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## Correspondence Memorandum

**Date:** May 25, 2018  
**To:** Audit Committee  
**From:** Yikchau Sze, Director  
Office of Internal Audit (OIA)  
**Subject:** Cash Reconciliation Process Audit

**This report is for Committee review and discussion. No action is required.**

Attached is the audit report of a cash reconciliation process audit. The results of this audit have been submitted and discussed with the Office of the Secretary, Department of Employee Trust Funds (ETF).

This audit was conducted in accordance with the biennial Audit Plan for fiscal year 2018-2019. The original audit scope included both cash reconciliation and cash processing processes that were in place at the Division of Trust Finance (DTF) of ETF. Due to key staff turnover and availability at the Office of Internal Audit, we have taken a phased approach to complete this audit. We now report to you results of the cash reconciliation audit first and will bring the results of the cash processing audit to you at a later time.

In December 2017 the OIA auditor assigned to conduct this cash audit transferred to the DTF Lead Worker Accountant position after completing the audit work of the cash reconciliation process. The vacant auditor position was filled in April 2018. The new auditor was assigned to perform a follow-up audit in late April 2018 to determine the status of the initial cash reconciliation audit findings. The results of the follow-up are documented at the end of each initial audit finding in the attached report.

Except for one recommendation regarding the monthly reconciliation, all other audit recommendations raised during the initial audit work have been fully implemented. All findings and observations are included in the attached report to communicate the deficiencies and process improvement opportunities identified in our initial audit work.

The initial audit work was completed by Amelia Slaney. The follow-up audit was conducted by Ramona Yee, who will be available at the Committee meeting to answer any questions.

Attachment: Cash Reconciliation Process Audit Report

Reviewed and approved by Robert J. Conlin, Secretary

Electronically Signed 6/11/18

Board	Mtg Date	Item #
AUD	6.21.18	3

# ***Office of Internal Audit***

Cash Reconciliation Process Audit



May 21, 2018

## **Objective:**

The audit objective was to determine whether the cash reconciliation process completed by the Department of Employee Trust Funds (ETF) Division of Trust Finance (DTF) is working as intended. Specifically, we evaluated the controls within the cash reconciliation process and reviewed for accuracy and timeliness.

## **Scope:**

The audit scope focused on DTF's controls over the ETF cash reconciliation process for activities at ETF, the State of Wisconsin Investment Board (SWIB), and the Department of Administration (DOA). Initial audit work covered the reconciliation processes of June 2017 through November 2017, and follow-up audit work performed in April 2018 covered the reconciliations processes of December 2017 through April 2018.

## **Background:**

### *The Process*

ETF works collaboratively with SWIB and DOA to manage cash for the Core Trust Fund and the Variable Trust Fund. ETF is responsible for collecting contributions, processing annuitant payments and for ensuring cash is reported accurately in ETF's annual Comprehensive Annual Financial Report (CAFR). SWIB is responsible for investing cash for the Core and Variable Trust Funds and for preparing their annual financial reports. DOA is responsible for the daily record keeping of the receipts and disbursements activity of State Investment Fund (SIF) pool shares and for preparing the State's CAFR. A proper reconciliation of cash between ETF, SWIB and DOA is necessary to ensure cash activity is recorded and reported accurately, and to reduce the risk of misstatements in financial reporting.

Due to ETF, SWIB and DOA's varying roles, it is necessary for the agencies to communicate cash and investment activity to each other in order to have the information needed to complete their monthly cash reconciliations and, ultimately, prepare their respective annual financial statements. ETF relies on SWIB for investment balances and SWIB relies on ETF for cash balances for financial reporting. As a result, at the end of each month there are several inter-agency steps that must be completed to ensure ETF cash is properly reconciled.

