Report 09-14
December 2009

An Audit

State Life Insurance Fund

Office of the Commissioner of Insurance

LEGISLATIVE AUDIT BUREAU

The Bureau is a nonpartisan legislative service agency responsible for conducting financial and program evaluation audits of state agencies. The Bureau's purpose is to provide assurance to the Legislature that financial transactions and management decisions are made effectively, efficiently, and in compliance with state law and that state agencies carry out the policies of the Legislature and the Governor. Audit Bureau reports typically contain reviews of financial transactions, analyses of agency performance or public policy issues, conclusions regarding the causes of problems found, and recommendations for improvement.

Reports are submitted to the Joint Legislative Audit Committee and made available to other committees of the Legislature and to the public. The Audit Committee may arrange public hearings on the issues identified in a report and may introduce legislation in response to the audit recommendations. However, the findings, conclusions, and recommendations in the report are those of the Legislative Audit Bureau. For more information, write the Bureau at 22 East Mifflin Street, Suite 500, Madison, WI 53703, call (608) 266-2818, or send e-mail to leg.audit.info@legis.wisconsin.gov. Electronic copies of current reports are available at www.legis.wisconsin.gov/lab.

State Auditor – Janice Mueller

Audit Prepared by

Bryan Naab, *Deputy State Auditor and Contact Person*
Michelle Rudman
Timothy Gerberding
Rachael Runde
Matthew Schampers

Director of Publications – Jeanne Thieme
Report Design and Production – Susan Skowronski

CONTENTS

STATE OF WISCONSIN
Legislative Audit Bureau

22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703
(608) 266-2818
Fax (608) 267-0410
www.legis.wisconsin.gov/lab

Janice Mueller
State Auditor

December 3, 2009

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Vinehout and Representative Barca:

We have completed an audit of the financial statements of the Wisconsin State Life Insurance Fund for the years ended December 31, 2008, 2007, 2006, and 2005, as required by s. 13.94 (1)(de), Wis. Stats. The Fund 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. As of December 31, 2008, it had 28,195 life insurance policies in effect, and $214.8 million of life insurance in force. The Fund operates under specific statutory restrictions, including a prohibition on employing insurance agents and a limitation on coverage of $10,000 to any insured person.

The Fund prepares its financial statements in accordance with insurance accounting practices prescribed by the Commissioner of Insurance. We found its financial statements to be fairly presented in accordance with these accounting practices.

State statutes require the Fund's net profits to be distributed annually as policy dividends, except that the Fund's surplus must be maintained at a level between 7.0 and 10.0 percent of assets to ensure benefits can be paid as they are claimed. However, as we reported previously (report 05-17), the Fund's surplus-to-assets ratio was only 2.7 percent as of December 31, 2004, which was below the statutorily required minimum. The Office of the Commissioner of Insurance worked with the Fund's actuary and implemented several changes, including a new dividend policy, beginning in 2005. As a result, the surplus-to-assets ratio was 7.3 percent and within the statutorily required range as of December 31, 2008.

In a separate letter dated December 3, 2009, we make recommendations to improve the Fund's financial reporting, reconcile cash recorded in the State's central accounting system to cash recorded in the Fund's general ledger, and improve its security over computer systems and data.

We appreciate the courtesy and cooperation extended to us by the staff of the Office of the Commissioner of Insurance in completing our audit.

Respectfully submitted,

Janice Mueller

Janice Mueller
State Auditor

JM/BN/ss

Introduction ■

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

The Wisconsin State Life Insurance Fund, created in 1911 to provide low-cost individual life insurance to Wisconsin residents, is administered by the Office of the Commissioner of Insurance (OCI). The Fund functions much like a mutual life insurance company and is subject to the same regulatory requirements as any life insurance company licensed to operate in Wisconsin. The Fund receives no subsidies from the State of Wisconsin and is not permitted to use commissioned agents. The maximum level of coverage available to each policyholder is $10,000. Wisconsin is the only state that offers life insurance to its citizens.

The Fund offers two types of life insurance policies: term life and whole life. Term life insurance provides death protection for a specific period of time, and death benefits are paid only if the policyholder dies within that time period. In contrast, whole life insurance offers lifetime insurance for the insured individual and accumulates a cash value that is returned if the policy is surrendered before the death of the insured individual. In addition, the policyholder may borrow against the policy's cash value. The Fund offers four different whole life insurance policies. 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 or for the first 20 years of the policy, or in a single payment at the start of coverage. The Fund pays dividends on both term life insurance and whole life insurance. Policyholders may elect to accumulate dividends in their accounts, or use the dividends to offset premium amounts they owe, or have the dividends paid to them in cash.

