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**CORRESPONDENCE MEMORANDUM**

**DATE:** September 9, 2005

**TO:** Eric Stanchfield, Secretary  
Employee Trust Funds Board

**FROM:** Dave Stella, Deputy Secretary

**SUBJECT:** Internal Audit Biennial Report of Audits and Advisory Services  
July 1, 2003 - June 30, 2005

***Note: This report is informational only. No action is required.***

Internal Audit issues formal reports to the Secretary's Office and distributes condensed reports to the Employee Trust Funds (ETF) Board for all audits. For some sensitive business-related risks, Internal Audit may not issue a formal report and instead communicates verbally or by internal memo. Both services are covered in the attached biennial report.

ETF's previous Internal Audit Director retired in July 2005. We are currently in the process of recruiting for a new Director and hope to have someone on board by the end of 2005. In the meantime, please feel free to contact me with any questions about this report.

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**DEPARTMENT OF EMPLOYEE TRUST FUNDS  
INTERNAL AUDIT BIENNIAL REPORT  
July 1, 2003-June 30, 2005**

**AUDITS AND BUSINESS ADVISORY SERVICES**

***Reports Issued or In Progress***

**1. *Department-wide Risk Assessment/Audit Plan***

A process of continuous risk assessment with annual updates is planned for all Divisions within Employee Trust Funds (ETF). Retirement Services completed two consecutive risk assessments and during the past year Management Services was added. A combined report was submitted to the Secretary's Office in July 2005. Trust Finance and Employer Services risk assessment will begin after the new Director is hired.

A proposed biennial audit plan for 2005-2007 has been distributed to the Division Administrators and the Secretary's Office. The Audit Plan is a perpetual document that is continuously updated as new risks emerge. It includes specific assigned audits and a list of future unassigned audits. The intent is that the audit process as well as each audit will be risk based, thus utilizing limited audit resources in the most efficient manner possible.

**2. *Internal Control Review of Close-out of Inactive Accounts (Report 2004-1)***

This audit is completed and a report was issued to the Secretary with copies to the ETF Board.

**3. *Stale-dated Check Payments to Individuals (Reports 2004-2, 2004-3, and 2004-5)***

Phase one of the audit reviewed ETF paper checks that stale-dated and were automatically re-issued without appropriate internal controls. Phase two examined the stale-dated paper checks going to estates, which were determined to have separate issues. Phase three determined the status of actions taken to address critical internal control deficiencies identified in phase one. The audit is completed and a report was issued to the Secretary with copies to the ETF Board.

**4. *WEBS Member Record Integrity Review for Changes 1999 & 2000 and Act 11 (Reports 2003-2 and 2004-7)***

This audit of all member records was instituted as an independent annual review. It serves as an integrity check against major errors and unusual changes. It is also a deterrent to fraudulent activity by a single staff member or in collusion with others – such as programmers.

Internal Audit began by auditing all ETF staff on a test basis. Then, it moved to an audit of all members using participant account ledger (PAL) data. The new PAL system efficiently provided money, service, employment, and other audit data.

The audits were developed prior to a Legislative Audit Bureau (LAB) management letter that commented on risks associated with programmer security access. Internal Audit had identified access security risks of programmers in prior audits and determined that an analytical audit of this nature could mitigate risk related to access security. Initially, LAB suggested reviewing only

programmer member accounts but concurred that auditing all member records was a more comprehensive control.

Ultimately, this audit can serve as an entry/exit analysis of member account records. This type of major integrity analysis reconciles the status of all member records between years and is advisable for large retirement systems such as the Wisconsin Retirement System. During future audits, the service component will be expanded to include the exit component of this analysis.

The audit is completed and a report was issued to the Secretary with copies to the ETF Board.

#### **5. *Custom File Maintenance (CFM) Audit (Reports 2005-4 and 4B)***

This internal control audit was expanded at the request of the former Division of Information Technology Administrator to include a time and cost analysis of CFM activities. The audit component included a review of controls over the formal CFM process. The audit and time and cost study are completed and reports were issued to the Secretary with copies to the ETF Board.

#### **6. *Match of WEBS Records to Social Security Administration Death Master and Monthly Updates (Report 2004-6)***

The Division of Trust Finance and Employer Services requested this audit. Results were stratified according to account value as a means to assist in identifying higher risk areas. Internal Audit identified the need to flag accounts where death has occurred so staff will give proper scrutiny if application is made for a benefit.

#### **7. *40.65 Duty Disability Offsets Business Advisory Review (Report 2005-6)***

This review was requested by the Secretary's Office. The scope included identifying ways to electronically match existing duty disability monthly payments with other internally managed electronic records. The objective was to provide a more efficient method to identify offsets to 40.65 benefits. This would help ETF avoid or minimize retroactive adjustments and recoveries and mitigate the risk of poor public and legislative perception when adjustments are required. The review has been completed and was provided to the Secretary's Office.

#### **8. *Briefing by Internal Audit Director Regarding Areas of Risk***

The former Audit Director prepared two briefing documents and met with members of the previous and current Secretary's Office on two areas of risk described below.