To begin the monthly process, DTF completes a reconciliation of the daily Core and Variable Funds cash activity reported by DOA, to the ETF and SWIB cash activity reported in STAR, which is the State's accounting system. ETF then prepares a *Cash*

*Reported to SWIB Summary* of the ETF-reconciled cash balance and provides it to SWIB. SWIB records ETF's cash balance in their accounting system and then generates monthly financial statements that are provided to ETF. ETF uses the monthly financial statements to record the changes in cash and investments in ETF's system, and to complete the monthly reconciliation of cash between the ETF and SWIB general ledgers. Without these interactions between ETF and SWIB, each agency would have an incomplete set of accounting records for the Core and Variable Funds and would not be able to reconcile their cash and investment accounts.

## Testing:

The Office of Internal Audit (OIA) conducted this audit by:

- obtaining an understanding of DTF's procedures for reconciling cash between ETF, SWIB, and DOA, including conducting interviews and performing process walkthroughs with responsible staff;
- testing the balances on the *Cash Reported to SWIB Summary* for September 2017;
- testing the daily and monthly cash reconciliation processes for selected months; and
- following up in April 2018 to determine the status of the initial cash reconciliation audit findings after staff turnover occurred in OIA and DTF.

### Test Daily Reconciliation Process

To test the daily reconciliation process, we traced the daily cash receipts and disbursements to the DOA SIF Pool Share Sheet and tested cash activity for SWIB and ETF by querying STAR. We recalculated DTF subtotals and reviewed the reconciliation spreadsheet for reasonableness. During our testing we identified an immaterial timing variance, as well as several process improvements for DTF to consider.

### Test Cash Reported to SWIB Summary

We tested the cash balances reported on the *Cash Reported to SWIB Summary* as of September 30, 2017, by querying cash activity from STAR, tracing timing differences to source documents and comparing DTF's spreadsheet to DOA's cash activity provided to DTF. We identified a minor variance that was excluded from DTF's totals. We also found that DTF sometimes reported timing differences to SWIB without knowing whether they relate to ETF, SWIB, or DOA --which caused temporary timing differences.

### Test Monthly Reconciliation Process

We tested the monthly reconciliation completed as of June 30, 2017, for the Core and Variable Trust Funds, because it was the only monthly reconciliation DTF had completed when we started our audit work. To reconcile ETF cash with SWIB, ETF

must consider cash activity recorded in the general ledger and timing differences and adjustments that would be unknown to SWIB. We traced beginning cash balances and current year cash activity to a query of STAR data. We traced other reconciling amounts to source documentation, or additional queries of STAR data, and reviewed the reconciling items for reasonableness. We identified an error of \$4,319.07 that should not have been included as a reconciling item by DTF. We also found that DTF included a \$2.9 million reconciling item that appears to have resulted from ETF's conversion to STAR in 2015. For calendar year 2015 and 2016 financial statements, ETF made journal entries to temporarily correct the variance for financial reporting. We recommend that ETF research and resolve the \$2.9 million variance going forward.

#### April 2018 Follow-up Testing

To test DTF's progress in addressing the initial audit findings, we performed walkthroughs of the updated daily and monthly reconciliation procedures, as well as the preparation of the *Cash Reported to SWIB Summary*, to ensure completeness and inclusion of the OIA recommendations. We determined the timeliness of the monthly reconciliation for the months of December 2017 through March 2018. We also traced the STAR journal entry created to adjust for the \$2.9 million reconciling item to the supporting documentation and ensured it was properly processed in STAR.

### **Results:**

During our initial 2017 audit work, OIA identified five issues and provided recommendations for DTF to consider. After completion of the April 2018 follow-up audit work, we noted there was only one recommendation that was not fully implemented.

For the one outstanding recommendation, the original finding, description of the April 2018 follow-up audit work and management response are described below.

#### Finding

#### ***DTF has not completed the monthly cash reconciliation consistently and timely.***

During our initial 2017 audit work, it was determined that DTF had recently created the monthly reconciliation process to compare ETF and SWIB's cash balances. DTF intended to complete the process each month. In October 2017, DTF created the first monthly reconciliation for the month ended June 30, 2017 and appeared to make additional changes to the reconciliation into December 2017. The only other monthly reconciliation completed by the end of our audit work in December 2017 was for the month ended October 31, 2017, which was completed in November 2017. Since the process was newly developed, DTF was still making changes to the process. If DTF does not complete monthly reconciliations in a timely manner, variances may not be discovered, resolved, or reported to SWIB or DOA, which could impact financial reporting accuracy.

