Report 16-12
December 2016

State Life Insurance Fund

Calendar Years 2015, 2014, and 2013

Office of the Commissioner of Insurance

STATE OF WISCONSIN



Legislative Audit Bureau

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STATE OF WISCONSIN
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Celebrating 50 Years of Service 1966-2016

Joe Chrisman
State Auditor

December 13, 2016

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) (de), Wis. Stats., we have completed an audit of the financial statements of the Wisconsin State Life Insurance Fund (SLIF) for the years ended December 31, 2015, December 31, 2014, and December 31, 2013. SLIF provides low-cost life insurance policies to Wisconsin residents, is self-funded through premiums and investment earnings, and is administered by the Office of the Commissioner of Insurance (OCI). As of December 31, 2015, SLIF had 25,132 life insurance policies in effect and $194.1 million of life insurance in force. SLIF operates under specific statutory restrictions, including a prohibition on employing insurance agents and a limitation on coverage of $10,000 for any insured individual.

SLIF prepares its financial statements on a regulatory basis in accordance with financial reporting requirements prescribed by the Wisconsin Commissioner of Insurance, but not in accordance with generally accepted accounting principles. We found SLIF's financial statements to be fairly presented in accordance with the financial reporting requirements it follows.

State statutes require SLIF's net profits to be distributed annually as policy dividends and specify that, to the extent practicable, the ratio of SLIF's surplus to its assets is to be between 7.0 percent and 10.0 percent. The surplus-to-assets ratio exceeded the statutorily specified range as of December 31, 2011, and, as anticipated in report 13-16, OCI took steps to reduce the ratio by the end of 2014. SLIF's surplus-to-assets ratio was 9.9 percent and 9.2 percent as of December 31, 2014, and December 31, 2015, respectively.

We report significant deficiencies in internal control related to separation of duties over manual deposits and reconciliations between the State's central accounting system and SLIF's accounting system. We also identified a significant deficiency in the Department of Administration's centralized cash reconciliations, which are relied upon by SLIF. These deficiencies are included in our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is on page 39.

We appreciate the courtesy and cooperation extended to us by OCI staff in completing our audit.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/KE/ss

Introduction ■

The State Life Insurance Fund offers low-cost life insurance to Wisconsin residents.

The Wisconsin State Life Insurance Fund (SLIF), which was created in 1911 to provide low-cost individual life insurance to Wisconsin residents, is administered by the Office of the Commissioner of Insurance (OCI). SLIF is subject to the same regulatory requirements as any life insurance company licensed to operate in Wisconsin. Wisconsin is the only state that offers life insurance to its citizens. SLIF receives no subsidies from the State of Wisconsin.

SLIF offers a maximum of $10,000 in coverage for an individual through two types of life insurance policies: term life and whole life. Term life insurance provides coverage for a specific period of time, and death benefits are paid only if the insured individual dies within that time period. In contrast, whole life insurance offers lifetime insurance for the policyholder and accumulates a cash value that is returned if the policy is surrendered before the death of the insured individual. In addition, the whole life policyholder may borrow against the policy's cash value.

SLIF offers four different whole life insurance policy plans. Ordinary whole life insurance is the most popular and requires premiums to be paid each year during the insured individual's life. The other whole life policies require premiums be paid up to the age of 65, for the first 20 years of the policy, or in a single payment at the start of coverage.

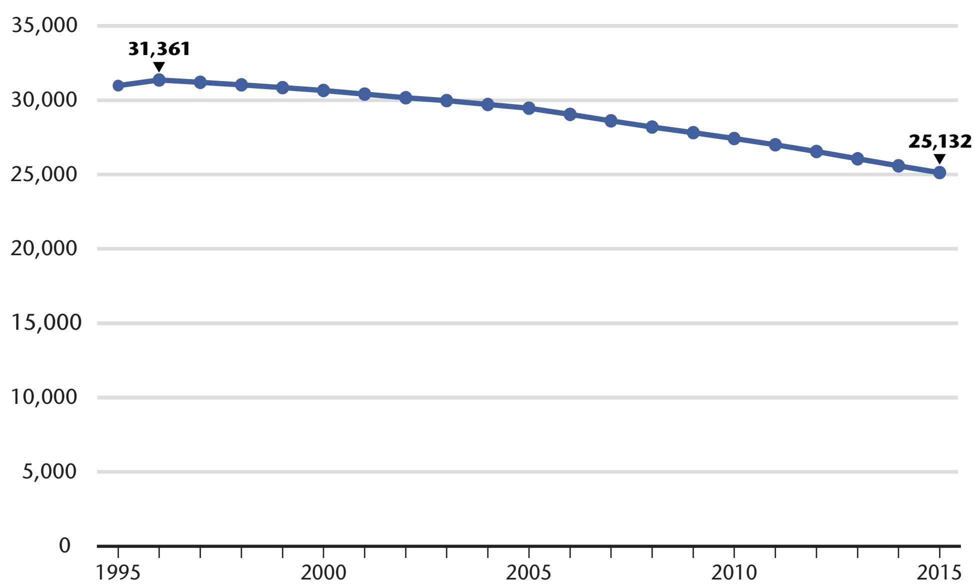
SLIF pays dividends on both term life insurance and whole life insurance. Policyholders may elect to accumulate dividends in their accounts, use the dividends to offset premium amounts they owe, or have the dividends paid to them in cash.

The number of policies has declined and was 25,132 as of December 31, 2015.

By statute, OCI is not allowed to advertise this life insurance program, and SLIF is not permitted to use commissioned agents. As shown in Figure 1, the number of policies has been declining since December 31, 1996, when there were 31,361 policies. There were 25,132 policies as of December 31, 2015. The amount of insurance in force has also declined and was $194.1 million as of December 31, 2015. The number of new policies issued each year has been less than the total number of death claims and the number of policies surrendered for other reasons, such as failure to pay the annual premium. The continued decline is likely due to a combination of OCI's inability to advertise, the $10,000 limitation on coverage, and private sector competition.

Figure 1

State Life Insurance Fund
Number of Policies as of December 31



Surplus-to-Assets Ratio

The surplus balance of SLIF represents the difference between its assets, which are primarily investment holdings, and its liabilities, which are primarily actuarially determined reserves to pay future insurance benefits. The surplus balance increases when SLIF's revenues, including insurance premiums and investment earnings, are greater than its expenses, including benefit expenses and dividends paid to policyholders. It is important that SLIF have an adequate surplus balance in the event the actuarially determined reserves are not sufficient to pay benefits as they come due.

Statutes specify that, to the extent practicable, the ratio of SLIF's surplus to its assets is to be between 7.0 percent and 10.0 percent.