##### ***Coutts/Dejarlis Supreme Court Decision - Implementation of ETF Rule 52***

The previous Deputy Secretary requested that Internal Audit analyze the estimates related to a Division of Insurance Services initiative to review all 40.65 benefits processed by ETF prior to the Coutts/Dejarlis Supreme Court decision. ETF's interpretation of the Supreme Court decision was the foundation of the 40.65 rule (ETF 52) that was being applied retroactively. Internal Audit reviewed available documentation for the case and provided the previous Deputy Secretary with a written opinion on risks related to ETF's interpretation of the Supreme Court decision. Since then, various cases and appeals have heightened concern about the processing of Coutts/DeJarlis adjustments. They have been suspended pending further court review of similar pending litigation that was commenced after the Supreme Court's decision.

*Conversion from the Transaction Amortization Account (TAA) to the Market Recognition Account (MRA) Smoothing Mechanism*

The former Director began a review of the new MRA in early 2000, shortly after the Wisconsin Retirement System (WRS) experienced some investment losses due to the financial market downturn. The Director reviewed documents provided to the Department, Board, and Legislature, which included past actuarial reports. The review raised issues regarding risks that face the WRS and ETF as a result of the change. The results and possible actions were provided to the Secretary's Office. Since then, the WRS actuary has acknowledged "problems with the statute," referring to the statutory provision which describes the formula for the MRA but provides no flexibility to refine the MRA results based on future trends. The LAB will include review of the MRA in the work to be done in the actuarial audit.

## **TECHNICAL ASSISTANCE**

### **9. *Social Security Administration (SSA) Death Match to Annuity System***

Internal Audit continued to complete the out-State death match using SSA records through most of the biennium. The review process has now been transferred to the Division of Retirement Services.

### **10. *Locating Lost Contact Members***

The Internal Audit Director acted as security administrator for the product "InsightGovernment." The product continues to be the primary source for locating lost contacts and is a major reason for the reduction in the number of published lost contacts at age 70½. In 2004, Internal Audit tested and put in place a software upgrade. Administration of the service has now been transferred to Retirement Services.

### **11. *Coordination of Department Procedures***

Internal Audit continued to coordinate and provide training on developing ETF procedures. The Secretary's Office and Internal Audit have emphasized the importance of written documentation and risks related to turnover for key positions where retirements are expected. The issue of key staff turnover was added to the workforce planning process currently underway to address concerns related to potential loss of institutional knowledge. Procedure coordination responsibilities were recently reassigned to the Division of Management Services.

### **12. *Audit Follow-up Process for Internal Audit and Legislative Audit Bureau (LAB) Observations***

Internal Audit coordinated audit follow-up process changes that will provide the Secretary's Office with greater assurance that follow-up activities are recorded and tracked. As a result, audit observations for Internal Audit and LAB will be in a centralized location for ease of access and monitoring. The goal is to ensure more timely action by operating Divisions. Further audit follow-up process refinements will include Third Party Administrator (TPA) audits. This new process will be maintained and updated by managers or assigned staff.

### **13. *Assistance with Security Monitoring Process***

Internal Audit continues to provide assistance and review additional needs for security monitoring and controls.

## **OTHER ACTIVITIES**

### **14. “Public Pensions Systems: Operational Risks of Defined and Other Benefit Plans and Controls to Mitigate Those Risks”**

The Association of Public Pension Fund Auditors (APPFA) developed this comprehensive risk document. Vicki Wickliffe (retired ETF auditor) was Co-chair of the committee that created this document. It has received endorsement from the Government Finance Officers Association (GFOA) and the National Association of State Retirement Administrators (NASRA).

### **15. Whistle-Blower Contact**

The former Internal Audit Director was ETF’s contact. There were no formal written contacts during the past year and one confidential complaint was handled verbally. A new contact person will be named in the near future.

### **16. Employee Suggestion Program**

The Audit Director was a member of this committee. Work has been done to improve program requirements on a statewide basis. Within ETF, viable options were identified for staff to submit suggestions that are related to their own job – provided the suggestion is not related to a specific assignment to identify improvements.

### **17. ETF Mentor Programs**

Internal Audit (Vicki Wickliffe) successfully mentored one staff person in procedure development processes. This was useful for both parties and resulted in some changes for this function.

### **18. State, National, and International Affiliations**

*Association of Public Pension Fund Auditors (APPFA):* The former Audit Director was the APPFA Audit Committee Chair during 2003 –2004. APPFA has over 70 members and almost \$2 trillion in assets under management and is the preferred training choice of public pension fund auditors in the U.S.A. and Canada.

*International Government Relations Committee (GRC) of the Institute of Internal Auditors (IIA):* The former Audit Director was working with an international committee including members appointed by David Walker of the Government Accountability Office (GAO) on a position paper regarding Internal Audit’s Role in Governance.

*IIA Local Chapter:* The former Audit Director was the Chair of the Chapter Government Relations Committee. He also worked with the UW-LaCrosse to consider development of an IIA Endorsed Internal Audit Curriculum.