Report 19-17
September 2019

Department of Employee Trust Funds

Calendar Year 2018

State of Wisconsin

Legislative Audit Bureau

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CONTENTS

OPINIONS PUBLISHED SEPARATELY

The financial statements and our opinions on them are found in the Department of Employee Trust Funds' *2018 Comprehensive Annual Financial Report.*

STATE OF WISCONSIN | Legislative Audit Bureau
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Joe Chrisman
State Auditor

September 27, 2019

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94 (1) (dd), Wis. Stats., and as requested by the Department of Employee Trust Funds (ETF), we have completed an audit of ETF's financial statements of 11 separate funds used to account for the financial position and activity of various benefit programs available to state and local government employees, including the Wisconsin Retirement System (WRS). ETF's *2018 Comprehensive Annual Financial Report*, which can be found on its website, includes the statements and our unmodified opinions on them.

The WRS is the largest program administered by ETF. The WRS fiduciary net position, which represents resources available to pay pension benefits, decreased from $104.4 billion as of December 31, 2017, to $96.7 billion as of December 31, 2018, or by 7.3 percent. ETF calculated a net pension liability of $3.6 billion as of December 31, 2018. Under accounting standards, each employer participating in the WRS will be required to report its proportionate share of the net pension liability on its financial statements if prepared on the basis of generally accepted accounting principles. To assist employers with this reporting, ETF prepared employer schedules. We audited and provided unmodified opinions on these schedules in report 19-18.

ETF calculated a net OPEB liability of $431.5 million for the State Retiree Life Insurance program and a net OPEB liability of $258.0 million for the Local Retiree Life Insurance program. Other postemployment benefits (OPEB) refer to the benefits, other than pensions, that a state or local government employee may receive after they have left employment, generally upon retirement. Under accounting standards, each employer participating in an OPEB program is required to report its proportionate share of the net OPEB liability on its financial statements if prepared on the basis of generally accepted accounting principles. To assist employers with this reporting, ETF prepared employer schedules. We audited and provided unmodified opinions on these schedules in reports 19-19 and 19-20.

We appreciate the courtesy and cooperation extended to us by ETF staff during the audit. A response from ETF follows the appendices.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/CS/ss

Introduction

ETF administers employee benefit programs for participating state and local government employees.

The Department of Employee Trust Funds (ETF) administers employee benefit programs for participating state and local government employees. These programs include the Wisconsin Retirement System (WRS) and health and life insurance programs for active and retired employees of the State and participating local governments. ETF reports the financial activity of programs it administers in financial statements that are included in its Comprehensive Annual Financial Report (CAFR). These financial statements are prepared by ETF using generally accepted accounting principles (GAAP) prescribed by the Governmental Accounting Standards Board (GASB).

ETF administers the eight benefit programs shown in Table 1.

Table 1

Programs Administered by ETF

Program	Description
Retirement	
WRS	The WRS provides post-retirement financial benefits to participating employees, as well as disability and death benefits to participants and their beneficiaries. As of December 31, 2018, the WRS had 1,507 participating employers and a total membership of 641,892. Total membership includes 257,911 active participants, 209,059 retired participants or their beneficiaries who were receiving WRS benefits, and 174,922 inactive participants.
Milwaukee Retirement Systems	The Milwaukee Retirement Systems invests other retirement systems' funds with the WRS. Currently, the Milwaukee Retirement System invests funds from two Milwaukee Public Schools Supplemental Retirement Plans.
Disability	
Duty Disability Insurance	This program offers special disability benefits to protective occupation members in the WRS, such as police officers, firefighters, and correctional officers. As of December 31, 2018, this program was providing benefits to approximately 1,000 disabled members or their beneficiaries.
Income Continuation Insurance	This program offers short-term and long-term disability benefits for employees of the State of Wisconsin, including those employed by state agencies and authorities such as the University of Wisconsin (UW) Hospitals and Clinics Authority, and local governments. During 2018, benefits were provided to approximately 2,600 participants.
Health and Life	
Group Health Insurance[1]	This program offers health insurance coverage, including medical, pharmacy, and dental benefits, to active and retired employees of the State of Wisconsin, including those employed by state agencies and authorities such as the UW Hospitals and Clinics Authority, and local governments. Approximately 80,000 active employees and 26,900 retired employees were participating in the program as of December 31, 2018.
Group Life Insurance[2]	This program offers group life insurance coverage for active and retired employees of the State of Wisconsin, including those employed by state agencies and authorities such as UW Hospitals and Clinics Authority, and 719 local governments.
Other	
Accumulated Sick Leave Conversion Credits	This program provides for the conversion of the value of unused sick leave at the time of retirement into an account to be used to pay for post-retirement health insurance for retired employees of the State of Wisconsin, including those employed by state agencies and authorities such as the UW Hospitals and Clinics Authority. As of December 31, 2018, approximately 17,200 retired employees and others were using these credits.
Employee Reimbursement Accounts and Commuter Benefits	This program offers employees of the State pre-tax payroll deductions that are credited to an account for the reimbursement of qualifying medical costs, dependent care costs, and transportation expenses, such as bus passes, parking, and other transit costs. In 2018, approximately 20,100 employees had a medical account, 3,600 employees had a dependent care account, and 3,000 employees had a commuter benefit account.

[1] Includes the Health Insurance, State Retiree Health Insurance, and Local Retiree Health Insurance funds.

[2] Includes the Life Insurance (not presented in the 2018 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

ETF Administration

The ETF Secretary and the governing boards oversee the administration of the programs reported in ETF's CAFR. The programs are administered by ETF using the services provided by multiple entities, including third-party administrators, actuaries, and the State of Wisconsin Investment Board (SWIB).

The ETF Board is responsible for the overall direction and oversight of ETF.

Under s. 40.03, Wis. Stats., the 13-member ETF Board is responsible for the overall direction and oversight of ETF. Statutes specifically identify that, among other items, the ETF Board is responsible for:

- appointing the Secretary of ETF;
- selecting and retaining an actuary to perform all necessary actuarial services for benefit programs administered by ETF; and
- approving the contribution rates and actuarial assumptions determined by the actuary.

The 2019 ETF Board members are shown in Appendix 1 and include:

- the Governor, or the Governor's designee on the Group Insurance Board;
- the Administrator of the Division of Personnel Management in the Department of Administration (DOA), or designee;
- four members of the Teachers Retirement Board;
- four members of the Wisconsin Retirement Board;
- one member nominated by the Governor and appointed with the advice and consent of the Senate, as a public representative, who is not a member of the WRS but has at least five years of actuarial, insurance, or employee benefits plan experience;
- one annuitant elected by retired WRS participants; and
- one active WRS participant who must be either a technical college or school district educational support personnel employee, elected by participating employees who meet the same employment criteria.

Although the ETF Board is the overall governing body for ETF, the 13-member Teachers Retirement Board and the 9-member Wisconsin Retirement Board each serve in an advisory role on issues related to the WRS. The members of the Teachers Retirement Board and the Wisconsin Retirement Board represent state and local government employers, employees, annuitants, and the general public.

The Group Insurance Board oversees certain benefit programs.