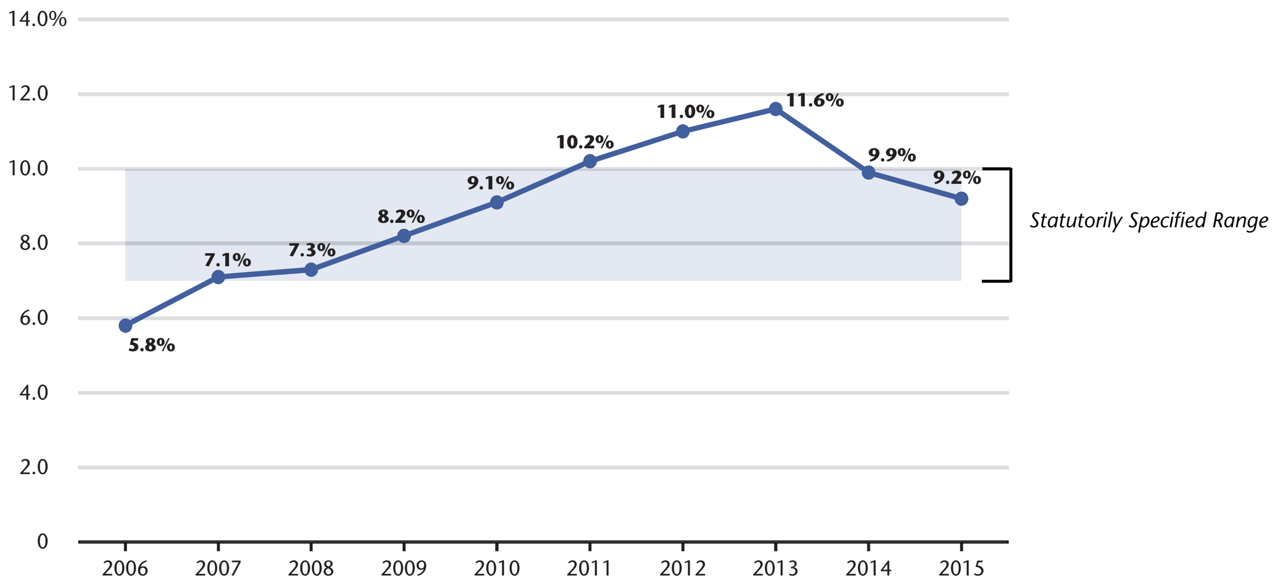
Section 607.15, Wis. Stats., provides that SLIF's net profits be distributed annually to policyholders in the form of dividends. However, statutes also specify that, to the extent practicable, the ratio of SLIF's surplus to its assets is to be between 7.0 percent and 10.0 percent. Some factors affecting the surplus-to-assets ratio, such as actuarially determined reserve balances, are not controllable by SLIF staff. However, staff can adjust the level of dividends paid to policyholders. Periodically, staff will assess whether the dividend scale, which determines the dividends to pay to the various types of policyholders, needs to be adjusted to maintain a surplus-to-assets ratio within the statutorily specified range of 7.0 percent to 10.0 percent. If a dividend adjustment is necessary, staff work with SLIF's actuary to review and adjust certain assumptions, such as anticipated investment earnings and mortality rates, which are used in the calculation of the dividend scale.

The surplus-to-assets ratio was 9.2 percent as of December 31, 2015.

The dividend scale was adjusted in 2005 and 2006 in an effort to increase the surplus-to-assets ratio, which had declined below the statutorily specified minimum of 7.0 percent. As a result of these adjustments, which we described in report 09-14, the ratio was within the statutorily specified range as of December 31, 2007. However, as we described in report 13-16, the surplus-to-assets ratio continued to increase. As of December 31, 2011, the ratio exceeded the statutorily specified maximum of 10.0 percent and, as anticipated in report 13-16, OCI implemented plans to adjust the dividend scale to reduce the surplus-to-assets ratio by the end of 2014. As shown in Figure 2, the surplus-to-assets ratio was within the statutorily specified range at 9.9 percent and 9.2 percent as of December 31, 2014, and December 31, 2015, respectively.

Figure 2

State Life Insurance Fund
Surplus-to-Assets Ratio as of December 31[1]



[1] Calculated based on amounts included in the audited financial statements.

Internal Control over Financial Reporting

In our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 39, we report significant deficiencies in internal control related to separation of duties over manual deposits and reconciliations between the State's central accounting system and SLIF's accounting system. We also report a significant deficiency in internal controls over cash reconciliations at the Department of Administration (DOA). SLIF relies on these controls at DOA. Due to the pervasiveness of this deficiency and its effects on state agencies and programs, this deficiency is reported to users of SLIF's financial statements. We did not request a response from the management of SLIF since DOA is responsible for corrective action.

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Audit Opinion

STATE OF WISCONSIN
Legislative Audit Bureau
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Joe Chrisman
State Auditor

Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards*

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

Mr. Theodore K. Nickel, Commissioner
Office of the Commissioner of Insurance

Report on the Financial Statements

We have audited the accompanying regulatory basis financial statements and the related notes of the Wisconsin State Life Insurance Fund (SLIF) as of and for the years ended December 31, 2015, December 31, 2014, and December 31, 2013, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management of the Fund is responsible for the preparation and fair presentation of these regulatory basis financial statements in accordance with financial reporting requirements prescribed by the State of Wisconsin Commissioner of Insurance, which are the statutory accounting principles established by the National Association of Insurance Commissioners. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on these financial statements.

Basis for Adverse Opinion—U.S. Generally Accepted Accounting Principles

As described in Note 2A to the financial statements, the regulatory basis financial statements are prepared by SLIF in accordance with the financial reporting requirements prescribed by the State of Wisconsin Commissioner of Insurance. This is a basis of accounting other than accounting principles generally accepted in the United States of America.

Although not reasonably determinable, the effects on the financial statements of the variances between this regulatory basis of accounting and accounting principles generally accepted in the United States of America are presumed to be material. Therefore, auditing standards generally accepted in the United States of America require that we issue an adverse opinion on the financial statements based on accounting principles generally accepted in the United States of America.

Adverse Opinion—U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed above in "Basis for Adverse Opinion—U.S. Generally Accepted Accounting Principles," the financial statements referred to in the first paragraph do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of SLIF as of December 31, 2015, December 31, 2014, and December 31, 2013, or changes in financial position or cash flows thereof for the years then ended.

Unmodified Opinion—Regulatory Basis of Accounting

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the regulatory basis financial position of SLIF as of December 31, 2015, December 31, 2014, and December 31, 2013, and the respective regulatory basis changes in its financial position and its regulatory basis cash flows thereof for the years then ended, in accordance with the financial reporting requirements prescribed by the State of Wisconsin Commissioner of Insurance as described in Note 2A to the financial statements.

Emphasis of Matter

As discussed in Note 2A to the financial statements, the financial statements referred to above present only SLIF and do not purport to, and do not, present fairly the financial position of the State of Wisconsin, the changes in its financial position, or where applicable, its cash flows. Our opinion is not modified with respect to this matter.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the regulatory basis financial statements of SLIF. The supplementary information included as Management's Discussion and Analysis on pages 13 through 19 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated December 7, 2016, on our consideration of SLIF's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SLIF's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

December 7, 2016

Management's Discussion and Analysis ■

Prepared by the Wisconsin State Life Insurance Fund's Management

This section presents the Management's Discussion and Analysis of the financial performance of the Wisconsin State Life Insurance Fund during the calendar years ended December 31, 2015, December 31, 2014, and December 31, 2013. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the Office of the Commissioner of Insurance, which manages the Fund.