**Recommendation from Initial 2017 Audit Work:**

**We recommend that DTF complete the monthly cash reconciliation each month, and in a timely manner.**

**Results from April 2018 Follow-up Audit Work:**

In April 2018 we followed up on this finding and found for the months of December 2017 through April 2018, DTF completed a monthly cash reconciliation; however, the reconciliations were not completed in a timely manner. The December 2017 reconciliation had a final sign-off date of March 18, 2018, while the January and February 2018 reconciliations had sign-off dates of April 18, 2018 and April 23, 2018, respectively. As of the end of April, there was no sign-off on the March 2018 reconciliation. Also, we noted the written procedures do not include a timeframe by which the monthly cash reconciliation should be completed. Based on these results and discussions with DTF, ***we recommend DTF update their written procedures to include a reasonable and consistently defined timeframe for completing the monthly cash reconciliation.***

**Management Response:**

DTF will update the written procedures to include a timeframe for completing and reviewing the cash reconciliation. The purpose of this reconciliation is to identify any issues in advance of year-end financial reporting to allow staff time to research and resolve without affecting the year-end audit timeline. Given this purpose and consideration of other controls, management believes the risk of financial misstatement in ETF's annual CAFR is low if this reconciliation is not completed timely. Management has decided to perform this reconciliation quarterly going forward. Experience has shown a quarterly reconciliation will serve the same purpose. While staff will strive to complete the reconciliation timely, because this is not a key control, there may be times when the reconciliation is not completed and/or reviewed within the desired timeframe due to other priorities or staff vacancies.

Responsible Staff: Marilyn Lim

Completion Date: Written procedures updated by July 31, 2018

**Fully Implemented Findings and Observations**

During our initial 2017 audit work, OIA identified two additional findings and two observations that were shared with DTF. These issues, recommendations, and a brief description of the April 2018 follow-up work performed, are documented below to provide a complete disclosure of all recommendations identified in the Cash Reconciliation Process audit. **During our April 2018 follow-up work we determined that all recommendations related to these findings and observations have been fully implemented; therefore, no management response was required.**

Findings

**1. DTF's written procedures for daily and monthly cash reconciliations were incomplete and did not include certain elements of the current process.**

During our initial 2017 audit work, we noted DTF had recently created written procedures for the daily cash reconciliation and noted that the procedures were a work in progress. At the time of our initial audit work, the procedures did not include all steps or reflect recent changes made to the daily cash reconciliation process. DTF had not yet developed written procedures for the monthly cash reconciliation process. Complete and current written procedures are necessary to ensure consistency of the cash reconciliation process and make cross-training of staff more manageable. Without complete and updated written procedures for the cash reconciliation processes, there is increased risk of error and inconsistency. Lack of written procedures may also increase the time necessary for appropriate supervisory review.

**Recommendation from Initial 2017 Audit Work:**

**We recommend that DTF complete and update procedural documentation for daily and monthly cash reconciliation processes.**

**Results from April 2018 Follow-up Audit Work:**

DTF has updated the daily cash reconciliation procedures and created monthly cash reconciliation procedures that adequately reflect the steps followed to perform these reconciliations.

**2. DTF has not resolved a \$2.9 million variance in the monthly cash reconciliation.**

During our initial 2017 audit work we identified a variance of \$2.9 million between ETF and SWIB cash balances, which had been a recurring reconciling item in the monthly cash reconciliation. Due to staff turnover and lack of documentation of accounting system conversion between WiSMART, FMIS, and STAR, DTF was not certain what caused the \$2.9 million variance. DTF had accrued and reversed entries to temporarily correct the \$2.9 million variance for financial reporting. Variances identified in the monthly cash reconciliation should be researched and resolved when possible.

