participants that may be used to pay for health insurance premiums after retirement. Eligible participants or their beneficiaries may also use these credits at the time of layoff or death.

State agencies submit an Accumulated Sick Leave Certification Form to ETF to enroll eligible participants in both programs. This form provides the participant's base salary rate, accumulated sick leave hours, years of continuous state service, and calculation of the credits to be awarded. Agencies are responsible for ensuring the accuracy of the information on the forms.

During the last several audits, we have found errors in state agencies' calculation of sick leave credits. Overall, the errors have not had a material effect on the financial statements. However, such errors could result in ETF paying health insurance premiums in excess of credits actually earned or prematurely ceasing to pay health insurance premiums for participants with understated credits.

During our 2004 audit, we recommended that ETF work with the Office of State Employment Relations to establish a plan for promoting accurate completion of the Accumulated Sick Leave Certification forms. In response, ETF has taken several steps to further educate state agencies on the calculation of sick leave conversion credits, including issuing an employer bulletin, revising the Accumulated Sick Leave Certification Form, and updating the State Health Insurance Manual. The Office of State Employment Relations also updated the chapter on the supplemental program in the Wisconsin Human Resource Handbook. Most recently, ETF staff made a presentation on the calculation of sick leave credits at a February 2007 state payroll council meeting. We will continue to monitor the effectiveness of these efforts in future audits.