In addition to the ETF Board, the 11-member Group Insurance Board is responsible for setting policies and overseeing administration of the Group Health Insurance, Group Life Insurance, Employee Reimbursement Accounts and Commuter Benefits, and the Income Continuation Insurance programs. In February 2019, we completed an evaluation of the oversight provided by the Group Insurance Board as report 19-2. The 2019 Group Insurance Board members are shown in Appendix 2 and include:

- the Governor, or designee;
- the Administrator of the Division of Personnel Management in DOA, or designee;
- the Attorney General, or designee;
- the Secretary of DOA, or designee;
- the Commissioner of Insurance, or designee;
- a member appointed by the Governor;
- an insured participant in the WRS who is a teacher and is appointed by the Governor;
- an insured participant in the WRS who is not a teacher and is appointed by the Governor;
- an insured participant in the WRS who is a retired employee and is appointed by the Governor;
- an insured participant who is an employee of a local unit of government and is appointed by the Governor; and
- the chief executive or member of the governing body of a local unit of government that is a participating employer in the WRS and is appointed by the Governor.

Table 2 shows the programs that ETF administered and the board that had authority over the policies and administration of each program, as of December 31, 2018.

Table 2

ETF Board and Group Insurance Board Authority, by Program
As of December 31, 2018

Program	ETF Board	Group Insurance Board
Wisconsin Retirement System	✓	
Milwaukee Retirement Systems	✓	
Duty Disability Insurance	✓	
Income Continuation Insurance		✓[1]
Group Health Insurance[2]		✓
Group Life Insurance[3]		✓
Accumulated Sick Leave Conversion Credits	✓	
Employee Reimbursement Accounts and Commuter Benefits		✓

[1] At its February 8, 2017 meeting, the Group Insurance Board approved moving the authority of this program to the ETF Board. However, current statutes have not been modified to permit this change.

[2] Includes the Health Insurance, State Retiree Health Insurance, and Local Retiree Health Insurance funds.

[3] Includes the Life Insurance (not presented in the 2018 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

Third-party administrators are used to help administer several of the benefit programs.

The Secretary of ETF is charged with implementing the policies approved by each of the boards, and with managing the daily operations of ETF. Each program administered by ETF has its own unique requirements related to eligibility, contributions, benefit payment determination, and reporting. As of July 1, 2019, ETF was authorized 274.20 full-time equivalent positions. In addition, ETF uses third-party administrators to perform administrative functions for certain benefit programs, such as determining participant eligibility, processing participant claims, and making benefit payments to participants. For example, ETF uses a third-party administrator to determine eligibility for and pay benefits to participants in the Income Continuation Insurance program.

ETF uses actuaries to perform actuarial calculations for several benefit programs.

ETF also uses actuaries to perform actuarial calculations for several benefit programs it administers. Although the role of the actuary for each program varies due to the different program requirements, the duties generally include performing calculations to project future benefit payments, determining a liability for costs that have been incurred but not reported, and comparing these liabilities against the projected assets that will be available. In addition, the actuaries may recommend changes to contribution rates intended to increase or decrease contribution revenues that provide future assets to fund projected liabilities.

As shown in Table 3, third-party administrators were used for four of the eight benefit programs and actuaries were used for six of the eight programs, as of December 31, 2018.

Table 3

ETF's Use of Third-Party Administrators and Actuaries, by Program
As of December 31, 2018

Program	Third-Party Administrator	Actuary
Wisconsin Retirement System		✓
Milwaukee Retirement Systems		
Duty Disability Insurance		✓
Income Continuation Insurance	✓	✓
Group Health Insurance[1]	✓	✓
Group Life Insurance[2]	✓	✓
Accumulated Sick Leave Conversion Credits		✓
Employee Reimbursement Accounts and Commuter Benefits	✓	

[1] Includes the Health Insurance, State Retiree Health Insurance, and Local Retiree Health Insurance funds.

[2] Includes the Life Insurance (not presented in the 2018 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

With the exception of group life insurance assets, which were held by the third-party administrator, the assets of the programs were invested by SWIB in one or more of the following funds: Core Retirement Investment Trust Fund (Core Fund), Variable Retirement Investment Trust Fund (Variable Fund), or the State Investment Fund (SIF), as shown in Table 4.

Table 4

Investments, by Program
As of December 31, 2018

Program	Core Fund [1]	Variable Fund [1]	State Investment Fund	Third-Party Administrator
Wisconsin Retirement System	✓	✓		
Milwaukee Retirement Systems	✓	✓		
Duty Disability Insurance	✓			
Income Continuation Insurance	✓			
Group Health Insurance[2]	✓			
Group Life Insurance[3]				✓
Accumulated Sick Leave Conversion Credits	✓			
Employee Reimbursement Accounts and Commuter Benefits			✓	

[1] Excess cash of the Core Fund and Variable Fund are invested in the State Investment Fund.

[2] Includes the Health Insurance, State Retiree Health Insurance, and Local Retiree Health Insurance funds.

[3] Includes the Life Insurance (not presented in the 2018 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

Assets of the benefit programs were invested in different funds.

The Core Fund is a fully diversified fund, or balanced fund, which provides less volatile investment returns and is invested for the long term in several types of investments. The Variable Fund is an equity fund, or stock fund, which provides returns that are typically more volatile than the Core Fund. The SIF invests the excess operating funds of the State and local governments with the objective of providing liquidity, safety of principal, and competitive rates of return. Report 19-15 provides more information about the investment performance and financial condition of the Core Fund and Variable Fund as of December 31, 2018, and report 18-17 provides similar information for the SIF as of June 30, 2018.

Investment income or loss of the Core Fund and the Variable Fund is allocated to each benefit program invested in these funds.

For financial reporting, ETF allocates the fair value of the investment income or loss to each program that participates in the Core Fund. Investment income or loss is allocated from the Core Fund to the Milwaukee Retirement Systems on a monthly basis based upon the Milwaukee Retirement Systems' relative share of the Core Fund and the monthly change in the fair value of the Core Fund. Investment income or loss is allocated to the remaining programs in the Core Fund based on each program's average annual balance to the total average annual balance of all participating programs in the Core Fund. ETF calculates the average annual balance using the beginning-of-year net asset balance and end-of-year net asset balance for each program. Investment income or loss of the Variable Fund is allocated to the

Milwaukee Retirement Systems on a monthly basis based upon the Milwaukee Retirement Systems' relative share of the Variable Fund and the monthly change in the fair value of the Variable Fund. Each program's share of the $3.6 billion investment loss in the Core Fund and the $602.9 million investment loss for the Variable Fund for the year ended December 31, 2018, is shown in Table 5.

Table 5

Core Fund and Variable Fund Investment Loss Allocation, at Fair Value
For the Year Ended December 31, 2018
(in millions)

Program	Core Fund Investment Loss	Variable Fund Investment Loss
Wisconsin Retirement System	$3,448.8	$601.6
Milwaukee Retirement Systems	6.4	1.3
Duty Disability Insurance	23.6	
Income Continuation Insurance	3.9	
Group Health Insurance[1]	8.9	
Accumulated Sick Leave Conversion Credits	93.7	
Total	**$3,585.3**	**$602.9**

[1] Includes the Health Insurance, State Retiree Health Insurance, and Local Retiree Health Insurance funds.

The Employee Reimbursement Accounts and Commuter Benefits program reported investment income totaling $117,189 from the SIF for the year ended December 31, 2018.