Overview of the Fund

The Fund was established in 1911 in response to a national scandal over the improper practices of some life insurance companies. The Fund is a state-sponsored life insurance program for the benefit of the residents of Wisconsin but receives no subsidies from the State of Wisconsin. It is not permitted to use commissioned agents, does not advertise, and is exempt from federal income tax. As a result, overhead expenses are minimal. Chapter 607, Wis. Stats., provides that the Fund is to provide low-cost life insurance for residents of Wisconsin. The maximum amount of coverage per individual is $10,000. The Fund offers five different policy plans, which all pay dividends.

The Fund operates on a calendar year basis. Administrative costs and operating costs, including claim payments, are funded through premiums collected from policyholders, policy loan interest, and investment earnings.

During the current audit period, the Fund took steps to bring the surplus-to-assets ratio back in compliance with s. 607.15, Wis. Stats., which requires, to the extent practicable, that the ratio of surplus to assets be between 7.0 percent and 10.0 percent. Since the ratio was above 10.0 percent, the Fund increased dividends in 2014 and, as of December 31, 2015, the ratio was 9.2 percent.

Financial Statements

The Fund's financial statements have been prepared on a statutory basis of accounting, which is a type of regulatory basis of accounting, in accordance with accounting practices prescribed by the State of Wisconsin Commissioner of Insurance, which include practices recommended by the National Association of Insurance Commissioners (NAIC).

The Fund's financial statements comprise two components: 1) the financial statements, and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Following this section are the financial statements and notes as they relate to the Fund. The financial statements include:

- the Balance Sheet—Statutory Basis, which provides information on the assets and the liabilities of the Fund, with the difference reported as fund surplus;
- the Statement of Operations and Changes in Fund Surplus—Statutory Basis, which presents the revenues earned and the expenses incurred during the year on an accrual basis, as well as the changes in fund surplus; and
- the Statement of Cash Flows—Statutory Basis, which presents information related to cash inflows and outflows summarized by operating, investing, and financing activities and helps measure the Fund's ability to meet financial obligations as they mature.

In this discussion and analysis, the reasons for the changes in financial activity for calendar years 2015, 2014, and 2013 are reviewed.

Assets

As shown in Table A, the largest portion of the Fund's assets, 93.2 percent as of December 31, 2015, is in the form of bonds invested through the State of Wisconsin Investment Board. Fund investments are managed by the State of Wisconsin Investment Board pursuant to statutory requirements and in accordance with established investment guidelines. All bonds are carried at amortized cost using the scientific method to amortize any premiums and discounts.

Table A

Fund Assets
As of December 31

	2015	2014	2013	2012
Total Assets	$101,418,666	$100,175,423	$98,909,817	$96,761,176
Bonds	$ 94,522,091	$ 93,494,641	$92,046,492	$89,334,111
Percentage of Total Assets	93.2%	93.3%	93.1%	92.3%

Generally, the turnover in the portfolio is very low due to the long duration of the investments in the portfolio, which is the result of an effort to match the future maturities of investments with expected future payouts of benefits.

As required by NAIC accounting standards, the Fund's Statement of Operations and Changes in Fund Surplus reported $0 in net realized capital losses or gains on any bond sale. Other realized gains and losses are accounted for in the interest maintenance reserve (IMR) and amortized into net investment income over the life of the bonds sold.

The Fund's remaining assets consist of contract loans, receivables, cash, and cash equivalents.

Liabilities

The largest area of the Fund's liabilities is the aggregate reserves for life insurance contracts, as shown in Table B.

Table B

Fund Liabilities
As of December 31

	2015	2014	2013	2012
Total Liabilities	$92,107,784	$90,262,363	$87,405,088	$86,123,844
Aggregate Reserves for Life Insurance Contracts	$65,381,205	$65,023,291	$64,618,890	$64,094,484
Percentage of Total Liabilities	71.0%	72.0%	73.9%	74.4%

The aggregate reserves for life insurance contracts are the amounts required by NAIC to be reported on the Balance Sheet to show the ability to pay all future claims on the Fund's insurance policies. Because the average age of policyholders is increasing, additional reserves are necessary to fund expected benefit payments upon death.

In addition to the policy reserves, liabilities consist of deposit accounts, also referred to as "deposit-type contracts," held by the Fund for the benefit of the policyholders. The liability for deposit-type contracts includes proceeds held on deposit, consisting of the value of matured policies and proceeds from death claims left in the Fund, and dividends left in the Fund to accumulate. Annually, the Fund pays interest on the deposit accounts.

As shown in Table C, the liability for deposit-type contracts increased in calendar years 2013 through 2015. The increase in calendar years 2014 and 2015 is due to a change made to the dividend scale that increased the amount of dividends paid.

Table C

Deposit-type Contracts
As of December 31

	2015	2014	2013	2012
Liability for Deposit-type Contracts	$22,011,082	$20,768,205	$19,722,959	$19,188,233
Percentage Change from Prior Year	6.0%	5.3%	2.8%	2.4%

As shown in Table D, interest credited to deposit-type contracts increased slightly in calendar year 2013 through 2015. The increase in calendar years 2014 and 2015 is due to the increase in deposit-type contracts.

Table D

Interest Expense on Deposit-type Contracts
Calendar Year Ended December 31

	2015	2014	2013	2012
Interest Expense on Deposit-type Contracts	$674,033	$639,694	$611,053	$590,650
Percentage Change from Prior Year	5.4%	4.7%	3.5%	3.1%

Revenues

The Fund's revenues include investment earnings, insurance premiums, and interest on policy loans. There were 25,132 life insurance policies in effect as of December 31, 2015, a decrease of 1,426 policies, or 5.4 percent, from the December 31, 2012 policy count of 26,558.

The increase in fund revenues in calendar year 2013, as shown in Table E, may be attributed to new rates implemented. The decreases in revenue for calendar years 2014 and 2015 are due to the decline in insurance premium revenues resulting from fewer policies in effect.

Table E

Changes in Fund Revenues
Calendar Year Ended December 31

	2015	2014	2013	2012
Revenue	$6,856,679	$6,922,958	$7,107,417	$6,998,945
Percentage Change from Prior Year	(1.0)%	(2.6)%	1.5%	(0.6)%

Expenses

The Fund pays benefits to policyholders in the event of death, at maturity of the policy, upon surrender of the policy, or in the event the covered individual becomes disabled. The policy benefit claims experience of the Fund has been increasing due to the number of older policies maturing and the number of claims rising due to the aging of those insured by the Fund. Total policy benefits for each year are shown in Table F. In calendar years 2015, 2014, and 2013, the change in policy benefits was primarily related to an increase or decrease in the number of death claims and the number of policies that matured during the year.