The number of insured individuals has declined and was 28,195 as of December 31, 2008.

The number of policies has been declining since 1996, when it reached 31,360. As shown in Table 1, it was 28,195 as of December 31, 2008. The amount of insurance in force has likewise declined to $214.8 million, in part because fewer new policies are being issued and because an increasing number of policyholders are surrendering their whole life policies.

Table 1

Number of Policies

December 31	Policies in Force	Insurance in Force
2004	29,712	$223,492,000
2005	29,467	222,329,000
2006	29,046	219,886,000
2007	28,615	217,295,000
2008	28,195	214,848,000

Surplus-to-Assets Ratio

The surplus balance of the State Life Insurance Fund represents the difference between the assets of the Fund, which are primarily investment holdings, and its liabilities, which are primarily funds reserved to cover insurance benefits. The surplus balance grows when the Fund's earnings, including insurance premiums and investment earnings, are greater than its expenses, including benefit expenses and dividends paid to policyholders. It is important that the Fund have an adequate surplus balance in the event the actuarially determined reserve amounts are not sufficient to pay benefits as they come due.

The Fund's ratio of surplus to assets is required to be between 7.0 and 10.0 percent.

Section 607.15, Wis. Stats., provides that the net profits of the Fund be distributed annually to policyholders in the form of dividends. However, the Legislature has also specified that, to the extent feasible, the ratio of the Fund's surplus to its assets must be between 7.0 percent and 10.0 percent. Some factors affecting changes in the surplus-to-assets ratio, such as required reserve balances, are not controllable by the Fund's staff. However, staff can control the level of dividends paid to policyholders. To do so, they periodically assess whether the dividends need to be adjusted to maintain a surplus-to-assets ratio within the statutory guidelines. If a dividend adjustment is necessary, staff work with the Fund's actuary to review the assumptions, such as anticipated investment earnings and mortality rates, that are used in the calculation of the dividend scale, which determines the level of dividends to pay to the various types of policyholders.

The dividend scale that was used to pay dividends through 2004 went into effect in 1998 and was based upon the expected investment earnings, expenses, and mortality assumptions at that time. However, the surplus-to-assets ratio declined, as discussed in our previous audit (report 05-17), largely because of continued payment of dividends in excess of the Fund's earnings and an increase in reserve balances. Correcting financial reporting errors that we detected during that audit caused the surplus-to-assets ratio to decline even further.

The Office's actions increased the surplus-to-assets ratio to 7.3 percent as of December 31, 2008.

Staff worked with the Fund's actuary and developed a new dividend scale that took effect in August 2005. In addition, a reduction in the interest rate the Fund pays on certain deposits, which took effect on January 1, 2006, improved the surplus-to-assets ratio. As shown in Table 2, the surplus-to-assets ratio again met the minimum requirement of 7.0 percent as of December 31, 2007. The ratio continued to increase and was 7.3 percent as of December 31, 2008.

Table 2

State Life Insurance Fund
Surplus-to-Assets Ratio

December 31	Ratio[1]
2001	8.1%
2002	5.5
2003	4.2
2004	2.7
2005	4.6
2006	5.8
2007	7.1
2008	7.3

[1] The surplus and assets reported in audited financial statements were used to calculate the ratios.

We encourage OCI to continue to annually assess the surplus-to-assets ratio and take any necessary steps to ensure it remains within the statutory surplus-to-assets ratio guidelines.

Internal Controls over Financial Reporting

During our audit of the Fund's financial statements, we identified three internal control weaknesses that are discussed below and included in our Report on Internal Control and Compliance.

We identified errors in the Fund's financial statements.

First, we found the need for significant audit adjustments to the financial statements. For example, staff initially overstated the dividends to policyholders account by $796,000 for 2008. In addition, staff made other accounting errors that we believe should have been detected and investigated through routine review of the Fund's financial statements. We include a recommendation that the Fund's staff more thoroughly review the financial statements to ensure they are reasonable and materially accurate.

The Fund's staff need to investigate and resolve differences in recorded cash balances.