Benefits Administration System

ETF and the vendor hired to develop the Benefits Administration System have been in a contract dispute since March 2018.

In 2010, ETF completed a business risk-assessment process that highlighted the need to replace its legacy systems and began an initiative to modernize the administration of the benefit programs. One component of this modernization project was the development of the Benefits Administration System (BAS), which began in 2014 and was expected to be implemented in three phases over several years. The first phase of the project, which replaced ETF's imaging, workflow, and document management systems, was implemented in November 2015. Work on the remaining phases of the project stopped in March 2018 due to a contract dispute. ETF and the vendor were unable to resolve the dispute and, in March 2019, ETF filed a complaint in Dane County Circuit Court for damages suffered as a result of the contractor failing to fulfill the contract. The contractor subsequently filed a counterclaim in June 2019. Both lawsuits are pending.

ETF reports annually to the Legislature's Joint Committee on Finance and the Secretary of the Department of Administration on the status of its progress in modernizing its business processes and integrating its information technology systems. On June 28, 2019, ETF reported that it had conducted an analysis to determine options for moving forward with its modernization efforts. ETF indicated its first project will be replacing the imaging, workflow, and document management systems. According to ETF, because these proprietary systems are no longer supported, it has begun efforts to replace them with a system that will be able to integrate with future administration systems.

Through December 31, 2017, ETF expended and recorded as a capital asset $33.1 million for the development of BAS.

ETF administrative costs, including costs related to the development of BAS, are funded through revenues collected from each benefit program. Through December 31, 2017, ETF expended and recorded as a capital asset $33.1 million for the development of BAS, including $8.9 million for the imaging, workflow, and document management systems that will require replacement. Each benefit program, except the Milwaukee Retirement Systems, was allocated a portion of these expenses based on ETF's methodology for allocating administrative costs. Similarly, these programs will be expected to fund costs associated with the replacement systems and the development of any future administration systems.

The information systems scheduled to be replaced with BAS continue to age and present risks for ETF to manage. ETF will need to continue to maintain these older systems to ensure effective administration of each benefit program.

Audit Results

As required by statutes, we have completed an audit of the financial statements and related notes of the 11 funds reported in ETF's separately issued CAFR as of and for the year ended December 31, 2018. The financial statements presented in ETF's CAFR include information related to the contributions, benefits, and investment income or loss of each program. The contribution and benefit requirements differ among the programs and are established by statute, administrative code, and board decisions. In addition, various tax laws may affect the administration of a program and the amount of contributions that may be collected or the benefits that may be provided.

We provided unmodified opinions on the financial statements of programs administered by ETF for the year ended December 31, 2018.

To complete our audit of the financial statements, we reviewed ETF's internal controls over financial reporting, tested financial transactions, and reviewed the financial statements, notes, and required supplementary information that were prepared by ETF management. In addition to providing unmodified opinions on the financial statements and related notes as of and for the year ended December 31, 2018, we have issued our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 35. As discussed in this report, our consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. During our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

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Wisconsin Retirement System

The WRS is a cost-sharing, multiple-employer, defined-benefit pension plan.

Created in January 1982, the WRS is a cost-sharing, multiple-employer, defined-benefit pension plan that provides post-retirement financial benefits to participating employees, as well as disability and death benefits to participants and their beneficiaries. Further, the WRS is an irrevocable trust and all funds remain in the trust and can only be used to fund pension benefits.

As of December 31, 2018, 641,892 individuals participated in the WRS, including:

- 257,911 (40.2 percent) active participants who were making contributions;
- 209,059 (32.6 percent) retired participants or their beneficiaries who were receiving WRS benefits; and
- 174,922 (27.2 percent) inactive participants, such as former employees, who were not yet receiving benefits and who were not required to make contributions.

ETF and SWIB work together to manage the WRS.

The WRS is one of the 10 largest public pension plans in the United States. As of December 31, 2018, the WRS had a fiduciary net position of $96.7 billion, which represents resources available to pay pension benefits. ETF is responsible for managing the operations of the WRS that interact with employers and participants, including collecting contributions from and paying retirement benefits to WRS participants. SWIB is responsible for managing WRS investments. ETF and SWIB work closely together to ensure the solvency and long-term future of the WRS. We evaluate SWIB's management of investments on a biennial basis. Our most recent management audit report (report 18-19) was published in December 2018.

WRS Participating Employers

Section 40.21, Wis. Stats., allows any Wisconsin public employer to participate in the WRS, but statutes require certain entities to participate, including state agencies and all counties except Milwaukee County, which maintains its own retirement system. In addition:

- second-, third-, and fourth-class cities must allow police officers and paid firefighters to participate if those employees were allowed to participate in Wisconsin's retirement system before March 31, 1978;
- villages with a population of 5,000 or more must allow police officers to participate, and villages with a population of 5,500 or more must also allow paid firefighters to participate, if those employees were allowed to participate in Wisconsin's retirement system before March 31, 1978; and
- school districts must allow employees in teaching positions to participate.

As of December 31, 2018, 1,507 employers were participating in the WRS.

As shown in Table 6 most of the 1,507 employers that participated in the WRS as of December 31, 2018, were local governments and school districts.

Table 6

Types of Employers Participating in the WRS
As of December 31, 2018

Type	Number
School Districts	422
Villages	271
Towns	265
Special Districts[1]	206
Cities	188
Counties	71
State Agencies, UW System, and Public Authorities	56
Wisconsin Technical College System Districts	16
Cooperative Educational Service Agencies	12
Total Employers	**1,507**

[1] Includes employers such as the Madison Metropolitan Sewerage District, the Oshkosh City Housing Authority, and the South Central Library System.

Under current law, any employee of a participating WRS employer is eligible to participate in the WRS if the expected duration of employment is one year or more and the employee is expected to be employed for at least two-thirds of what is considered full-time. Current statutes require five years of service before such an employee is considered vested.

WRS Funding

The WRS is funded through a combination of employer and employee contributions and investment earnings.

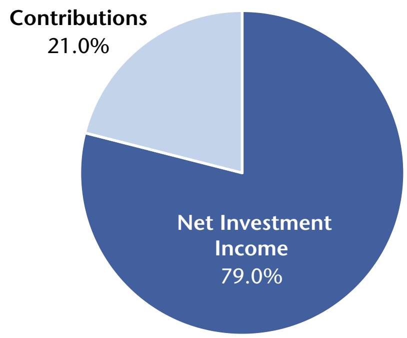
The WRS is funded through annual employer and employee contributions and investment earnings. The ETF Board has established a WRS funding policy with three primary goals:

- ensure funds are adequate to pay benefits;
- maintain stable and predictable contribution rates for employers and employees; and
- maintain inter-generational equity to ensure the cost of the benefits is paid for by the generation that receives the benefits.

From 2009 through 2018, net investment income, represented 79.0 percent of total funding for the WRS. Employer and employee contributions represented 21.0 percent of total funding for the WRS, as shown in Figure 1.

Figure 1

WRS Funding Sources
2009 through 2018



Net investment income decreased from a gain of $14.9 billion in 2017 to a loss of $4.1 billion in 2018.

