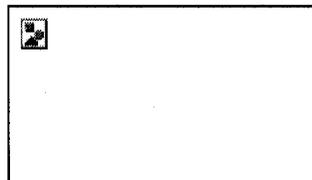


**Compliance Audit of Administration of  
Employee Benefit Program by  
Third Party Administrator**

**Deferred Compensation Program**

**For the Period Beginning January 1, 1997  
Through December 31, 1998**





August 16, 1999

Mr. Eric Stanchfield, Secretary  
Deferred Compensation Board  
c/o Department of Employee Trust Funds  
801 West Badger Road  
Madison, WI 53713

Dear Mr. Stanchfield and Board Members:

We are pleased to report the findings from our engagement with you to review the administration, for the period beginning January 1, 1997 through December 31, 1998, of the State of Wisconsin Deferred Compensation program (WDC) as performed by National Deferred Compensation, Inc. (NDC).

As the third party administrator for the WDC, NDC is responsible for meeting certain performance measures and adhering to the terms of the contract with the State of Wisconsin. Based on our past compliance auditing experience with NDC and discussions with Department of Employee Trust Funds (DETF) personnel, we identified several key performance measures for testing. These performance measures were agreed upon by DETF personnel. Our approach was tailored as follows:

### **Program Administration**

We reviewed the following items relative to NDC's administration of the WDC and compliance with the Administrative Services Only (ASO) contract:

- Adherence to prescribed performance standards.
- Business practices and internal control structure, including review of the Service Auditor Report on the Policies and Procedures Placed in Operation and Tests of Operating Effectiveness (SAS 70 report).
- In conjunction with substantive testing, we reviewed recordkeeping and reporting functions, including billings for administration and adherence to ASO contract fee schedule. We also reviewed investment yield versus third party fund statements as well as banking practices and reconciliations.

As an additional service, we developed and administered a survey/questionnaire to monitor the current level of satisfaction that participants have with NDC and its administration of the WDC. We will be primarily responsible for sending initial and subsequent requests for information and compiling and presenting the results obtained from this procedure. The results of this survey will be published under separate letter to you.

### **Substantive Testing**

We commenced testing of the populations identified below by requesting an electronic data file of all WDC participants during the examination period. From this file provided by NDC, we generated the following random sample populations:

- 25 participants experiencing all of the following:
  - ⇒ 2 or more exchange transactions.
  - ⇒ Change in allocation of deferral dollars.
- 10 participants (five from each year) accessing NDC's Interactive Voice Response (IVR) System.
- 28 participants (14 from each year) receiving withdrawals (payouts) from their account via the following options:
  - ⇒ Lump sum.
  - ⇒ Partial lump sum.
  - ⇒ Periodic payments from an account.
    - Priority option.
    - Assumed interest rate option.
  - ⇒ Annuity options.
  - ⇒ De minimis option.

### **Executive Summary**

The procedures used in testing NDC's adherence to the provisions of the contract are enumerated in the attached report. Additionally, in the attached report, we have also described the results of our tests, significant findings, and our observations relative to NDC's WDC transaction processing. A summary of our procedures and findings is presented below.

*Program Administration* We evaluated NDC's performance relative to the ASO contract with the WDC. Specifically, we assessed NDC's performance relative to established performance standards, reviewed NDC's business practices and SAS 70 reports, and reviewed the recordkeeping and reporting functions specific to the WDC. In general, we found that NDC is administering the WDC effectively by adhering to established performance standards, maintaining an effective internal control environment and accurately recording and reporting WDC transactions.

However, we did identify one area of noncompliance related to NDC's IVR system regarding the production of a weekly audit report. This report was part of the agreed-upon procedures for administration of the IVR. It was designed to detect any errors that might occur in processing the transactions requested through the IVR on NDC's mainframe computer system. It appears that this weekly report did not get placed in to production.

*Data Analysis and Substantive Testing* We requested electronic data directly from NDC's WDC processing system. We selected our sample populations from this data and requested that NDC personnel provide all related files and supporting information for our review. In general, the results of our procedures were positive. We found that NDC adheres to its prescribed WDC processing practices and procedures and that deferrals are processed in accordance with the ASO contract, rules and applicable laws and regulations.

We would like to take this opportunity to recognize the NDC personnel that assisted us during our fieldwork. They were extremely knowledgeable, capable and helpful. Their patience, expertise and preparedness were recognized and greatly appreciated.

Finally, we sincerely appreciate the opportunity to be of service to you, the DETF, the State of Wisconsin and the Deferred Compensation Board. We look forward to discussing any comments or questions that you may have regarding our procedures, results, findings and observations.