Table F

Policy Benefits
Calendar Year Ended December 31

	2015	2014	2013	2012
Policy Benefits	$2,202,858	$2,093,422	$2,184,663	$1,978,572
Percentage Change from Prior Year	5.2%	(4.2)%	10.4%	8.6%

General expenses are used to support the administration of the Fund. The Fund had an increase in general expenses in 2013, as shown in Table G, due to audit expenses incurred in calendar year 2013. In calendar year 2014, general expenses were also higher than other years due to system upgrades and actuarial expenses to change the dividend scale.

Table G

General Expenses
Calendar Year Ended December 31

	2015	2014	2013	2012
General Expenses	$576,420	$623,276	$682,775	$566,140
Percentage Change from Prior Year	(7.5%)	(8.7%)	20.6%	3.3%

Dividends and Surplus

Annually, the Fund pays dividends on all active policies. According to state statute, "The net profits of the life fund shall be distributed annually among the policyholders, except that so far as is practicably possible, the ratio of surplus to assets shall be kept between 7% and 10%." Dividends paid over calendar years 2015, 2014, and 2013 are reflected in Table H. The Fund changed the dividend scale in 2014 to bring the ratio below the required 10 percent maximum.

Table H

Dividends
Calendar Year Ended December 31

	2015	2014	2013	2012
Dividends	$3,574,935	$4,707,862	$2,096,882	$2,116,145
Percentage Change from Prior Year	(24.1%)	124.5%	(0.9%)	0.6%

As shown in Table I, the surplus-to-assets ratio was within the statutorily specified range of 7.0 percent to 10.0 percent except during calendar years 2012 and 2013.

Table I

Surplus-to-Assets Ratio
Calendar Year Ended December 31

	2015	2014	2013	2012
Surplus	$ 9,310,882	$ 9,913,060	$11,504,729	$10,637,332
Total Assets	$101,418,666	$100,175,423	$98,909,817	$96,761,176
Surplus-to-Assets Ratio	9.2%	9.9%	11.6%	11.0%

Contacting the Fund's Financial Management

The financial report is designed to provide the Legislature, the executive branch of government, policyholders, the public, and other interested parties with an overview of the financial results of the Fund's activities and to show the Fund's financial position. If you have questions about this report, or need additional information, contact the Wisconsin State Life Insurance Fund manager at:

Office of the Commissioner of Insurance
125 South Webster Street, Post Office Box 7873
Madison, Wisconsin 53707-7873.

General information relating to the Fund can be found at the Fund's website, *https://oci.wi.gov/Pages/Funds/SLIFOverview.aspx.*

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Financial Statements ■

Balance Sheet—Statutory Basis
December 31, 2015, December 31, 2014, and December 31, 2013

	December 31, 2015	December 31, 2014	December 31, 2013
ASSETS			
Bonds (Note 3)	$ 94,522,091	$ 93,494,641	$ 92,046,492
Cash, Cash Equivalents, and Short-Term Investments (Note 3)	2,000,781	1,765,328	1,699,298
Contract Loans	3,432,331	3,463,479	3,563,418
Investment Income Receivable	1,398,941	1,384,814	1,521,203
Deferred Premiums and Uncollected Premiums (Note 9)	64,522	67,161	79,406
TOTAL ASSETS	**$ 101,418,666**	**$ 100,175,423**	**$ 98,909,817**
LIABILITIES AND FUND SURPLUS			
Aggregate Reserves for Life Insurance Contracts (Note 7)	$ 65,381,205	$ 65,023,291	$ 64,618,890
Liability for Deposit-type Contracts (Note 8)	22,011,082	20,768,205	19,722,959
Contract Claims (Note 2)	344,000	282,294	313,500
Dividends Due and Unpaid, Plus Those Payable in the Following Year (Note 5)	3,654,301	3,659,259	2,142,709
Premiums Received in Advance	24,353	24,660	106,908
Interest Maintenance Reserve (Note 2)	298,356	117,818	130,946
General Expenses Payable	42,877	46,507	42,603
Asset Valuation Reserve (Note 2)	285,438	302,107	297,081
Other Liabilities	66,172	38,222	29,492
Total Liabilities	92,107,784	90,262,363	87,405,088
Fund Surplus (Note 5)	9,310,882	9,913,060	11,504,729
TOTAL LIABILITIES AND FUND SURPLUS	**$ 101,418,666**	**$ 100,175,423**	**$ 98,909,817**

The accompanying notes are an integral part of this statement.

Statement of Operations and Changes in Fund Surplus—Statutory Basis for the Years Ended December 31, 2015, December 31, 2014, and December 31, 2013

	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013
REVENUES			
Premiums (Note 2)	$ 1,373,611	$ 1,557,460	$ 1,470,847
Net Investment Income (Note 4)	5,446,567	5,345,970	5,523,118
Amortization of Interest Maintenance Reserve	34,586	18,007	674
Miscellaneous Income	1,915	1,521	112,778
Total Revenues	**6,856,679**	**6,922,958**	**7,107,417**
OPERATING EXPENSES			
Benefits:			
Death Benefits	1,479,950	1,141,685	1,390,388
Matured Endowments	351,000	364,000	244,000
Surrender Benefits	363,175	579,076	540,588
Disability Benefits	8,733	8,661	9,687
Interest and Adjustments on Contract or Deposit-type Contract Funds	674,033	639,694	611,053
Increase in Aggregate Reserves for Life Insurance Contracts	357,914	404,401	524,406
Total Benefits	3,234,805	3,137,517	3,320,122
General Expenses	576,420	623,276	682,755
Total Operating Expenses	**3,811,225**	**3,760,793**	**4,002,877**
Net Income from Operations before Dividends and Net Realized Capital Gain (Loss)	**3,045,454**	**3,162,165**	**3,104,540**
Dividends to Policyholders (Note 5)	(3,574,935)	(4,707,862)	(2,096,882)
Net Realized Capital Gain (Loss)	0	0	0
NET INCOME (LOSS)	**$ (529,481)**	**$ (1,545,697)**	**$ 1,007,658**
CHANGES IN FUND SURPLUS			
Fund Surplus at Beginning of Period	$ 9,913,060	$ 11,504,729	$ 10,637,332
Net Income (Loss)	(529,481)	(1,545,697)	1,007,658
Change in Asset Valuation Reserve	16,669	(5,026)	(44,527)
Change in Net Unrealized Capital Gain (Loss)	(89,366)	(40,946)	(95,734)
NET CHANGE IN FUND SURPLUS	**(602,178)**	**(1,591,669)**	**867,397**
Fund Surplus at End of Period	$ 9,310,882	$ 9,913,060	$ 11,504,729

The accompanying notes are an integral part of this statement.