Net investment income, which is the sum of realized and unrealized gains and losses less SWIB's investment expenses and amounts distributed to other benefit programs, decreased by $19.0 billion or 127.2 percent from a gain of $14.9 billion in 2017 to a loss of $4.1 billion in 2018. The decrease in net investment income reflects the decrease in investment returns of the Core Fund and the Variable Fund. The gross investment return (gross of management fees) of the Core Fund decreased from a gain of 16.2 percent in 2017 to a loss of 3.3 percent in 2018, and the gross investment return of the Variable Fund decreased from a gain of 23.2 percent in 2017 to a loss of 7.9 percent in 2018.

The long-term expected rate of return assumption for the WRS was decreased from 7.2 percent to 7.0 percent effective for the December 31, 2018 actuarial valuation.

As noted, WRS assets are invested by SWIB in the Core Fund and Variable Fund. SWIB has a fiduciary responsibility to prudently invest the pension assets in a diversified manner to meet WRS funding needs while minimizing the risk of large losses. SWIB's investment strategy is to meet the long-term expected rate of return assumption. From 2011 through 2018, the return assumption was 7.2 percent. The ETF Board approved a decrease in the long-term expected rate of return assumption to 7.0 percent for the December 31, 2018 actuarial valuation.

As of December 31, 2018, SWIB's 20-year return for the Core Fund, net of management fees was 6.0 percent, which is less than the long-term expected rate of return assumption of 7.0 percent. As of December 31, 2018, SWIB's 30-year return for the Core Fund, net of management fees, was 8.3 percent.

Contribution rates, which include both an employer and an employee share, are actuarially determined as a percentage of an employee's earnings and are approved annually by the ETF Board. Contributions to the WRS from employers and employees increased by $20.4 million or 1.0 percent to $2.0 billion in 2018. As shown in Table 7, total contribution rates for "general employees," which include teachers and most other employees, ranged from a low of 11.6 percent for 2011 to a high of 14.0 percent for 2014.

Table 7

Total Contribution Rates for General Employees in the WRS

Calendar Year	Total Contribution Rate[1]
2011	11.6
2012	11.8
2013	13.3
2014	14.0
2015	13.6
2016	13.2
2017	13.6
2018	13.4
2019	13.1
2020	13.5

[1] Includes both the employer share and the employee share of contributions and benefit adjustment contributions, but does not include prior-service cost rates for specific employers.

The basic objective of the WRS is to invest contributions so that investment income and the contributions will be sufficient to pay projected future pension benefits.

The basic objective of the WRS is to invest contributions paid by employers and employees so that the investment income and the contributions will be sufficient to pay projected future pension benefits. Contribution rates are set to fund the benefits earned by employees during the year. In setting these rates, one of the most significant factors considered is investment performance.

In order to maintain steady contribution rates and comply with s. 40.04 (3) (am), Wis. Stats., the consulting actuary for the WRS uses the market recognition account (MRA) to smooth investment income or loss for the Core Fund investment activity over a five-year period. The MRA accumulates the difference between actual investment income or loss and expected investment income calculated at the long-term expected rate of return assumption of 7.0 percent. The difference is then distributed into the calculated plan net assets over a five-year period so that the expected investment income is affected by portions of the previous five years' amounts included in the MRA. This results in less volatility in net assets and, thus, less volatility in the calculation of the contribution rates for employers and employees.

ETF uses the market recognition account to smooth investment income or loss and to help maintain steady contribution rates.

Because of the use of the MRA, investment income or loss used for purposes of determining contribution rates differs from the investment income or loss recognized on the financial statements. For instance, the investment loss of the Core Fund for 2018 for finanical reporting, was $3.6 billion based upon the fair value of the investments, of which the WRS's share was a loss of $3.4 billion. Taking into consideration the smoothing mechanism employed through the MRA, the actuary recognized an investment income amount of $4.6 billion. This amount was used in determining the actuarial value of the WRS assets as of December 31, 2018, and determining contribution rates for 2020.

WRS Benefits

The WRS is a defined-benefit plan that provides participants with lifelong monthly retirement benefits and, depending upon the annuity type selected, may also provide benefits to a beneficiary after the participant's death. These benefits are initially determined by either a formula, which is based on the participant's years of service and final average salary, or a money purchase benefit, which is based on the participant's contributions, an employer's matching contributions, and investment income. The method that yields the largest benefit payment is used to calculate a participant's initial benefit. This benefit may be increased or decreased based on the investment performance of the retirement fund assets, in addition to other actuarial experience, but would generally not be adjusted below the initial benefit amount. A defined-benefit plan is in contrast to a defined-contribution plan, such as a 401(k) plan, in which benefits are based on the amounts contributed to a participant's account and investment gains or losses on those funds.

The average annual annuity paid increased from $25,181 in 2017 to $25,893 in 2018, or by 2.8 percent.

Total WRS benefit payments provided to retired participants or their beneficiaries increased from $5.2 billion in 2017 to $5.5 billion in 2018, or by 5.9 percent. The number of retired participants increased from 203,300 as of December 31, 2017, to 209,059 as of December 31, 2018. The average annual annuity paid increased from $25,181 in 2017 to $25,893 in 2018, or by 2.8 percent.

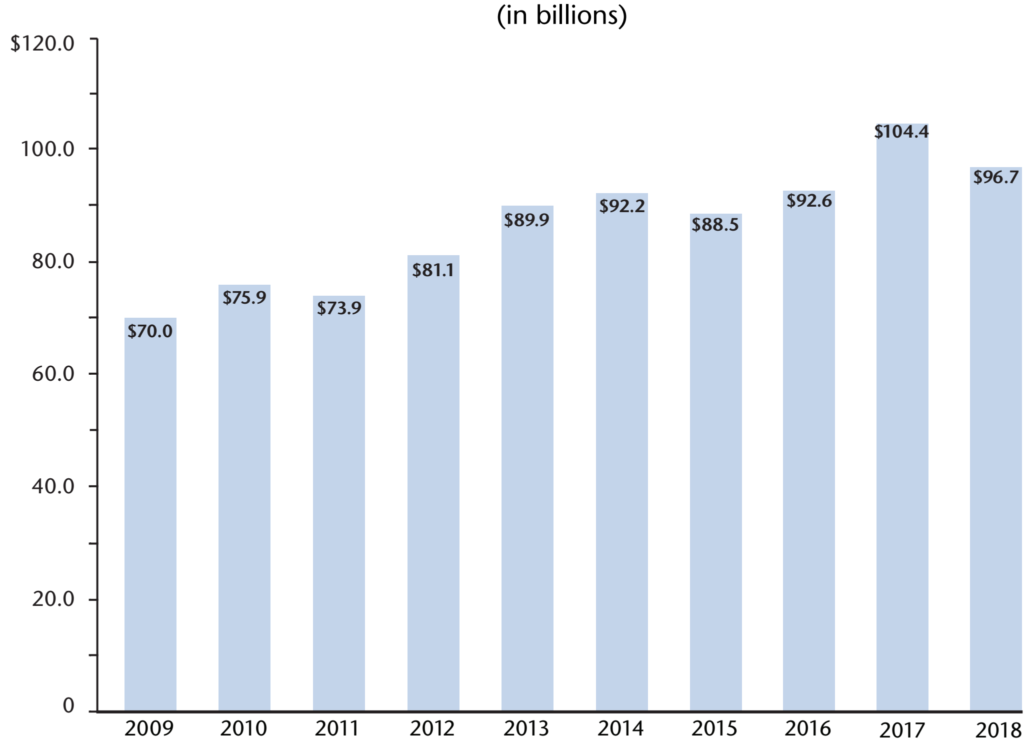
Financial Condition of the WRS

As of December 31, 2018, the fiduciary net position of the WRS was $96.7 billion.