Best regards,

GRANT THORNTON LLP

Dean C. Rugotska  
Director

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**State of Wisconsin  
Department of Employee Trust Funds**

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We have performed certain procedures, as discussed below, in evaluating the performance of the Third Party Administrator (TPA) for the WDC for state and local government employees. We applied the procedures enumerated below for the period beginning January 1, 1997 through December 31, 1998.

As described below, we reviewed the policies and procedures of NDC relative to adherence with the Contract with the State of Wisconsin (Contract) for administering the WDC for state and local government employees. Additionally, we also reviewed NDC's performance with respect to compliance with internally developed WDC policies and procedures. Our procedures and findings are presented below.

***I. Background***

The WDC, authorized by s. 40.80, Wis. Stats., and Section 457 of the Internal Revenue Code (IRC), is

generally available to all state and university employees and employees of participating local government employers. Employees classified as Limited Term Employees (LTE's) are excluded per state statutes.

The program has several distinct features:

- The IRC allows participants to defer up to 33-1/3% of annual includible compensation or \$8,000 in 1998 and \$7,500 in 1997 (whichever is less) to a Section 457 deferred compensation program.
- The WDC provides participants with the ability to:
  - ⇒ Change the amount of deferral at any time.
  - ⇒ Redirect deferrals to other investment options on an unlimited basis.
  - ⇒ Exchange account balances from one investment option to another on a daily basis.
- NDC provides:
  - ⇒ A toll-free number to participants for exchanges and account information.
  - ⇒ Same day processing of deposits and exchanges.
  - ⇒ A quarterly statement of account within 30 days of the end of the period.
  - ⇒ An IVR to access account information and effectuate transactions.
- Participants are provided several payout options, including:
  - ⇒ Lump-sum or partial lump-sum distribution.
  - ⇒ Periodic payments from an account.
    - Priority option.
    - Assumed interest rate option.
  - ⇒ Several types of annuity options from a contracted insurance company.
  - ⇒ De minimis option.

The WDC is a supplemental retirement savings program that receives employee deferrals and reinvests investment earnings. The administrative agent, NDC, is responsible for providing the following:

- Technical assistance.
- Program administration.
- Promotional material and forms.
- Marketing and enrollment services.
- Customer services.
- Hardship withdrawals and payout services and counseling.
- Error resolution procedures.
- Annual evaluation of all investment products.
- Recordkeeping and accounting.
- Bank accounts and performance bond.
- Quarterly and monthly reports to the DETF and quarterly reports to participants.
- Asset allocation service (effective February 1, 1998).
- Internet website (available September 1, 1997).

The DETF is primarily responsible for providing the following:

- Assistance to NDC with communication to state employees.
- Salary and wage deductions.
- Approval of promotional materials and investment providers.
- Operating decisions.

- Securing and monitoring the contract with the TPA.

NDC was previously audited by Grant Thornton LLP for ASO contract compliance during the period beginning January 1, 1995 through June 30, 1996 and during the period beginning January 1, 1992 (date of assumption of plan administration) through December 31, 1994.

## *II. Objectives of the Engagement*

The primary objectives of this engagement are described as follows:

1. Determine whether NDC is adhering to the terms of the ASO contract, including established performance standards.
2. Review NDC's business practices and internal control structure relative to the WDC.
3. Determine that NDC is processing deferral transactions accurately and on a timely basis, in compliance with contractual regulations and requirements.
4. Determine that the WDC is being properly charged and credited for deferral processing and contract administration.

## *III. Scope of the Engagement*

The nature of our work with respect to this engagement represents the performance of certain procedures. We applied the procedures described below to certain documents, records and systems at NDC to assist the DETF and the Deferred Compensation Board in connection with monitoring the administration of the WDC. This report covers the program years 1997 and 1998.

## *IV. Procedures Performed*

In order to accomplish the objectives of this engagement, we performed the following procedures:

### **A. Program Administration**

In conjunction with the performance of substantive testing procedures, we also reviewed monthly and quarterly reports prepared for both internal and external reporting purposes. We reviewed this supporting documentation with respect to compliance with the ASO contract and related performance standards as well as NDC's maintenance of an adequate internal control structure.

1. ASO Contract and Performance Standards - We performed substantive testing of individual participant transactions (see IV. B. below) to determine if NDC is operating in accordance with the ASO contract. In conjunction with our substantive testing, we reviewed and randomly tested individual statistics from the quarterly *Performance Standards Report* for each quarter during the period under examination to determine if NDC is achieving the desired success rate with respect to established contract performance standards (i.e., 95% or greater).