Second, the Fund's staff did not implement our prior audit recommendation and has not reconciled the cash recorded on the Fund's general ledger to the cash recorded in WiSMART, the State's central accounting system. As of December 31, 2008, the cash balance recorded on WiSMART was $40,937 lower than the cash balance recorded in the Fund's general ledger. We include a recommendation that the Fund's staff work with the State Controller's Office to investigate and resolve differences between the cash balances recorded on the systems.

Finally, OCI should continue to strengthen its security over computer systems to reduce the risk that unauthorized users can access the Fund's data and transactions and the risk that equipment and data could be lost or stolen. We include a recommendation that OCI improve its computer password standards, further limit access to computer equipment and electronically stored data, and ensure safe storage of computer back-up tapes.

▪ ▪ ▪ ▪

Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the Wisconsin State Life Insurance Fund

We have audited the accompanying financial statements of the Wisconsin State Life Insurance Fund as of and for the years ended December 31, 2008, 2007, 2006, and 2005, as listed in the table of contents. These financial statements, which are prepared in accordance with the basis of accounting prescribed or permitted by the Commissioner of Insurance, are the responsibility of the Wisconsin State Life Insurance Fund's management. 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*, 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2A, the financial statements referred to in the first paragraph present only the Wisconsin State Life Insurance Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the results of its operations and changes in financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

As described more fully in Note 2, the Wisconsin State Life Insurance Fund presents these financial statements using accounting practices that are prescribed or permitted by the Commissioner of Insurance of the State of Wisconsin, as authorized by Wisconsin Statutes. This comprehensive basis of accounting differs from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to in the first paragraph do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Wisconsin State Life Insurance Fund as of December 31, 2008, 2007, 2006, and 2005, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to in the first paragraph do present fairly, in all material respects, the financial position of the Wisconsin State Life Insurance Fund as of December 31, 2008, 2007, 2006, and 2005, and the results of its operations and changes in fund surplus and its cash flows for the years then ended in conformity with the accounting practices prescribed or permitted by the Commissioner of Insurance of the State of Wisconsin.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Wisconsin State Life Insurance Fund. The supplementary information included as Management's Discussion and Analysis on pages 9 through 16 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 12, 2009, on our consideration of the Wisconsin State Life Insurance Fund'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* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

November 12, 2009 by

Bryan Naab
Deputy State Auditor for Financial Audit

Management's Discussion and Analysis ■

Prepared by the Wisconsin State Life Insurance Fund's Management

This section presents management's discussion and analysis of the financial performance of the Wisconsin State Life Insurance Fund during the calendar years ended December 31, 2008, 2007, 2006, and 2005. 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 has taken steps to bring the surplus-to-assets ratio back in compliance with s. 607.15, Wis. Stats, which requires the ratio of surplus to assets be between 7.0 and 10.0 percent. Steps included a reduction in dividends paid to policyholders and a decrease in the interest rate paid related to certain deposit-type contracts.

Financial Statements

The Fund's financial statements have been prepared on the basis of accounting practices prescribed or permitted by the 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, 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, 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, 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 between calendar years 2008, 2007, 2006, and 2005 are reviewed.

Assets

As shown in Table A, the largest portion of the Fund's assets, 92.2 percent in calendar year 2008, 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 mortgage-backed and asset-backed securities are carried at amortized cost using the scientific method to amortize any bond premiums and discounts. All other bonds are carried at amortized cost using the straight-line method of amortization.

Table A

Fund Assets
As of December 31

	2008	2007	2006	2005	2004
Total Assets	$87,839,710	$87,016,036	$84,828,519	$82,963,007	$81,197,487
Bonds	$80,996,310	$79,514,026	$76,825,094	$75,209,728	$71,881,259
Percentage of Assets that Are Bonds	92.2%	91.4%	90.6%	90.7%	88.5%

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 a result of the economic recession, certain corporate bonds unexpectedly declined in value during calendar year 2008 due to the unexpected bankruptcies of Lehman Brothers and General Motors. As required by NAIC accounting standards, the Fund's net investment income reported on the Statement of Operations and Changes in Fund Surplus included realized losses on these bonds totaling $1.2 million in calendar year 2008. Other gains and losses realized in calendar year 2008 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

	2008	2007	2006	2005	2004
Total Liabilities	$81,410,998	$80,829,084	$79,924,384	$79,135,799	$79,025,141
Aggregate Reserves for Life Insurance Contracts	$60,956,924	$60,057,292	$59,088,458	$57,980,006	$56,610,600
Percentage of Total Liabilities	74.9%	74.3%	73.9%	73.3%	71.6%

The aggregate reserves for life insurance contracts are the amounts required by law 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 the 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, while the liability for deposit-type contracts continued to increase in calendar year 2004 and calendar year 2005, as it had in prior years, the liability has been fairly constant from December 31, 2005, to December 31, 2008.