Statement of Cash Flows—Statutory Basis for the Years Ended December 31, 2015, December 31, 2014, and December 31, 2013

	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013
CASH FROM OPERATIONS			
Premiums Collected Net of Reinsurance	$ 1,377,222	$ 1,488,978	$ 1,557,286
Net Investment Income	5,495,206	5,552,760	5,589,905
Miscellaneous Income	1,915	1,521	112,778
Total Receipts	6,874,343	7,043,259	7,259,969
Benefit and Loss Related Payments	2,815,185	2,764,322	2,663,650
Expenses Paid and Aggregate Write-ins for Deductions	581,403	620,640	686,605
Dividends Paid to Policyholders	3,579,893	3,191,312	2,105,622
Total Benefits and Expenses	6,976,481	6,576,274	5,455,877
Net Cash Provided by Operating Activities	**(102,138)**	**466,985**	**1,804,092**
CASH FROM INVESTMENTS			
Cash Received from Sale of Bonds	5,791,098	1,569,111	5,479,271
Cash Paid for Purchase of Bonds	(6,658,626)	(3,041,709)	(8,121,843)
Decrease (Increase) in Contract Loans	31,148	99,939	37,818
Net Cash Used in Investing Activities	**(836,380)**	**(1,372,659)**	**(2,604,754)**
CASH FROM FINANCING AND MISCELLANEOUS SOURCES			
Net Deposits on Deposit-type Contract and Other Insurance Liabilities	1,242,877	1,045,246	534,726
Other Cash Provided (Applied)	(68,906)	(73,542)	(246,556)
Net Cash Provided by Financing and Miscellaneous Activities	1,173,971	971,704	288,170
NET CHANGE IN CASH, CASH EQUIVALENTS, AND SHORT-TERM INVESTMENTS	**235,453**	**66,030**	**(512,492)**
Cash, Cash Equivalents, and Short-Term Investments at January 1	1,765,328	1,699,298	2,211,790
Cash, Cash Equivalents, and Short-Term Investments at December 31	$ 2,000,781	$ 1,765,328	$ 1,699,298

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ▪

1. Description of the Fund

The Wisconsin State Life Insurance Fund, which is part of the State of Wisconsin financial reporting entity and is reported as an enterprise fund in the State's basic financial statements, was created in 1911 to provide life insurance policies to Wisconsin residents at the lowest possible cost. The Fund is administered by the Office of the Commissioner of Insurance.

The Fund's operation is similar to that of a mutual life insurance company, and the Fund is subject to the same regulatory requirements as any life insurance company licensed to operate in Wisconsin. The Fund is also subject to unique statutory restrictions, such as a prohibition on employing agents and a maximum coverage of $10,000, which are designed to limit the competitive advantage the Fund may have over private insurance companies. The Fund offers two basic policies: whole life insurance and term life insurance. As of December 31, 2015, the Fund had 25,132 life insurance policies in effect, including 23,667 whole life insurance policies and 1,465 term life insurance policies. The total amount of insurance in force as of December 31, 2015, was $194,092,706.

2. Summary of Significant Accounting Policies

A. Accounting Practices

The financial statements present the financial position and results of operations of only the activity of the State Life Insurance Fund and are not intended to present the financial activity for the State of Wisconsin as a whole. The Fund's financial statements are presented on a statutory basis of accounting, which is a type of regulatory basis of accounting, in accordance with accounting practices prescribed by the State of Wisconsin Commissioner of Insurance. The National Association of Insurance Commissioners' (NAIC's) *Accounting Practices and Procedures Manual* (commonly referred to as the Codification) has been adopted by the State of Wisconsin Commissioner of Insurance as the prescribed practices for the Fund, as permitted by s. 623.02, Wis. Stats. The accounting practices and procedures prescribed by the State of Wisconsin Commissioner of Insurance vary in some respects from accounting principles generally accepted in the United States. The following table shows the most significant differences between the statutory accounting standards and generally accepted accounting principles.

Financial Statement Area	Statutory Accounting Standards	Generally Accepted Accounting Principles
Bond Valuation	NAIC category 1 to 5 at amortized cost; NAIC category 6 at lower of amortized cost or fair value. A permanent impairment should be reported as a realized loss, with the cost basis written down to fair value.	Fair value.
Asset Valuation Reserve (AVR)	Formula-driven reserve balance. Established to mitigate potential credit-related investment losses. Year-to-year changes are charged or credited directly to surplus.	Not applicable.
Interest Maintenance Reserve (IMR)	Captures interest-related realized gains and losses on sale of investments and amortizes these to income over the remaining life of the investment sold.	Not applicable.
Realized Investment Gains (Losses)	Only non-IMR gains and losses are reported in income.	Reported as income.
Unrealized Investment Gains (Losses)	Recorded directly to surplus for assets recorded at fair value.	Reported as income.
Due and Deferred Premiums	Due premiums recorded as asset, except that certain balances over 90 days due would be nonadmitted; deferred premiums recorded as asset.	Due premiums reported as asset; deferred premiums offset against liabilities for future policy benefits.
Dividends	Provision made for dividends expected to be paid over the year subsequent to the date of the financial statements, whether or not declared or apportioned.	Provision made for accumulated earnings expected to be paid to policyholders, including pro rata portion of dividends incurred to valuation date; future dividends are accrued over the premium-paying period of the contract.
Contract Acquisition Costs	Charged to expense in current operations when incurred.	Deferred and amortized in relation to the premium revenue recognized.

B. Use of Estimates

The preparation of the financial statements in conformity with statutory accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

C. Accounting Policies

Premiums—Premiums are reported as earned on the policy anniversary date.

New Business Expenses—Expenses incurred in connection with acquiring new insurance business, including acquisition costs, are charged to operations as incurred.

Dividends—The amount of dividends to be paid to policyholders is determined annually by the contracted actuary and the Fund's management at the Office of the Commissioner of Insurance. The aggregate amount of policyholders' dividends is determined based on interest earnings, mortality, and expense experience for the Fund and judgment as to the appropriate level of statutory surplus to be retained by the Fund in order to be in accordance with s. 607.15, Wis. Stats., which requires that the ratio of surplus to assets is to be between 7.0 percent and 10.0 percent, insofar as is practicably possible.

Contract Loans—Policyholders may borrow from the Fund amounts up to the cash surrender value of their insurance policies. Such contract loans are reported at outstanding indebtedness to the Fund. Interest on contract loans is charged in arrears.

Bonds—In accordance with statutory accounting standards, the Fund reports bonds at amortized cost using the scientific method to amortize bond premiums and discounts, which recognizes the time-value of money and amortizes principal receipts on a pro rata basis, using the securities' current information as opposed to the initial amortized value. NAIC category 6 bonds are reported at the lower of amortized cost or fair value.

Interest Maintenance Reserve—The IMR accumulates interest-related realized gains and losses and amortizes them into income over the remaining life of the investments sold. The State Life Insurance Fund uses the IMR method that amortizes groups of assets based on the average maturity dates using standard amortization tables developed by NAIC.

Contract Claims—The liability for unpaid claims includes reported claims that were not paid at year-end and estimates of claims that were incurred but not reported, based on claims reported in the following January.