2. Business Practices and Internal Control Structure - As noted during the previous compliance audit, NDC maintains proprietary documentation for its processing system. This system documentation appears to be updated continuously. We also reviewed NDC's SAS 70 Reports, as prepared by Deloitte & Touche LLP for 1997 and KPMG for 1998.

Additionally, by conducting our fieldwork at NDC's facility in Columbus, OH, and its service center in Madison, WI, we observed direct application of the policies, procedures and programs for administering the WDC. We also obtained an understanding of the WDC transaction processing system during our fieldwork through substantive testing and inquiry of key NDC personnel responsible for deferred compensation processing.

3. Recordkeeping and Reporting - We tested the clerical accuracy and propriety of various reports and documents prepared by NDC. We also reviewed the propriety, reasonableness and timeliness of the information included in these documents relative to the ASO contract reporting requirements for participants and the DETF.
4. Billings for Administration - We tested billings for administration in conjunction with administrative charge testing. Specifically, we tested administrative processing fees submitted to the DETF for several different months. We recalculated these amounts, noting their propriety with the amounts specified in the ASO contract and the amounts being credited to NDC's bank account. In addition, we verified that reimbursement amounts recorded by NDC on one of the monthly reports to the department and deposited in the bank account agreed to the amounts the investment companies transferred to NDC.
5. Investments - We tested individual participant deferrals and total deferrals for investment in the appropriate investment fund alternatives. By verifying individual participants as a component of a total investment into a fund, we subsequently verified that the total investment was credited to the corresponding fund's investment account statement and charged to NDC's bank statement.
6. Banking Activities - We examined several of NDC's monthly bank statements and related bank reconciliations on a random basis for the program year 1997 and 1998. We examined specific items (transfers, investments out, deferrals in, transfers from the DETF, etc.) related to the WDC program.
7. IVR System - We obtained the transaction audit reports for the period April 1998 through December 1998 for each person in our sample. We then compared the transaction audit report to the participant's year-end statement to ensure that all of the IVR system transactions initiated by the participants in our sample were actually recorded in the system.

## **B. Substantive Testing**

We requested a system generated data file from NDC containing all WDC participants during the period beginning January 1, 1997 through December 31, 1998. From this file, we randomly selected by social security number the following sample populations and provided them to both the DETF and NDC:

- 25 participants experiencing all of the following:
  - ⇒ Two or more exchange transactions.
  - ⇒ Change in allocation of deferral dollars.
- 10 participants (five from each year) accessing NDC's IVR system.
- 28 participants (14 from each year, two per option) receiving withdrawals (payouts) from their account via the following options:

- ⇒ Lump sum.
- ⇒ Partial lump sum.
- ⇒ Periodic payments from an account:
  - Priority option.
  - Assumed interest rate option.
- ⇒ Annuity options.
- ⇒ De minimis option.

For each participant in each population, we randomly selected one particular transaction date for testing. With the assistance of NDC personnel, we reviewed documentation of all the participant's transactions selected in our samples. We tested the samples by applying the following procedures:

1. Enrollment and eligibility - We determined if the employee participating in WDC was properly enrolled in the program by performing the following procedures:
  - a) Examined WDC enrollment information noting the following:
    - (1) Enrollment form appeared complete including proper signatures and approvals.
    - (2) Effective date (i.e., enrollment date) corresponded to the effective date via the system.
    - (3) Effective date appeared to be properly determined based on the guidelines in the program documents. (Effective date will be the first pay date that is at least 31 days after the employee has elected participation, i.e., signed the form).
  - b) Reviewed the NDC administrative system noting the following:
    - (1) Account information for each participant was established within five working days of receipt of the signed application.
    - (2) Deferrals began with the first pay date after 31 days from the date the application was signed.
2. Deferral amount - We determined the propriety of the deferral amount credited to the participant's account through the following steps:
  - a) Corroborated participant deferral amount from NDC's system with deferral amount specified by participant on enrollment form or through an amendment (paper or electronic).
  - b) Noted that total deferrals during the program year under examination are less than \$8,000 in 1998 or \$7,500 in 1997, unless participants have elected to use the Sec. 457 catch-up provision.
  - c) Verified that participant's deferrals were being invested in the appropriate fund (s), as elected by the participant.
  - d) Recalculated and verified that deferral allocations credited to the participant's account were per the participant's instructions.
  - e) Verified that deferral amounts received from the employer are credited to participant accounts within 48 hours (1997) or 24 hours (1998).
  - f) Verified that deferral changes are processed within five working days of receipt of request with an effective date of the first pay date after 31 days from the date of

the request.

- g) Verified that allocation changes are processed within five working days of receipt of request with an effective date of the next payroll deferral.