Table C

Deposit-type Contracts
As of December 31

	2008	2007	2006	2005	2004
Liability for Deposit-type Contracts	$17,404,750	$17,209,084	$16,971,560	$16,938,468	$15,937,610
Percentage Change from Prior Year	1.1%	1.4%	0.2%	6.3%	9.5%

One reason for the reduced growth during calendar years 2006, 2007, and 2008, was that some policyholders withdrew their deposits from the Fund because the Fund reduced the interest rate paid on certain deposits to 3 percent effective January 1, 2006, from the previous 5 percent. This reduction was part of the Fund's efforts to ensure the surplus-to-assets ratio is at least 7.0 percent, the minimum statutorily required balance. In addition, dividend reductions took place effective August 1, 2005, and then again January 1, 2006, which limited the increase in the deposit-type contracts. As shown in Table D, the reduced interest rate and the reduced amount of accrued dividends caused the interest expense on deposit-type contracts to decline in calendar years 2005, 2006, and 2007.

Table D

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

	2008	2007	2006	2005	2004
Interest Expense on Deposit-type Contracts	$529,451	$523,474	$530,810	$649,008	$749,017
Percentage Change from Prior Year	1.1%	(1.4)%	(18.2)%	(13.4)%	9.7%

Revenues

Revenue earned in the Fund is from investment income, premium income, and interest income on policy loans. There were 28,195 life insurance policies in effect as of December 31, 2008, a decrease of 1,272 policies, or 4.3 percent, from the December 31, 2005 policy count of 29,467.

The decreases in revenues shown in Table E for calendar years 2007 and 2008 are because of the decline in insurance premium revenues resulting from fewer policies in effect, and the decline in investment income caused, in part, by the write-offs for losses in 2008 related to bonds issued by Lehman Brothers and General Motors.

Table E

Changes in Fund Revenues
Calendar Year Ended December 31

	2008	2007	2006	2005	2004
Revenue	$7,148,702	$7,236,146	$7,243,289	$7,240,317	$7,188,403
Percentage Change from Prior Year	(1.2)%	(0.1)%	0.1%	0.7%	(8.8)%

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 year 2006, the change in policy benefits was primarily related to an increase in the number of death claims and an increase in the number of insurance policies that were surrendered because of the dividend reductions that were made in 2005 and 2006. In calendar year 2008, the Fund incurred another increase in the number of death claims and an increase in the number of policies that matured during the year.

Table F

Policy Benefits
Calendar Year Ended December 31

	2008	2007	2006	2005	2004
Policy Benefits	$1,871,948	$1,775,712	$1,785,318	$1,390,753	$1,374,921
Percentage Change from Prior Year	5.4%	(0.5)%	28.4%	1.2%	3.8%

General expenses are used to support the administration of the Fund. The Fund had an increase in general expenses in 2005, as shown in Table G, due to the actuarial expenses to develop a new dividend scale. The Fund also had audit expenses in calendar year 2005 for the Legislative Audit Bureau's audit. In calendar year 2008, the Fund again had an increase in actuarial expenses to develop a new plan series using the 2001 Commissioners Standard Ordinary (CSO) mortality table. This also involved additional expenses in printing a new brochure with the rates for the new plan series.