The Net Position Restricted for Pensions (fiduciary net position) of the WRS represents the value of the plan's assets that are available to meet benefit obligations as they become due. As of December 31, 2018, the WRS had a fiduciary net position of $96.7 billion, which was a 7.3 percent decrease from the prior year. This decrease is primarily attributed to a decrease in the fair value of investments as of December 31, 2018. From December 31, 2009, through December 31, 2018, the fiduciary net position of the WRS increased by $26.7 billion, or by 38.2 percent, as shown in Figure 2.

Figure 2

Wisconsin Retirement System
Fiduciary Net Position[1]
As of December 31
(in billions)



[1] Shown as Net Position Restricted for Pensions on the financial statements.

WRS Accounts and Reserves

The fiduciary net position of the WRS primarily consists of three statutorily required reserves.

The fiduciary net position of the WRS primarily consists of three statutorily required reserves: the employee accumulation reserve, the employer accumulation reserve, and the annuity reserve. The employee accumulation reserve consists of employee required contributions, contributions paid by the employer on behalf of the employee, any voluntary additional contributions, and investment earnings. A separate account is maintained in this reserve for each WRS participant. If a participant leaves state service before being eligible to receive a retirement benefit, the participant can receive the balance of the contributions and earnings included in the account.

The employer accumulation reserve consists of all employer-required contributions, amounts to amortize the employer's share of the unfunded accrued liabilities, and investment earnings. Unlike the employee accumulation reserve, the employer accumulation reserve is pooled into one account. Contribution rates are set to fund the benefits earned by employees during the year based, in part, on the balances of the employee accumulation reserve and the employer accumulation reserve.

Amounts are transferred into the annuity reserve to meet future benefit obligations.

The annuity reserve consists of the amounts transferred from the employee accumulation reserve and the employer accumulation reserve. Based upon the number of WRS participants and beneficiaries of participants that began to receive benefits in the past year, the actuaries determine the amount to transfer to the annuity reserve. The actuarially determined transfer amount is calculated based upon the present value of expected benefit payments. During 2018, the total amount transferred into the annuity reserve for the benefits expected to be provided to approximately 10,000 participants was $3.7 billion, including adjustments for prior-year transfers.

The annuity reserve was $60.2 billion as of December 31, 2018, and represented the largest share of the WRS fiduciary net position.

The remaining fiduciary net position of the WRS is primarily in the MRA to account for earnings that have not been distributed, and smaller amounts maintained in other administrative accounts. As shown in Table 8, the $60.2 billion annuity reserve represented the largest share (62.3 percent) of the WRS fiduciary net position as of December 31, 2018.

Table 8

WRS Reserve and Account Balances
As of December 31, 2018
(in millions)

Reserve/Account	Balance	Percentage of Total
Employee Accumulation Reserve	$18,456.3	19.1%
Employer Accumulation Reserve	22,728.9	23.5
Annuity Reserve	60,236.0	62.3
Market Recognition Account[1]	(4,729.3)	(4.9)
Other[2]	45.1	<1
Total WRS Fiduciary Net Position	**$96,737.1**	

[1] The balance in this account will fluctuate based on investment performance. A negative balance represents investment losses that will be allocated in future years.

[2] Includes accounts that hold undistributed amounts for investments that have not yet been allocated and other administrative accounts.

Since 2009, the annuity reserve balance has increased by $20.5 billion, or 51.6 percent.

The employee accumulation reserve, the employer accumulation reserve, and the annuity reserve work together to ensure the WRS is accumulating sufficient assets to meet future benefit obligations as they become due. Since 2009, the annuity reserve balance has increased by $20.5 billion, or 51.6 percent, largely because the number of participants receiving benefits increased from 150,671 to 209,059. From 2009 to 2018, the employee accumulation reserve balance increased and the employer accumulation reserve balance decreased, as shown in Table 9.

Table 9

WRS Reserve and Account Balances
(in millions)

Reserve/Account	December 31, 2009	December 31, 2018	Increase (Decrease)	Percentage Increase (Decrease)
Employee Accumulation Reserve	$16,152.5	$18,456.3	$ 2,303.8	14.3%
Employer Accumulation Reserve	23,059.3	22,728.9	(330.4)	(1.4)
Annuity Reserve	39,731.6	60,236.0	20,504.4	51.6
Market Recognition Account[1]	(9,040.8)	(4,729.3)	4,311.5	47.7
Other[2]	93.7	45.1	(48.6)	(51.9)
Total WRS Fiduciary Net Position	**$69,996.3**	**$96,737.1**	**$26,740.8**	38.2

[1] The balance in this account will fluctuate based on investment performance. A negative balance represents investment losses that will be allocated in future years.

[2] Includes accounts that hold undistributed amounts for investments that have not yet been allocated and other administrative accounts.

A number of factors affect the balance in the employee accumulation reserve and the employer accumulation reserve, including the amounts transferred to the annuity reserve, contributions received from the employee and the employer for active employees, and investment earnings. From December 2009 to December 2018, the number of active and inactive participants increased from 415,646 to 432,833. The balance in the MRA, which represents investment losses that will be allocated in future years, was a negative $4.7 billion as of December 31, 2018. The MRA balance fluctuates based on investment performance, and was positive, representing investment gains, in two of the last five years.

Pension Accounting Standards

Accounting standards for public pension plans establish accounting and financial reporting requirements for measuring the pension liability, as well as requirements for both the notes and required supplementary information to the WRS financial statements, and the GAAP-based financial statements of the 1,507 employers that participate in the plan. The accounting standards require ETF to calculate the total pension liability and the net pension liability or asset for the WRS. Each of the participating employers in the WRS reports its proportionate share of this net pension liability or asset in its own financial statements if prepared under GAAP.

Calculating the Total Pension Liability

The total pension liability is the sum of the amounts needed to pay for the pension benefits earned by each participant.

The total pension liability for the WRS is the sum of the amounts needed to pay for the pension benefits earned by each participant based on service provided as of the date the actuarial valuation is performed. A total pension liability exists because the employers participating in the WRS have committed to provide benefits to their employees in the future when those employees retire. That commitment is part of employee compensation and constitutes a liability.

The calculation of the total pension liability is complex and includes various actuarial assumptions and calculations, such as:

- a projection of future benefit payments for current and former participants and their beneficiaries based upon the current terms of the WRS;
- a discount of those payments to their present value, or the amount of funds currently needed to provide the projected payments in the future; and
- an allocation of the present value of benefit payments over past, present, and future periods of employee service.

The total pension liability for the WRS was $100.3 billion as of December 31, 2018.

To determine the total pension liability for the WRS as of December 31, 2018, ETF's actuary performed an actuarial valuation as of December 31, 2017, and adjusted for changes in assumptions, interest earned, contributions paid, benefits paid and dividend adjustments during 2018. The total pension liability for the WRS was $100.3 billion as of December 31, 2018.