3. Earnings and withdrawals - We examined each selected participant's account at NDC to determine if earnings and withdrawals were processed properly. The following procedures were performed with respect to earnings and withdrawals:

- a) Recalculated earnings amounts credited and charged to participant accounts, including:

(1) Interest - Examined investment account statement (from third party fund) for interest earned (typically December 31 statement). Noted propriety of the following between the participant's account and the investment account statement:

- Reasonableness of interest rate earned on participant's account versus rate on face of statement.
- Reasonableness of amount credited versus participant account balance (monthly and annual basis).

(2) Dividends - Examined investments account statement (from third party fund) for a month that dividends were earned. Noted propriety of the following between the participant's account and the investment account statement:

- Dividend amount per share.
- Share price and number of shares.
- Date of dividend.
- Document the date the dividend amount was credited to the participant's account to ensure dividends are posted no later than the next business day following the dividend reinvestment date.

(3) Gain/(Loss) - Recalculated and confirmed reasonableness of gain/(loss) on participant account balance as follows:

- Verified number of participant shares by testing deposits (deferrals), earnings, charges (see #4 below), withdrawals and exchanges [see b), c) and d) below] and cross footing total.
- Multiplied total number of shares by ending share price from investment account statement (at December 31) to verify reasonableness of ending account balance - tested ending share price amount by comparing to price listed in *Wall Street Journal*.

- b) Analyzed exchanges among investment options, noting the propriety of the following:

- Value and date of exchange reflected in all affected investment accounts.
- Value of the participant's account remained the same on exchange date.
- Recalculated number of shares, if applicable, in the account shares were transferred to.

- Verified share price, if applicable, on date of exchange with investment account statement from third party.
  - For those participants selecting the asset allocation service, effective February 1, 1998, recalculated participant investment balance percentages to ensure the account is rebalanced to identically match the participant's model portfolio at the time the election is made as well as when it is reviewed on a quarterly basis and determined to be out of balance by 5% or more in any one investment option or asset class.
  - Determined if deferral decisions by participants after an investment option (Twentieth Century Select Fund in 1997 and Twentieth Century Growth Fund in 1998) is removed from the WDC is invested as directed by participants (or rolled into the Vanguard Admiral U.S. Treasury Money Market Fund if the participants failed to provide alternate instructions) in a timely fashion.
- c) Determined if withdrawals were paid appropriately and within the appropriate time requirements based on the type of payment elected by the participant (i.e., lump-sum, partial lump-sum, proportional payments, annuity options, priority option, assumed interest rate option or de minimis option.).
- d) For withdrawals, verified that deferrals were only made up to the age of 70½ (unless the participant is still employed and receiving income). For those participants over age 70½ (who are not employed and receiving income), verified that distribution of assets began by April 1<sup>st</sup> following the year after reaching age 70½. Birthday information was verified upon inspection of enrollment information from procedure #1 above.
4. Administrative charges - Recalculated charges assessed to each selected participant's account as follows:
- a) Traced the administrative fee from the participant statement into a detailed listing of administrative charges by fund.
- b) The total administrative charges by fund were traced and agreed to a monthly summary that is provided to the DETF. To test the system's calculation of the administrative charges:
- Calculated the program's December 31 asset fee percentage by dividing the asset fee from the participant statement by the ending participant asset balance. The resulting percentage was compared to the range of percentages specified in the asset fee arrangement for propriety.
  - Recalculated administrative fees charged to each participant based upon the tiered asset fee schedule (from July 1, 1997 to June 30, 1998 fees were charged as follows: .30% on the \$5,000; .20% between \$5,001 and \$50,000; and .10% over \$50,000; from July 1, 1998 the percentages are .30%, .15% and .05%).
  - We also performed the following procedures:
    - (1) Footed the administrative charge detail listing for each fund and in total.
    - (2) Noted that totals of detailed listings were appropriately reflected in monthly summaries provided to the DETF.

During our substantive testing, we contacted NDC for clarification and additional information relating to our initial findings relative to the samples.

## ***V. Summary of Findings and Observations***

In general, NDC is administering the WDC in accordance with the terms of the ASO contract. NDC also appears to be adhering to the performance standards established in the ASO contract during the period under examination. NDC appears to be administering the WDC utilizing a system of internal controls that are sufficiently documented and updated in a timely manner. As a result of this positive control environment, WDC transactions appear to be processed accurately, timely and in compliance with contractual regulations and requirements.

### **A. Program Administration**

With respect to program administration, we reviewed the following documents:

- ASO contract between the WDC and NDC.
- SAS 70 Reports
- Affirmative Action Plan
- Business Recovery Plan (Disaster Recovery Plan)

We reviewed the items identified below as key business practices of NDC relative to the WDC:

- Monthly bank statements and reconciliations.
- Monthly third party fund statements.
- Quarterly WDC statements submitted to the DETF and participants.
- Billings for administration.