Table G

General Expenses
Calendar Year Ended December 31

	2008	2007	2006	2005	2004
General Expenses	$601,353	$545,983	$591,185	$601,661	$531,955
Percentage Change from Prior Year	10.1%	(7.6)%	(1.7)%	13.1%	(6.2)%

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 the last four years are reflected in Table H:

Table H

Dividends
Calendar Year Ended December 31

	2008	2007	2006	2005	2004
Dividends	$2,080,133	$2,066,105	$2,062,645	$1,489,820	$4,123,485
Percentage Change from Prior Year	0.7%	0.2%	38.4%	(63.9)%	1.9%

The calendar year 2004 dividends included an accrual for the estimated dividends to be paid during calendar year 2005. This accrual was based on the information known at the time the financial statements were prepared. However, dividend reductions were subsequently implemented in August 2005 (as well as in January 2006) in the Fund's efforts to ensure the surplus-to-assets ratio was raised above the statutorily required minimum. The calendar year 2005 dividends reported in the financial statements were significantly lower than the amount reported for calendar year 2004 because 1) the dividends paid in 2005 were lower than the dividends paid in 2004; and 2) an accounting adjustment was needed because the dividends actually paid during 2005 were lower than the dividend amount accrued at the end of calendar year 2004.

As shown in Table I, the surplus-to-assets ratio was in statutory compliance as of December 31, 2007, because of the reduction of the dividend scale and interest rates paid on certain deposit-type accounts.

Table I

Surplus-to-Assets Ratio
Calendar Year Ended December 31

	2008	2007	2006	2005	2004
Surplus	$6,428,712	$6,186,952	$4,904,135	$3,827,208	$2,172,346
Total Assets	$87,839,710	$87,016,036	$84,828,519	$82,963,007	$81,197,487
Surplus-to-Assets Ratio	7.3%	7.1%	5.8%	4.6%	2.7%

Fund management worked with the Fund's actuary to address alternatives to increase the surplus. A dividend restructuring was implemented effective August 1, 2005. A new dividend scale was developed based on a projected investment yield of 6.8 percent, as opposed to the previous scale that was based on a yield of 9.71 percent.

Effective January 1, 2006, the dividend scale was readjusted to reflect a projected investment earnings yield of 6.0 percent. In addition, as previously noted, management decreased the interest rate paid on certain deposit-type accounts from 5.0 percent per year to an interest rate of 3.0 percent per year. These efforts brought the surplus-to-assets ratio to within the statutory guidelines by the end of calendar year 2007.

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 director at the 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 Web site, *http://www.oci.wi.gov/slif.htm.*

▪ ▪ ▪ ▪

Financial Statements ■

Balance Sheet—Statutory Basis
December 31, 2008, December 31, 2007, December 31, 2006, and December 31, 2005

	December 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005
ASSETS				
Bonds (Note 3)	$ 80,996,310	$ 79,514,026	$ 76,825,094	$ 75,209,728
Cash, Cash Equivalents, and Short-Term Investments (Note 3)	1,521,657	2,268,608	2,830,468	2,610,223
Contract Loans	3,789,515	3,762,905	3,727,629	3,702,894
Investment Income Receivable	1,428,188	1,361,412	1,322,640	1,308,676
Deferred Premiums and Uncollected Premiums (Note 9)	104,040	109,085	118,618	131,486
Amounts Recoverable from Reinsurers	0	0	4,070	0
TOTAL ASSETS	$ 87,839,710	$ 87,016,036	$ 84,828,519	$ 82,963,007
LIABILITIES AND FUND SURPLUS				
Aggregate Reserves for Life Insurance Contracts (Note 7)	$ 60,956,924	$ 60,057,292	$ 59,088,458	$ 57,980,006
Liability for Deposit-type Contracts (Note 8)	17,404,750	17,209,084	16,971,560	16,938,468
Contract Claims (Note 2)	228,000	212,000	220,381	139,464
Dividends Due and Unpaid, Plus Those Payable in the Following Year (Note 5)	2,125,290	2,117,267	2,121,744	2,135,520
Premiums Received in Advance	53,143	49,757	51,985	50,055
Interest Maintenance Reserve (Note 2)	421,997	707,211	1,077,510	1,503,498
General Expenses Payable	46,833	54,485	53,877	90,510
Asset Valuation Reserve (Note 2)	0	277,256	204,035	153,094
Other Liabilities	174,061	144,732	134,834	145,184
Total Liabilities	81,410,998	80,829,084	79,924,384	79,135,799
Fund Surplus (Note 5)	6,428,712	6,186,952	4,904,135	3,827,208
TOTAL LIABILITIES AND FUND SURPLUS	$ 87,839,710	$ 87,016,036	$ 84,828,519	$ 82,963,007

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, 2008, December 31, 2007, December 31, 2006, and December 31, 2005