The discount rate can have a significant effect on the amount of the total pension liability.

The discount rate is a critical factor in calculating a pension plan liability, and it can have a significant effect on the amount of the total pension liability. The discount rate, or interest rate, is used to calculate the present value of projected benefit payments and is specifically defined under the accounting standards. ETF used the long-term expected rate of return assumption for the WRS, which is 7.0 percent, as the discount rate because current and projected future plan assets are expected to cover the projected benefit payments for the WRS. Increasing or decreasing the discount rate can have a significant effect on the total pension liability. For instance, a one percentage point decrease in the discount rate (6.0 percent) would increase the total pension liability to $110.9 billion.

Calculating a Net Pension Liability or Asset

To determine the net pension liability or asset, the accounting standards require the total pension liability to be subtracted from the pension plan's fiduciary net position. When the total pension liability is greater than the fiduciary net position, the pension plan will disclose a net pension liability in its notes. When the fiduciary net position is greater than the total pension liability, the pension plan will disclose a net pension asset in its notes.

ETF reported a net pension liability of $3.6 billion for the WRS as of December 31, 2018.

As of December 31, 2018, the WRS had a fiduciary net position of $96.7 billion and a total pension liability of $100.3 billion, which resulted in a net pension liability of $3.6 billion. A net pension liability indicates that, as of December 31, 2018, the assets of the WRS were not sufficient to cover the projected liability for benefit payments to employees under the financial reporting standards. This represents a decrease from the net pension asset of $3.0 billion, reported as of December 31, 2017. A decrease in the value of the investments of the Core Fund and the Variable Fund from December 31, 2017, to December 31, 2018, was the primary cause of the $7.7 billion decrease in the fiduciary net position and resulted in the reporting of a net pension liability as of December 31, 2018.

As shown in Table 10, the WRS has reported a net pension liability in three of the past five years. The fluctuation between a net pension liability and a net pension asset is largely associated with the change in fair value of the investments as of the end of each calendar year. Under the accounting standards, pension plan assets are valued at fair value as of the reporting period end date, which is December 31 for the WRS. The use of the fair value of the plan assets in the calculation will cause a large degree of volatility in the reported net pension liability or asset, depending upon investment performance and fluctuations in the investment market.

Table 10

WRS Net Pension Asset (Liability)
As of December 31
(in billions)

	2014	2015	2016	2017	2018
Fiduciary Net Position	$92.2	$88.5	$92.6	$104.4	$ 96.7
Total Pension Liability	(89.7)	(90.1)	(93.4)	(101.4)	(100.3)
Net Pension Asset (Liability)	**$ 2.5**	**$ (1.6)**	**$ (0.8)**	**$ 3.0**	**$ (3.6)**

Employer Reporting

Employers participating in the WRS have made a commitment to provide pension benefits and have an obligation to make contributions to fund those benefits.

As noted, the WRS is a cost-sharing, multiple-employer, defined-benefit pension plan with 1,507 participating employers. In this type of pension plan, the contributions are combined and the benefits are paid out of a common pool of assets. By participating in the WRS, employers have made a commitment to provide pension benefits to employees, and they are obligated to make contributions into the future to ensure that sufficient resources are available to make the benefit payments. Therefore, because the employers participating in the WRS have ultimate responsibility for the resulting pension obligations, each participating employer is required to report its proportionate share of the net pension liability or asset in its GAAP-based financial statements.

Each employer participating in the WRS must report its proportionate share of the net pension liability in its GAAP-based financial statements.

To assist employers participating in the WRS in determining the employer's proportionate share of these amounts, ETF has prepared a Schedule of Employer Allocations and a Schedule of Collective Pension Amounts as of and for the year ended December 31, 2018. We audited these schedules and provided unmodified opinions on them in report 19-18. Because the WRS has calculated a net pension liability for the year ended December 31, 2018, each employer participating in the WRS must report its proportionate share of the net pension liability in its GAAP-based financial statements.

The proportionate share of the net pension liability for State of Wisconsin agencies as of December 31, 2018, was $986.2 million, of which $474.4 million related to UW System. The net pension liability for the state agencies will be included in the State's GAAP-based financial statements, which will be published in the State of Wisconsin's CAFR for the year ended June 30, 2019.

Comparison to Other Pension Plans

Differences in the structure of pension plans and timing of pension plan reporting will affect the comparability across pension plans.

Comparability of the pension liability across public pension plans has increased with the use of accounting standards for pension plans that prescribe how the liability is calculated. However, because pension plans have different plan structures, planned asset allocations, and investment strategies, the comparability of pension plans is affected. In addition, because pension plans have varying fiscal-year ends, changes in the condition of investment markets at different points in time during a year will also affect comparability.

We collected information from other cost-sharing, multiple-employer, defined-benefit plans that were part of the WRS peer group defined by an annual study performed by a private firm. At 96.5 percent, the

WRS had the second-highest funded ratio in comparison to these plans, as shown in Table 11.

Table 11

Comparison of Selected Pension Plans Based on Financial Reporting Methodology[1, 2]
(in billions)

Pension Plan	Total Pension Liability	Fiduciary Net Position	Net Pension Asset	Net Pension Liability	Funded Ratio
New York State and Local Employees' Retirement System[3]	$216.3	$212.1	n/a	$ 4.2	98.0%
Wisconsin Retirement System (WRS)[4]	100.3	96.7	n/a	3.6	96.5
Iowa Public Employees Retirement System	38.6	32.3	n/a	6.3	83.6
Oregon Public Employees Retirement System	84.4	69.3	n/a	15.1	82.1
Indiana Public Retirement System—Public Employees Retirement Fund	16.1	12.7	n/a	3.4	78.9
State Teachers Retirement System of Ohio	96.9	74.9	n/a	22.0	77.3
Ohio Public Employees Retirement System[4]	108.7	81.4	n/a	27.3	74.9
Virginia Retirement System—Teachers Retirement System	46.7	34.9	n/a	11.8	74.8
Arizona State Retirement System	52.4	38.5	n/a	13.9	73.4
California State Teachers' Retirement System	316.8	224.9	n/a	91.9	71.0

[1] Based on information from other cost-sharing, multiple-employer, defined-benefit pension plans that were part of the WRS peer group as defined by an annual study performed by a private firm.

[2] Unless otherwise noted, for the plan year ended June 30, 2018.

[3] For the plan year ended March 31, 2018

[4] For the plan year ended December 31, 2018

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Other Postemployment Benefits (OPEB)

OPEB refers to the benefits, other than pensions, that a state or local government employee may receive after they have left employment, generally upon retirement. An OPEB plan can include medical, prescription drug, dental, vision, and other health-related benefits, whether provided separately or through a pension plan, as well as death benefits, life insurance, and long-term care coverage, when provided separately from a pension plan.

Accounting standards for OPEBs establish financial reporting requirements for measuring the OPEB liability for OPEB plans, as well as requirements for both the notes and required supplementary information to the OPEB plan financial statements, and the GAAP-based financial statements for the employers that participate in OPEB plans.