3. CASH AND INVESTMENTS

All cash is deposited with the State of Wisconsin and is invested by the State of Wisconsin Investment Board through the State Investment Fund, a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees as authorized in ss. 25.14 and 25.17, Wis. Stats. Balances pooled are restricted to legally stipulated investments. The State Investment Fund is not registered with the U.S. Securities and Exchange Commission as an investment company. Shares in the State Investment Fund are reported as cash equivalents and are carried at the cost of the participating shares, which is also the realizable value as of December 31. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

The State Life Insurance Fund's investments, both long-term and short-term, are managed by the Investment Board with an investment objective to maintain a diversified portfolio of high-quality publicly issued fixed-income obligations that will preserve principal, maximize income while minimizing costs to policyholders, and approximate the expected life of the Fund's insurance contracts. The Fund's investments include public bonds that consist of U.S. government obligations and public utility, railroad, industrial, and miscellaneous corporate obligations. In addition, some privately placed fixed-income securities, purchased by the Fund under prior investment guidelines, continue to be held by the Fund.

The book and fair values of the Fund's investments as of December 31, 2015, are as follows:

	Book Value	Fair Value
Government:		
Issuer Obligations	$37,061,433	$ 46,093,042
Mortgage-backed and Asset-backed	196	200
Total Government	37,061,629	46,093,242
Industrials and Miscellaneous	57,460,462	63,249,939
Total	$94,522,091	$109,343,181

The book and fair values of the Fund's investments as of December 31, 2014, are as follows:

	Book Value	Fair Value
Government:		
Issuer Obligations	$34,159,673	$ 44,715,212
Mortgage-backed and Asset-backed	419	443
Total Government	34,160,092	44,715,655
Industrials and Miscellaneous	59,334,549	70,280,474
Total	$93,494,641	$114,996,129

The book and fair values of the Fund's investments as of December 31, 2013, are as follows:

	Book Value	Fair Value
Government:		
Issuer Obligations	$32,651,181	$ 39,676,310
Mortgage-backed and Asset-backed	652	707
Total Government	32,651,833	39,677,017
Industrials and Miscellaneous	59,394,659	65,284,394
Total	$92,046,492	$104,961,411

Book values represent the bonds' amortized costs using the method of amortization discussed in Note 2. Fair values were obtained from information provided by NAIC's Securities and Valuation Office and the State of Wisconsin Investment Board.

The book and fair values of bonds, by contractual maturity, at December 31, 2015, follows. Actual maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Book Value	Fair Value
Due in One Year or Less	$ 1,497,572	$ 1,527,979
Due after One Year through Five Years	6,975,227	7,666,951
Due after Five Years through Ten Years	12,275,415	14,662,937
Due after Ten Years	73,773,877	85,485,314
Total	$94,522,091	$109,343,181

Proceeds from the sales of securities were $5.8 million in 2015, $1.6 million in 2014, and $5.5 million in 2013. The sales resulted in gross realized gains of $281,983 in 2015, $4,879 in 2014, and $121,402 in 2013, and gross realized losses of $66,860 in 2015, $0 in 2014, and $29,434 in 2013. Realized investment gains and losses are determined by specific identification. Generally, realized gains and losses are credited or charged to the IMR and amortized into income over the remaining life of the investments sold. However, realized gains and losses related to bonds that had certain changes in their credit ratings are reported in the financial statements in the year that the bonds are sold.

Excluding investments in U.S. Treasury securities and other obligations of the federal government, the Fund is not exposed to any significant concentration of credit risk in its investments.

4. NET INVESTMENT INCOME

Net investment income for calendar years 2015, 2014, and 2013 was generated from the following sources:

	2015	2014	2013
Bonds and Private Placements	$5,262,196	$5,273,934	$5,303,143
Contract Loans	242,709	105,942	255,118
State Investment Fund	(3,225)	(4,389)	(5,059)
Subtotal	5,501,680	5,375,487	5,553,202
Less Investment Expenses	55,113	29,517	30,084
Net Investment Income	$5,446,567	$5,345,970	$5,523,118

Net investment income does not include reported net realized capital gains (losses), which are reported separately on the Statement of Operations and Changes in Fund Surplus.

5. SURPLUS AND POLICYHOLDERS' DIVIDEND RESTRICTIONS

The Fund pays dividends on all active policies. The estimated dividends payable in the following year are charged to current operations. Of the amounts reported on the Balance Sheet, the amounts paid out between January 1 and March 31 of the following year were $945,593 for 2015; $950,088 for 2014; and $551,281 for 2013.

Section 607.15, Wis. Stats., requires that the surplus be maintained at a level between 7.0 percent and 10.0 percent of assets, insofar as is practicably possible. The Fund's surplus-to-assets ratio was 9.2 percent as of December 31, 2015; 9.9 percent as of December 31, 2014; and 11.6 percent as of December 31, 2013. The dividend formula was last changed in 2014 in order to increase dividends paid on each unit of insurance to allow the Fund to be in compliance with s. 607.15, Wis. Stats.

6. REINSURANCE

The Fund currently has a contract with Optimum Reinsurance Company for insuring those applicants considered high risk by the Fund. This company is not affiliated, owned in excess of 10.0 percent, or controlled, either directly or indirectly, by the Fund or any representative of the Fund. In addition, no policies issued by the Fund have been reinsured with a company chartered in a country other than the United States (excluding U.S. branches of such companies) that is owned in excess of 10.0 percent or controlled directly or indirectly by an insured, a beneficiary, a creditor of an insured, or any other person not primarily engaged in the insurance business.

Under its reinsurance agreement, the Fund retains the reserves and related assets; pays the reinsurer premiums for the ceded business; and is reimbursed for benefits, unusual expenses, and adjustments to required reserves. The reinsurer has no obligation for the reimbursement of dividends related to the ceded business. The Fund does not have any reinsurance agreements in effect under which the reinsurer may unilaterally cancel any reinsurance for reasons other than for nonpayment of premium or other similar credits. Neither does the Fund have any reinsurance agreements in effect such that the amount of losses paid or accrued through the statement date may result in payment to the reinsurer of amounts that, in aggregate and allowing for offset of mutual credits from other reinsurance agreements with the same reinsurer, exceed the total direct premium collected under the reinsured policies.

The following table contains the total life insurance in force and the amount of reinsurance ceded as of the end of each calendar year:

As of:	Total Life Insurance in Force	Reinsurance Ceded
December 31, 2015	$194,092,706	$2,147,500
December 31, 2014	197,235,353	2,180,500
December 31, 2013	200,586,353	2,200,500

The Fund is contingently liable with respect to ceded insurance should the reinsurer be unable to meet its assumed obligations. Commencing in 2007, the Fund started applying a reserve credit based on the reinsurance ceded life insurance to its aggregate reserve calculation. The reinsurance credit was $22,194 for 2015; $21,861 for 2014; and $22,256 for 2013.