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
REVENUES				
Premiums (Note 2)	$ 1,896,325	$ 2,001,228	$ 2,092,709	$ 2,184,468
Net Investment Income (Note 4)	4,954,347	4,862,398	4,724,585	4,600,852
Amortization of Interest Maintenance Reserve	285,216	370,299	425,995	454,997
Miscellaneous Income	12,814	2,221	0	0
Total Revenues	**7,148,702**	**7,236,146**	**7,243,289**	**7,240,317**
OPERATING EXPENSES				
Benefits:				
Death benefits	1,069,077	975,195	1,030,263	865,653
Matured endowments	252,500	147,000	207,000	196,500
Surrender benefits	539,824	641,597	536,578	316,741
Disability benefits	10,547	11,920	11,477	11,859
Interest and adjustments on contract or deposit-type contract funds	529,451	523,474	530,810	649,008
Increase in aggregate reserves for life insurance contracts	899,632	968,834	1,108,452	1,369,406
Total Benefits	3,301,031	3,268,020	3,424,580	3,409,167
General Expenses	601,353	545,983	591,185	601,661
Total Operating Expenses	**3,902,384**	**3,814,003**	**4,015,765**	**4,010,828**
Net Income from Operations before Dividends and Net Realized Capital Gain (Loss)	**3,246,318**	**3,422,143**	**3,227,524**	**3,229,489**
Dividends to Policyholders (Note 5)	(2,080,133)	(2,066,105)	(2,062,645)	(1,489,820)
Net Realized Capital Gain (Loss)	(1,201,681)	0	(37,011)	0
NET INCOME (LOSS)	**$ (35,496)**	**$ 1,356,038**	**$ 1,127,868**	**$ 1,739,669**
CHANGES IN FUND SURPLUS				
Surplus at Beginning of Period	$ 6,186,952	$ 4,904,135	$ 3,827,208	$ 2,172,346
Net Income (Loss)	(35,496)	1,356,038	1,127,868	1,739,669
Change in Asset Valuation Reserve	277,256	(73,221)	(50,941)	(84,807)
NET CHANGE IN SURPLUS ACCOUNT	**241,760**	**1,282,817**	**1,076,927**	**1,654,862**
Surplus at End of Period	$ 6,428,712	$ 6,186,952	$ 4,904,135	$ 3,827,208

The accompanying notes are an integral part of this statement.

Statement of Cash Flows—Statutory Basis
for the Years Ended December 31, 2008, December 31, 2007, December 31, 2006, and December 31, 2005

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
CASH FROM OPERATIONS				
Premiums Collected Net of Reinsurance	$ 1,908,259	$ 2,009,539	$ 2,110,782	$ 2,181,073
Net Investment Income	4,987,724	4,925,710	4,819,962	4,673,917
Miscellaneous Income	12,814	2,221	0	0
Total Receipts	6,908,797	6,937,470	6,930,744	6,854,990
Benefit and Loss Related Payments	2,385,398	2,303,497	2,239,281	2,051,904
Commissions, Expenses Paid, and Aggregate Write-ins for Deductions	612,996	546,219	631,013	564,455
Dividends Paid to Policyholders	2,072,110	2,070,581	2,076,423	3,526,218
Total Benefits and Expenses	5,070,504	4,920,297	4,946,717	6,142,577
Net Cash Provided by Operating Activities	**1,838,293**	**2,017,173**	**1,984,027**	**712,413**
CASH FROM INVESTMENTS				
Cash Received from Sale of Bonds	1,036,471	1,490,070	662,763	3,103,259
Cash Paid for Purchase of Bonds	(3,820,587)	(4,281,088)	(2,424,470)	(6,406,531)
Decrease (Increase) in Contract Loans	(26,610)	(35,276)	(24,736)	196
Net Cash Used in Investing Activities	**(2,810,726)**	**(2,826,294)**	**(1,786,443)**	**(3,303,076)**
CASH FROM FINANCING AND MISCELLANEOUS SOURCES				
Net Deposits on Deposit-type Contract and Other Insurance Liabilities	195,666	237,524	33,093	1,000,858
Other Cash Provided (Applied)	29,816	9,737	(10,432)	(19,954)
Net Cash Provided by Financing and Miscellaneous Activities	**225,482**	**247,261**	**22,661**	**980,904**
NET CHANGE IN CASH, CASH EQUIVALENTS, AND SHORT-TERM INVESTMENTS	**(746,951)**	**(561,860)**	**220,245**	**(1,609,759)**
Cash, Cash Equivalents, and Short-Term Investments at January 1	2,268,608	2,830,468	2,610,223	4,219,982
Cash, Cash Equivalents, and Short-Term Investments at December 31	$ 1,521,657	$ 2,268,608	$ 2,830,468	$ 2,610,223

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, 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 insurance. As of December 31, 2008, the Fund had 28,195 life insurance policies in effect, including 25,912 whole life insurance policies and 2,283 term policies. The total amount of insurance in force as of December 31, 2008, was $214,847,583.