Trusted and Non-Trusted OPEB Plans

One of the primary factors that determines how an OPEB plan is reported is the determination of whether a plan is administered through a trust. To be considered a trusted plan, all of the following requirements must be met:

- contributions from employers and employees and earnings on those contributions must be considered irrevocable;

- plan assets must be dedicated to providing benefits to plan members according to the benefit terms; and

- plan assets must be legally protected from creditors of the employer, employees, and ETF.

If any of these requirements is not met, the OPEB plan is considered a non-trusted plan and the employers participating in the plan are solely responsible for determining the effect of participation in these programs in their GAAP-based financial statements, including the calculation of the OPEB liability.

The State Retiree Life Insurance program and the Local Retiree Life Insurance program are considered trusted OPEB plans.

ETF administers four separate OPEB plans for retired individuals: the State Retiree Life Insurance program and the Local Retiree Life Insurance program, both of which are considered trusted OPEB plans; and the State Retiree Health Insurance program and the Local Retiree Health Insurance program, both of which are considered non-trusted OPEB plans. The assets accumulated for the State Retiree Life Insurance program and the Local Retiree Life Insurance program, represented by the fiduciary net position, are reported by ETF in the Statement of Fiduciary Net Position for each program. The State Retiree Health Insurance program and the Local Retiree Health Insurance program are considered non-trusted OPEB plans because the programs do not accumulate assets dedicated to providing benefits to plan members. The OPEB liability for the State Retiree Health Insurance program will be reported in the State of Wisconsin's CAFR for the year ended June 30, 2019. Information regarding the calculation of the OPEB liability for this program is included in report 19-21.

Retiree Life Insurance

Administered under the provisions of s. 40.70, Wis. Stats., the State Retiree Life Insurance program and the Local Retiree Life Insurance program provide postemployment life insurance coverage to all eligible employees of participating employers. The State of Wisconsin, including state agencies, such as UW System, and state authorities, such as the UW Hospitals and Clinics Authority, participates in the State Retiree Life Insurance program. There were 719 local government employers participating in the Local Retiree Life Insurance program as of December 31, 2018.

The third-party administrator for the State Retiree Life Insurance program and the Local Retiree Life Insurance program is responsible for the premium collection, benefit payment, and investment of assets accumulated for the payment of benefits. Employers pay stated contribution amounts to the program that are based upon the active employee premium amounts.

Calculating the Total OPEB Liability

The total OPEB liability is the sum of amounts needed to pay for the OPEB benefits earned by each participant as of the date of the actuarial valuation. A liability exists because the employers participating in the OPEB program have committed to providing the benefit at some point in the future. The calculation of the total OPEB liability is complex and includes various actuarial assumptions and calculations, such as:

- a projection of future benefit payments for active and retired participants and their beneficiaries based upon the current terms of the plan;
- a discount of those payments to their present value, which is the amount of funds needed currently to provide the projected payments in the future; and
- an allocation of the present value of benefit payments over past, present, and future periods of employee service.

As of December 31, 2018, the total OPEB liability was $775.5 million for the State Retiree Life Insurance program and $502.9 million for the Local Retiree Life Insurance program.

ETF's actuaries performed actuarial valuations as of January 1, 2018, and adjusted for changes such as interest earned, contributions paid, and benefits paid during 2018 to determine the total OPEB liability for the State Retiree Life Insurance program and for the Local Retiree Life Insurance program as of December 31, 2018. Based on these valuations, the total OPEB liability for the State Retiree Life Insurance program was $775.5 million as of December 31, 2018, and the total OPEB liability for the Local Retiree Life Insurance program was $502.9 million as of December 31, 2018.

The discount rate can have a significant effect on the amount of the total OPEB liability.

The discount rate is a critical factor in calculating the total OPEB liability, and it can have a significant effect on the amount of the total OPEB liability. The discount rate, or interest rate, used to calculate the present value of projected benefit payments is specifically defined under the accounting standards. Because the assets accumulated for the State Retiree Life Insurance program and the Local Retiree Life Insurance program are projected to be insufficient to make all projected future benefit payments of current active and retired eligible employees, ETF was required to use a blended discount rate in calculating the total OPEB liability for each program. The long-term expected rate of return of 5.0 percent was blended with the municipal bond rate of 4.10 percent as of December 31, 2018, using the Bond Buyer GO 20-Bond Municipal Bond Index. The blended discount rate for the State Retiree Life Insurance program was 4.20 percent, and the blended discount rate for the Local Retiree Life Insurance program was 4.22 percent. As a result, the OPEB liability calculated for each program is larger than if the long-term expected rate of return of 5.0 percent was used.

Calculating the Net OPEB Liability

To determine the net OPEB liability or asset, the accounting standards require the total OPEB liability be subtracted from the OPEB plan's fiduciary net position. When the total OPEB liability is greater than the fiduciary net position, the OPEB plan will disclose a net OPEB liability in its notes. When the fiduciary net position is greater than the total OPEB liability, the OPEB plan will disclose a net OPEB asset in its notes.

As of December 31, 2018, the net OPEB liability was $431.5 million for the State Retiree Life Insurance program and $258.0 million for the Local Retiree Life Insurance program.

As of December 31, 2018, the State Retiree Life Insurance program and the Local Retiree Life Insurance program each reported a net OPEB liability. The State Retiree Life Insurance program had a fiduciary net position of $344.0 million and a total OPEB liability of $775.5 million, which resulted in a net OPEB liability of $431.5 million as of December 31, 2018. The Local Retiree Life Insurance program had a fiduciary net position of $244.9 million and a total OPEB liability of $502.9 million, which resulted in a net OPEB liability of $258.0 million as of December 31, 2018. As shown in Table 12, this represents an improvement from the net OPEB liability reported as of December 31, 2017, for both programs. This improvement can be primarily attributed to an increase in the discount rate of 0.60 percent and 0.59 percent for the State Retiree Life Insurance program and the Local Retiree Life Insurance program, respectively.

Table 12

Net OPEB Liability for the State Retiree Life Insurance Program and the Local Retiree Life Insurance Program
As of December 31
(in millions)

	State Retiree Life Insurance			**Local Retiree Life Insurance**		
	2017	2018	Increase (Decrease)	2017	2018	Increase (Decrease)
Fiduciary Net Position	$ 352.0	$ 344.0	$ (8.0)	$ 244.2	$ 244.9	$ 0.7
Total OPEB Liability	(845.5)	(775.5)	70.0	(545.1)	(502.9)	42.2
Net OPEB Liability	**$(493.5)**	**$(431.5)**	**$ 62.0**	**$(300.9)**	**$(258.0)**	**$ 42.9**

A net OPEB liability indicates that, at that point in time, the projected liability for benefit payments to employees exceeded the assets of the fund.

A net OPEB liability indicates that, at that point in time, the projected liability for benefit payments to employees exceeded the assets of the fund. Based upon the calculation of the total OPEB liability and the fiduciary net position of the fund, the State Retiree Life Insurance program had a funded ratio of 44.4 percent and the Local Retiree Life Insurance program had a funded ratio of 48.7 percent as of December 31, 2018. Because GASB did not create the financial reporting methodology to be used for funding purposes, the existence of a net OPEB liability for the State Retiree Life Insurance program and the Local Retiree Life Insurance program should not be used to support a change in contribution rates for the programs. The Group Insurance Board has an approved funding policy for both the State Retiree Life Insurance program and the Local Retiree Life Insurance program and uses this policy, in addition to future liability calculations provided by the third-party administrator, in establishing contribution rates.