Payments to the reinsurer are treated as a reduction of premium income; claim payments received from the reinsurer are treated as a reduction of benefit expense. Reinsurance transactions reported in the Fund's operations are as follows:

	Premiums	Claims
2015	$42,099	$ 7,074
2014	36,990	3,109
2013	32,317	17,678

7. RESERVES FOR LIFE INSURANCE CONTRACTS

The aggregate reserve for life insurance contracts for policies issued prior to April 1977 is determined in accordance with the net level premium method, using the American Experience or 1958 Commissioners Standard Ordinary (CSO) mortality tables and an interest rate of 3.0 percent. Aggregate reserves for policies issued from April 1977 through March 1986 are based on the Commissioners Reserve Valuation Method, using the 1958 CSO mortality tables and an interest rate of 4.0 percent. Reserves for policies issued from April 1986 through December 1994 are based on a modified version of the Commissioners Reserve Valuation Method, using the 1980 CSO mortality tables and an interest rate of 5.0 percent. Reserves for policies issued from January 1, 1995, through December 31, 2008, are based on the Commissioners Reserve Valuation Method, using the 1980 CSO mortality tables and an interest rate of 4.0 percent. Reserves for policies issued from January 1, 2009, through December 31, 2012, are based on the Commissioners Reserve Valuation Method, using the 2001 CSO mortality tables and an interest rate of 4.0 percent. Reserves for policies issued since January 1, 2013, are based on the Commissioners Reserve Valuation Method, using the 2001 CSO tables and an interest rate of 3.5 percent.

The Fund waives deduction of deferred fractional premiums upon the death of the insured and returns any portion of the final premium beyond the date of death. Surrender values are not promised in excess of the legally computed reserves.

In addition to the gross premium for a rated age, extra premiums are charged for policies for individuals with high-risk factors issued after April 1, 1977. The Fund cedes 100 percent of the risk on substandard policies to its reinsurer. The Fund holds the standard reserve in its financial statements and did apply reserve credits related to reinsurance for this reporting period. Therefore, the actual reserve held by the Fund for substandard policies exceeds the minimum reserve that is required for such policies.

The State Life Insurance Fund had the following amounts of insurance in force for which gross premiums were less than net premiums determined according to the standard valuation set by the State of Wisconsin, and the following amounts of reserves to cover this deficiency as of December 31, 2015, December 31, 2014, and December 31, 2013:

	Dec. 31, 2015	Dec. 31, 2014	Dec. 31, 2013
Insurance in Force for Which Gross Premiums Were Less than Net Premiums	$17,573,500	$18,330,500	$19,150,500
Portion of Aggregate Reserves to Cover Deficiency	82,691	89,739	98,308

Tabular interest, tabular less actual reserve released, and tabular cost have been determined by NAIC formulas. Tabular interest on funds not involving life contingencies is also determined by a separate NAIC formula.

8. LIABILITY FOR DEPOSIT-TYPE CONTRACTS

All of the deposit-type contracts of the Fund are subject to discretionary withdrawal without adjustment. They are reported at book value and are not affected by reinsurance. The liability accounts reported as of December 31, 2015, December 31, 2014, and December 31, 2013, include:

	Dec. 31, 2015	Dec. 31, 2014	Dec. 31, 2013
Supplementary Contracts without Life Contingencies	$ 2,224,071	$ 2,055,496	$ 1,876,602
Dividends Left to Accumulate	18,136,430	17,060,635	16,230,109
Accrued Deposits	1,650,581	1,652,074	1,616,248
Total Liability for Deposit-type Contracts	$22,011,082	$20,768,205	$19,722,959

9. DEFERRED PREMIUMS AND UNCOLLECTED PREMIUM

As of December 31, deferred life insurance premiums and uncollected life insurance premiums, all of which were for ordinary life insurance, were:

	2015	2014	2013
Gross Premium:			
Ordinary New Business	$ 0	$ 288	$ 129
Ordinary Renewal	77,471	81,102	95,027
Total	$77,471	$81,390	$95,156
Net Premium:			
Ordinary New Business	$ 0	$ 18	$ 16
Ordinary Renewal	64,522	67,143	79,390
Total	$64,522	$67,161	$79,406

Gross premium is the premium charged to the policyholder. Net premium is the amount of premium used in the calculation of the statutory reserves and represents the amount needed to provide contract benefits based on statutory interest and mortality reserve assumptions. The difference between the gross and net premium represents the amount available for expenses.

10. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

As permanent, full-time employees of the State, the Fund's employees are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by ch. 40, Wis. Stats. State and local government public employees are entitled to an annual formula retirement benefit based on: 1) the employee's final average earnings; 2) years of creditable service; and 3) a formula factor. If an employee's contributions, matching employer's contributions, and interest credited to the employee's account exceed the value of the formula benefit, the retirement benefit may instead be calculated as a money purchase benefit. The Wisconsin Retirement System is considered part of the State of Wisconsin's financial reporting entity.

Generally, the State's policy is to fund retirement contributions based on a level-percentage-of-payroll basis to meet normal and prior service costs of the retirement system. Prior service costs were amortized over 40 years beginning January 2, 1990. However, in December 2003 the State issued bonds and subsequently fully liquidated its prior service liability balance as of January 2003. In addition, state agencies are required to make future contributions to fund the bond's debt service.

The retirement plan currently requires employee contributions equal to specified percentages of qualified earnings based on the employee classification, plus employer contributions at a rate determined annually. Both employee and employer contributions are included as part of general expenses each year. The State Life Insurance Fund's contributions to the plan were $25,202 for 2015, $27,291 for 2014, and $26,514 for 2013. The relative position of the State Life Insurance Fund in the Wisconsin Retirement System is not available, since the system is a statewide, multiple-employer plan.

The Fund is required to report other postemployment benefit (OPEB) expenses. OPEBs include such items as the implicit rate subsidy of retiree health insurance present in the contribution rates for existing employees under the State's health insurance program, and the postemployment coverage in the State's life insurance program. However, the Fund's financial statements do not include OPEBs because they are immaterial to the Fund as a whole.

Copies of the separately issued financial reports for the Wisconsin Retirement System and the life insurance program are available on the Department of Employee Trust Funds' website, *http://etf.wi.gov*. The disclosures for the health insurance plan are included in the State's Comprehensive Annual Financial Report, available on the Department of Administration's website, *http://doa.wi.gov*.

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Auditor’s Report ■

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State Auditor

Celebrating 50 Years of Service 1966-2016

Report 16-12

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. Theodore K. Nickel, Commissioner
Office of the Commissioner of Insurance

We have audited the regulatory basis financial statements and the related notes of the Wisconsin State Life Insurance Fund (SLIF) as of and for the years ended December 31, 2015, December 31, 2014, and December 31, 2013, and have issued our report thereon dated December 7, 2016. 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. We provided an adverse opinion on SLIF's financial statements based on generally accepted accounting principles as required by auditing standards and an unmodified opinion on SLIF's financial statements prepared on a regulatory basis in accordance with financial reporting requirements prescribed by the State of Wisconsin Commissioner of Insurance.