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 the basis of statutory accounting practices prescribed or permitted by the

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 as the prescribed and permitted practices for the Fund, as permitted by s. 623.02, Wis. Stats. Statutory accounting practices and procedures required by the Commissioner of Insurance and NAIC vary in some respects from accounting principles generally accepted in the United States. The following table shows the most significant differences between the codified statutory accounting practices and generally accepted accounting principles.

Financial Statement Area	Codified Statutory Accounting Practices	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.

Financial Statement Area	Codified Statutory Accounting Practices	Generally Accepted Accounting Principles
Dividends	Provision 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 practices requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. 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 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 the requirement of s. 607.15, Wis. Stats., which requires that the ratio of surplus to assets be kept between 7.0 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.

Bonds—NAIC requires bonds to be reported 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 to be reported at the lower of amortized cost or fair value. The Fund reports all mortgage-backed and asset-backed securities at amortized cost using the scientific method. However, all other bonds held by the Fund are reported at amortized cost using the straight-line method of amortization, rather than the scientific method. The effects of this departure from statutory accounting practices on surplus and net income are unknown but management believes them to be immaterial.

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 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, 2008, are as follows:

	Book Value	Fair Value
Government:		
Issuer obligations	$32,268,699	$41,976,085
Mortgage-backed and asset-backed	5,343	5,798
Total Government	32,274,042	41,981,883
Utilities	7,212,142	6,883,309
Industrials and Others	41,510,126	38,429,930
Total	$80,996,310	$87,295,122

The book and fair values of the Fund's investments as of December 31, 2007, are as follows:

	Book Value	Fair Value
Government:		
Issuer obligations	$32,327,972	$36,474,234
Mortgage-backed and asset-backed	12,887	13,568
Total Government	32,340,859	36,487,802
Utilities	7,227,237	7,275,026
Industrials and Others	39,945,930	39,326,472
Total	$79,514,026	$83,089,300

The book and fair values of the Fund's investments as of December 31, 2006, are as follows:

	Book Value	Fair Value
Government:		
Issuer obligations	$32,387,088	$34,997,076
Mortgage-backed and asset-backed	26,181	27,331
Total Government	32,413,269	35,024,407
Utilities	6,743,489	6,864,059
Industrials and Others	37,668,336	37,917,475
Total	$76,825,094	$79,805,941

The book and fair values of the Fund's investments as of December 31, 2005, are as follows:

	Book Value	Fair Value
Government:		
Issuer obligations	$32,446,202	$36,192,811
Mortgage-backed and asset-backed	49,101	51,776
Total Government	32,495,303	36,244,587
Utilities	6,758,621	7,143,563
Industrials and Others	35,955,804	36,747,518
Total	$75,209,728	$80,135,668

Book values represent the bonds' amortized costs using the methods 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 value of bonds, by contractual maturity, at December 31, 2008, 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	$ 4,506,131	$ 4,586,550
Due after One Year through Five Years	3,863,475	3,823,460
Due after Five Years through Ten Years	11,814,004	11,253,955
Due after Ten Years	60,812,700	67,631,157
Total	$80,996,310	$87,295,122

Proceeds from the sales of securities were $1.0 million in 2008, $1.5 million in 2007, $663,000 in 2006, and $3.1 million in 2005. The sales resulted in gross realized gains of $2, $1, $8, and $134,742, respectively, and gross realized losses of $1,201,691, $1, $37,012, and $47, respectively. 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.

In calendar year 2008, investments in Lehman Brothers with a book value of $499,432 were written down to their fair values of $53,605, and investments in General Motors with a book value of $913,594 were written down to their fair value of $157,730. The Lehman Brothers bonds were written down because Lehman Brothers filed for bankruptcy on September 14, 2008, and was subsequently assigned an NAIC credit designation of 6. The General Motors bonds were written down because General Motors was assigned an NAIC credit designation of 6 in 2008 and subsequently filed for bankruptcy on June 1, 2009.