Employer Reporting

Employers have made a commitment to provide postemployment life insurance benefits to employees and have an obligation to make contributions to fund these benefits.

For the State Retiree Life Insurance program and the Local Retiree Life Insurance program, contributions from employers are combined, by program, and the benefits are paid out of the common pool of assets established for each program. By participating in the State Retiree Life Insurance program or the Local Retiree Life Insurance program, each employer has made a commitment to provide postemployment life insurance benefits to employees and is obligated to make contributions into the future to ensure that sufficient resources are available to make the benefit payments. Therefore, because the employer for the State Retiree Life Insurance program and the employers participating in the Local Retiree Life Insurance program have responsibility for the resulting OPEB obligations, each employer will be required to report its share of the net OPEB liability on its GAAP-based financial statements.

Each participating employer must report its share of the net OPEB liability in its GAAP-based financial statements.

The State Retiree Life Insurance program includes state agencies, including UW System, and the various authorities that participate in the program, such as the UW Hospitals and Clinics Authority. To assist the State of Wisconsin and those agencies and authorities that are part of the State's financial reporting entity but that prepare separately issued financial statements, ETF has prepared a Schedule of Employer Allocations and a Schedule of Collective OPEB Amounts as of and for the year ended December 31, 2018. We audited these schedules and provided unmodified opinions on them in report 19-19. The net OPEB liability of $431.5 million for the State Retiree Life Insurance program will be included in the State's GAAP-based financial statements, which will be published in the State of Wisconsin's CAFR for the year ended June 30, 2019.

To assist employers participating in the Local Retiree Life Insurance program in determining the employer proportionate share of the net OPEB liability, ETF also prepared a Schedule of Employer Allocations and a Schedule of Collective OPEB Amounts as of and for the year ended December 31, 2018, for the Local Retiree Life Insurance program. We audited these schedules and provided unmodified opinions on them in report 19-20. Each local government that participates in the Local Retiree Life Insurance program must report its proportionate share of the net OPEB liability of $258.0 million for the Local Retiree Life Insurance program in its GAAP-based financial statements.

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Auditor's Report

STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman
State Auditor

Report 19-17

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-Chairpersons
Joint Legislative Audit Committee

Mr. Robert J. Conlin, Secretary
Department of Employee Trust Funds, and
Members of the Employee Trust Funds Board

We have audited the financial statements and related notes of the following fiduciary funds administered by the State of Wisconsin Department of Employee Trust Funds (ETF) as of and for the year ended December 31, 2018: the Wisconsin Retirement System, Accumulated Sick Leave Conversion Credits, Employee Reimbursement Accounts and Commuter Benefits, State Retiree Life Insurance, Local Retiree Life Insurance, Milwaukee Retirement Systems, State Retiree Health Insurance, and Local Retiree Health Insurance. In addition, we have audited the following proprietary funds administered by ETF as of and for the year ended December 31, 2018: Duty Disability Insurance, Health Insurance, and Income Continuation Insurance. We have issued our report thereon dated September 24, 2019. 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*, which is issued by the Comptroller General of the United States. The financial statements and related auditor's report have been included in ETF's *2018 Comprehensive Annual Financial Report.*

Internal Control over Financial Reporting

Management of ETF is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered ETF's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ETF's internal control. Accordingly, we do not express an opinion on the effectiveness of ETF's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent misstatements, or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of ETF's financial statements will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements are free from material misstatement, we performed tests of 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.*

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering ETF's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of ETF's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

September 24, 2019

Appendices

Appendix 1

Employee Trust Funds Board Membership

2019

Name	Affiliation	Board Member Since
Wayne Koessl, Chair	Appointed by the Wisconsin Retirement Board	1996
John David, Vice Chair	Appointed by the Wisconsin Retirement Board	2008
Robert Niendorf, Secretary	Appointed by the Teachers Retirement Board	1992
Stephen Arnold	Appointee of the Governor, with advice and consent of Senate, representing the public	2019
Malika Evanco	Designee of the Administrator, Division of Personnel Management, Department of Administration	2019
William Ford	Elected by retired WRS participants, and is a WRS annuitant	2011
Chris Heller	Appointed by Teachers Retirement Board	2019
Michael Langyel	Appointed by Teachers Retirement Board	2009
Katy Lounsbury	Designee of the Governor	2019
Leilani Paul	Elected by participating employees of either technical college or school district educational support personnel, and is an active WRS participant	2015
Roberta Rasmus	Appointed by the Teachers Retirement Board	2012
Steven Wilding	Appointed by the Wisconsin Retirement Board	2019
Vacant	Appointed by the Wisconsin Retirement Board	

Appendix 2

Group Insurance Board Membership

2019

Name	Affiliation	Board Member Since
Herschel Day, Chair	Appointee of the Governor, insured participant in WRS who is a teacher	2013
Nathan Houdek, Vice Chair	Designee of the Commissioner of Insurance	2019
Nancy Thompson, Secretary	Appointee of the Governor, chief executive or member of the governing body of a local unit of government that participates in the WRS	2012
Harper Donahue IV	Appointee of the Governor, insured participant in WRS who is an employee of a local unit of government	2019
Malika Evanco	Designee of the Administrator, Division of Personnel Management, Department of Administration	2019
Dan Fields	Appointee of the Governor, insured participant in WRS who is a retiree	2019
Katy Lounsbury	Designee of the Governor	2019
Brian Pahnke	Designee of the Secretary, Department of Administration	2019
Jackson Walter	Appointee of the Governor, insured participant in WRS who is not a teacher	2019
Bob Wimmer	Designee of the Attorney General	2018
Vacant	Appointee of the Governor	

Response ■

STATE OF WISCONSIN
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

Wisconsin Department
of Employee Trust Funds
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September 24, 2019

JOE CHRISMAN, STATE AUDITOR
LEGISLATIVE AUDIT BUREAU
22 E MIFFLIN ST SUITE 500
MADISON WI 53703

Dear Mr. Chrisman,

Thank you for the opportunity to review and comment on the audit of the Department of Employee Trust Funds (ETF) Comprehensive Annual Financial Report (CAFR) for the year ended December 31, 2018. The unmodified opinion combined with the fact that no internal control deficiencies were identified represents our continued efforts to strengthen our internal controls.

The Wisconsin Retirement System (WRS) continues to be in a strong financial position, regardless of which measure is applied. Under the funding methodology, which is calculated by the WRS actuary and used to set contribution rates, the funding ratio continues to be approximately 100%. This method smooths investment gains and losses over a five-year period to achieve one of the system's funding objectives of contribution stability and to ensure sufficient assets will be available to pay promised benefits.

Under the Governmental Accounting Standards Board (GASB) financial reporting methodology the funding ratio is 96.5%. This was a decrease from 102.9% as of December 31, 2017, primarily due to investment losses experienced in 2018. As noted in the report, the GASB methodology requires valuation of assets at fair value and therefore, this ratio will fluctuate from year to year depending upon investment performance.

In closing, we appreciate the professionalism and diligence of your staff in conducting the audit.

Sincerely,

Robert J. Conlin
Secretary