Internal Control over Financial Reporting

Management of SLIF 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 SLIF'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 SLIF's internal control. Accordingly, we do not express an opinion on the effectiveness of SLIF'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 SLIF'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, and therefore, material weaknesses or significant deficiencies may exist that were not identified. We consider the deficiency described in Finding 1 in the accompanying schedule of findings and responses to be a significant deficiency for the period covered by our audit. We also consider the deficiency described in Finding 2 in the accompanying schedule of findings and responses to be a significant deficiency for the year ended December 31, 2015. In addition, Finding 3 in the accompanying schedule of findings and responses reports a significant deficiency for the year ended December 31, 2015, that we identified with controls over the reconciliation of cash at the Department of Administration (DOA). We believe this deficiency should be reported to the users of the financial statements of SLIF.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SLIF's 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*. However, we note that SLIF's surplus-to-assets ratio was over the statutory maximum of 10.0 percent and was 11.4 percent as of December 31, 2013. SLIF implemented steps to bring the ratio within the statutorily specified range of 7.0 percent to 10.0 percent by December 31, 2014.

Wisconsin State Life Insurance Fund's Response to Findings

SLIF's written responses to the findings identified in our audit are included in the accompanying schedule of findings and responses. SLIF's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 SLIF'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 SLIF's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

December 7, 2016

SCHEDULE OF FINDINGS AND RESPONSES

Finding 1: Separation of Duties Over Manual Deposits

SLIF receives payments from policyholders for life insurance premiums, repayment of loans, and payment of loan interest. Payments of premiums are generally received through a lockbox, while repayments of policy loans and payments of loan interest are directly received and manually entered into the State's central accounting system by SLIF staff. In addition, other payments may be received and manually entered by SLIF staff, such as premium payments that do not match policyholder statements. Payments manually entered by SLIF totaled approximately $230,000 and were approximately 40 percent of total deposits for calendar year 2015.

To mitigate the risk of theft, fraud, or misstatement, it is important to have separation of duties for receiving payments, entering payments, maintaining custody of payments received, and reconciling cash. When these responsibilities cannot be adequately separated, compensating controls should be implemented by SLIF staff.

For certain types of payments directly received by SLIF staff, the same person is responsible for receiving, maintaining custody of, and manually entering the payments into both SLIF's systems and the State's central accounting system. This person is also responsible for performing the cash reconciliation. As a result, the same person may complete the full processing of a transaction for payments received by SLIF. Therefore, duties related to payments received directly by SLIF staff are not properly separated, creating a risk of theft, fraud, or misstatement, such as recording the funds to an improper policy.

The small number of SLIF staff, particularly those responsible for accounting-related duties, may present challenges in properly separating duties related to payments directly received by SLIF. However, no compensating controls were identified. For example, although SLIF staff indicated there is a review of entries made to SLIF's accounting system, such a review does not adequately ensure that all payments directly received were entered into the accounting system.

Recommendation
We recommend the State Life Insurance Fund modify staff responsibilities to ensure job duties related to payments directly received by the Fund are properly separated, or implement compensating controls at the Fund that effectively mitigate the risk of theft, fraud, and misstatement.

> *State Life Insurance Fund Response:*
> SLIF staff will segregate the duty of manual deposits within the State's central accounting system. The accountant will enter the deposit and the manager will review the deposit and complete the necessary accounting entry.

Finding 2: Reconciliation of State's Central Accounting System to Fund's Accounting System

SLIF staff use several agency-level systems to record SLIF's accounting transactions and to provide the information needed to prepare SLIF's annual financial statements. In addition, staff use the State's central accounting system to process payments, such as for dividends and payment of claims, as well as other receipts and disbursements of SLIF.

The State's central accounting system is also used by other state agencies responsible for processing accounting transactions for SLIF. For example, the State Controller's Office records premium revenue that SLIF receives through a lockbox. Accounting transactions recorded by other agencies are downloaded by SLIF's staff and used to update SLIF's accounting system, as well as other systems, as needed. It is important to reconcile the State's central accounting system records to SLIF's accounting system and other systems to ensure that all transactions processed by the central accounting system are properly reflected in SLIF's systems.

In report 09-14, we reported that SLIF staff did not reconcile the cash balance recorded in the State's central accounting system to the balance reported in SLIF's accounting system, and that the cash balance in SLIF's accounting system had differed from the State's central accounting system's cash balance by $40,937 as of December 31, 2008. From that time through September 30, 2015, SLIF staff completed monthly reconciliations, using the procedures and reconciliation template we provided. Although we saw improvements in the reconciliations over time, we continued to identify variances in certain cash reconciliations. For example, during our current audit we found that SLIF staff had not resolved a variance of $8,074 as of September 30, 2015, between the State's central accounting system and SLIF's accounting system.

In addition, subsequent to the State's implementation of a new central accounting system on October 1, 2015, and through December 31, 2015, SLIF staff did not complete monthly cash reconciliations. Although SLIF staff told us that, during this time, they reconciled cash activity according to information received from DOA's State Controller's Office to the cash recorded in SLIF's accounting system on a daily basis, these reconciliations were not documented.

The unresolved cash variance in the September 30, 2015 reconciliation and the lack of completed and documented reconciliations for the period from October 1, 2015, through December 31, 2015, could lead SLIF staff to believe the systems reconciled when in fact a reconciling item was missed and the systems were not in agreement. Further, there is an increased risk that unauthorized or inappropriate cash transactions were processed and not detected, that all transactions are not recorded on SLIF's accounting system, and that the cash reported as of December 31, 2015, may be misstated.

SLIF staff indicated that the September 30, 2015 variance was not resolved and the daily cash reconciliations were not documented because of other priorities related to the implementation of the State's new central accounting system. SLIF staff also told us that they have been documenting the daily reconciliations since June 20, 2016. In addition, the reports previously used by SLIF staff to complete the monthly reconciliations were not available upon implementation of the State's new central accounting system on October 1, 2015. Reports comparable to those available under the old accounting system first became available in June 2016.

Recommendation
We recommend the State Life Insurance Fund:

- perform and document reconciliations of cash between the State's central accounting system and the Fund's accounting system on at least a monthly basis;

- review and resolve variances identified in the cash reconciliations, including the variance as of September 30, 2015; and

- document procedures for reconciling cash under the State's new central accounting system.

  State Life Insurance Fund Response:
  Cash reconciliations are completed on a daily basis by SLIF as noted since June 20, 2016. Since June 20, 2016, the variances have been reviewed monthly with additional information being provided by DOA regarding disbursements that are completed by areas outside of SLIF. The September 2015 balance will be reviewed. Procedures for completing the cash reconciliation are documented and retained electronically.

Finding 3: Cash Reconciliations at the Department of Administration

DOA is responsible for performing certain centralized internal control functions related to cash. State agencies, including the Office of the Commissioner of Insurance, rely on these controls. As part of our separate audit of DOA, we identified a significant deficiency in the centralized controls related to cash. This weakness relates to the lack of complete and timely reconciliations of cash reported by the bank with cash balances reported in the State's central accounting system. This control is important to ensure cash balances are accurate and to ensure all receipts and disbursements have been properly recorded. Due to the pervasiveness of the deficiency and its effects on state agencies and programs, this deficiency is reported to the users of the financial statements of SLIF. We communicated this weakness to DOA, who agreed with the finding. DOA's response will be included in our separate report related to the State's Comprehensive Annual Financial Report. We did not request a response from the management of SLIF since DOA is responsible for corrective action.

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