We also tested the IVR system to ensure that changes made by participants via the IVR are actually recorded in the system.

**Observations**

- All reports, statements and reconciliations tested were clerically accurate.
- Summary reports were noted as accurate, helpful and informative when reviewing other source documents (investment account statements, bank statements, etc.).
- Although NDC's SAS 70 report for the period ended December 31, 1998 noted several internal control deficiencies, these findings have been corrected by NDC as disclosed in the SAS 70 report. In addition, we found no errors resulting from these internal control deficiencies during our substantive testing.
- We tested individual participant deferrals and total deferrals for investment in the appropriate investment fund alternatives. By verifying individual participants as a component of a total investment into a fund, we subsequently verified that the total investment was credited to the corresponding fund's investment account statement and charged to the plan's bank statement.
- We examined several monthly bank statements and related bank reconciliations for WDC on a random basis for the program year 1997 and 1998. We examined specific items (transfers, investments out, deferrals in, transfers from the DETF, etc.) related to the WDC. Bank statements did not appear to contain any unusual items or significant balances. Cutoff for purposes of preparing reconciliations appears to be proper; reconciling items are included in and excluded from the appropriate period.
- We compared the transaction audit reports to the year-end summary participant statements for each of the participants in our sample. As a result of our testing, it appears that all of the transactions initiated via the IVR by the participants in our sample have been properly recorded in the system. Although we did not discover any transaction errors related to the IVR system, NDC failed to produce weekly transaction audit reports designed to prevent transaction errors. NDC had agreed to produce these reports on a weekly basis due to a problem that occurred with the IVR system in April 1998. NDC was able to create a year-end transaction audit report for us, but indicated that they had not produced any of these reports on a weekly basis.

In general, we found that NDC is administering the WDC effectively by adhering to established performance standards, maintaining an effective internal control environment and accurately recording and reporting WDC transactions.

Other than not producing weekly IVR transaction audit reports as noted above, there were no negative findings or observations noted during the performance of procedures in this area.

**B. Substantive Testing****Enrollment**

We initiated our testing by requesting enrollment forms from NDC for our sample. In all cases, enrollment was proper and effective. Additionally, all enrolled participants selected appeared to be eligible for participation in the WDC. Generally, submission of deferrals indicates participation eligibility.

**Program Deferrals**

We verified that the amount specified by the employee on their enrollment form or electronically through the IVR system was the amount being credited to the participant's WDC account by NDC. Based upon our review of the enrollment form and transactions recorded in the IVR system, we also verified that the amount being deducted from the participant's payroll appeared to be within the maximum amount allowable under each program (i.e., less than \$8,000 in 1998 or \$7,500 in 1997).

**Earnings and Withdrawals**

We tested the propriety of each of the following credits and charges to each participant's WDC account:

- Interest
- Dividends
- Gain/(loss)
- Exchanges
- Withdrawals

We examined system-generated information from NDC and corroborated it with information from third party fund investment account statements. We also noted that the credits and charges identified above were reported accurately in total on statements sent to the DETF.

Additionally, we noted that all distributions tested were paid in a timely manner, in compliance with ASO requirements.

**Administrative Charges**

For all of the participants selected, we recalculated the charges assessed to their accounts. This included tracing the administrative fee from the participant statement into a detailed listing of administrative charges by fund. We also verified that the administrative fees charged were accurate by recalculating the fee charged based on the tiered asset fee schedule. The total administrative charges were then traced to the monthly summaries provided to the DETF to ensure that all fees were properly charged and accurately reported to the DETF.

In all cases, the administrative charges were properly calculated and reported to the DETF.

**Observations**

Since the majority of information at NDC is maintained principally on its processing system, "quick" transactional analysis by outside parties is difficult and cumbersome without system access.

There were no negative findings or observations noted during the performance of our procedures in this area.

<i>Summary</i>
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In connection with our compliance audit, nothing came to our attention that caused us to believe that NDC failed to comply with the terms of the Contract or state and federal regulations and requirements.

The objectives described above in Section II (*Objectives of the Engagement*) and the procedures described on the preceding pages do not constitute an audit conducted in accordance with generally accepted auditing standards. We do not express an opinion on the financial statements or accounts of NDC. This report relates only to the items and processes specified above and does not extend to any financial statements of NDC taken as a whole.

*Appendix 1*

Department of Employee Trust Funds Response

*Appendix 2*

National Deferred Compensation, Inc. Response