**Recommendation from Initial 2017 Audit Work:**

**We recommend that DTF research the \$2.9 million variance in cash between ETF and SWIB cash balances and resolve the variance.**

**Results from April 2018 Follow-up Audit Work:**

DTF researched the \$2.9 million variance between ETF and SWIB cash balances and determined it resulted from the missing Core Fund “appropriation” chartfield value in the ETF legacy accounting system, WISMART. As a result, when converting data from WISMART to STAR the appropriation chartfield was not populated because it was not in the source data coming from WISMART. In January 2018 DTF processed a journal entry in STAR to reflect the Core Fund appropriation chartfield value for this cash balance. OIA verified the \$2.9 million variance was a conversion issue only and did not have a direct impact on ETF’s actual cash balance. Since the \$2.9 million cash balance is now properly reflected in STAR, it is no longer necessary for DTF to make temporary adjusting entries for financial reporting purposes.

Observations

**1. DTF reported non-ETF timing differences when reporting cash balances to SWIB.**

During our initial 2017 audit work we noted that after the end of each month DTF provides SWIB with a *Cash Reported to SWIB Summary* of ETF cash balances. SWIB then records the change in ETF cash and reports back to ETF with a trial balance. DTF completes a monthly reconciliation to ensure that the SWIB cash balance reconciles with ETF cash balances. DTF receives a monthly file from DOA showing interfund transfers that resulted in timing differences, although the report does not specify which business unit the timing differences relate to. If there are interfund transfer timing differences, ETF should consider them when reporting cash balances to SWIB. It is important that ETF report only ETF cash activity because cash could be double counted if SWIB records the change in cash for non-ETF activity. Because SWIB records the change in cash each month, the risk of cash being double counted will self-correct the next month. Errors made in reporting cash to SWIB will cause temporary variances in DTF’s cash reconciliations and increase the time it takes to complete the cash reconciliations.

**Recommendation from Initial 2017 Audit Work:**

**We recommend that DTF determine the business unit for interfund timing differences and report cash balances and known timing differences for only ETF cash activity to SWIB.**

**Results from April 2018 Follow-up Audit Work:**

DTF has updated its written procedures to include a step to verify interfund timing differences relate to ETF. DTF identifies the ETF business unit by running a STAR query updated to include this chartfield. Therefore, only timing differences for ETF cash activity are being reported in the *Cash Reported to SWIB Summary*.



**2. DTF could improve the efficiency and documentation of the cash reconciliation processes.**

During our initial 2017 audit work we noted some steps taken by DTF to perform the monthly cash reconciliation could be completed in more efficient ways. Controls should be designed efficiently and documented in a way that is complete and easy to follow. Documentation of the monthly cash reconciliation was sometimes incomplete or unclear. As the monthly cash reconciliation process was new, DTF continues to work on improving the process and documentation to be the most efficient.

**Recommendation from Initial 2017 Audit Work:**

**We recommend that DTF take steps to improve the documentation, efficiency, and effectiveness of the cash reconciliations processes. We provided detailed steps DTF could implement to:**

- **improve documentation within reconciliation spreadsheet;**
- **obtain the ETF, SWIB and DOA general ledger data needed for the reconciliation; and**
- **ensure all variances are adequately researched, resolved, and/or reported to SWIB and DOA.**

**Results from April 2018 Follow-up Audit Work:**

DTF has implemented the recommended steps to improve the efficiency and documentation of the monthly cash reconciliation process. For example, DTF has revised the reconciliation spreadsheet to more clearly label column headings, added hyperlinks to other spreadsheets for reconciling items to provide an audit trail back to the original source of the data and added a reconciliation conclusion, where applicable. DTF has developed one STAR query for extracting ETF, SWIB and DOA general ledger data. DTF has also updated procedures to use SWIB general ledger data pulled directly from STAR, and ensure that all identified variances are researched, resolved or reported to SWIB and DOA.

**Conclusion:**

The Office of Internal Audit evaluated DTF's cash reconciliation process. We identified control deficiencies and communicated our findings, observations and recommendations to DTF after we completed our initial audit work in December 2017. In April 2018 OIA performed follow-up work to determine the status of the initial cash reconciliation audit findings and found, except for the monthly cash reconciliation finding, DTF has fully implemented all audit recommendations.