Excluding investments in United States 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 2008, 2007, 2006, and 2005 was generated from the following sources:

	2008	2007	2006	2005
Bonds and Private Placements	$4,661,867	$4,513,957	$4,369,138	$4,282,453
Contract Loans	258,720	256,563	254,411	251,488
State Investment Fund	51,073	131,362	127,331	87,317
Subtotal	4,971,660	4,901,882	4,750,880	4,621,258
Less Investment Expenses	17,313	39,484	26,295	20,406
Net Investment Income	$4,954,347	$4,862,398	$4,724,585	$4,600,852

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 Balance.

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 $540,587 for 2008; $537,456 for 2007; $535,137 for 2006; and $529,723 for 2005.

Section 607.15, Wis. Stats., requires that the surplus be maintained at a level between 7.0 and 10.0 percent of assets, so far as is practicably possible. The dividend formula was last changed in 2006 in order to decrease dividends paid on each unit of insurance to allow the Fund to be in compliance with s. 607.15, Wis. Stats. The Fund's surplus-to-assets ratio was 7.3 percent as of December 31, 2008; 7.1 percent as of December 31, 2007; 5.8 percent as of December 31, 2006; and 4.6 percent as of December 31, 2005.

6. REINSURANCE

The State Life Insurance 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, 2008	$214,848,000	$2,466,000
December 31, 2007	217,295,000	2,520,000
December 31, 2006	219,886,000	2,557,000
December 31, 2005	222,329,000	2,570,000

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 $24,079 for 2007 and $23,419 for 2008.

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
2008	$38,283	$30,073
2007	40,077	11,836
2006	40,920	14,737
2005	40,021	25,847

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 Valuations 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 Valuations Method, using the 1980 CSO mortality tables and an interest rate of 5.0 percent. Reserves for policies issued since January 1, 1995, are based on the Commissioners Reserve Valuations Method, using the 1980 CSO mortality tables and an interest rate of 4.0 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.

Extra premiums are charged for policies for individuals with high-risk factors issued after April 1, 1977, plus the gross premium for a rated age. 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 in 2007 and 2008. 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, 2008, 2007, 2006, and 2005:

	Dec. 31, 2008	Dec. 31, 2007	Dec. 31, 2006	Dec. 31, 2005
Insurance in Force for which Gross Premiums Were Less than Net Premiums	$22,061,500	$40,590,500	$41,600,000	$42,685,500
Portion of Aggregate Reserves to Cover Deficiency	143,477	154,492	164,810	176,522

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 for calendar years 2008, 2007, 2006, and 2005 include:

	2008	2007	2006	2005
Supplementary Contracts without Life Contingencies	$ 892,685	$ 867,750	$ 906,614	$ 977,534
Dividends Left to Accumulate	14,733,842	14,558,115	14,276,382	14,105,760
Accrued Deposits	1,778,013	1,783,219	1,788,564	1,855,174
Total Liability for Deposit-type Contracts	$17,404,540	$17,209,084	$16,971,560	$16,938,468

9. DEFERRED PREMIUMS AND UNCOLLECTED PREMIUMS

As of December 31, the Fund reported deferred life insurance premiums and uncollected life insurance premiums, all of which were for ordinary life insurance. The total gross and net premiums were:

	2008	2007	2006	2005
Gross Premium:				
Ordinary new business	$ 555	$ 802	$ 3,039	$ 2,424
Ordinary renewal	127,104	135,406	143,707	160,466
Total	$127,659	$136,208	$146,746	$162,890
Net Premium:				
Ordinary new business	$ 380	$ 364	$ 1,804	$ 1,377
Ordinary renewal	103,660	108,721	116,814	130,109
Total	$104,040	$109,085	$118,618	$131,486

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. The retirement plan 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 $32,168, $30,995, $22,265 and $24,483 for the years ended December 31, 2008, 2007, 2006, and 2005, respectively. 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.

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 Fund's Web Site, *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 Web Site, *http://www.doa.state.wi.us*.

11. AUDIT ADJUSTMENTS

The unaudited financial statements presented in the Commissioner of Insurance's annual reports to the Governor and the Legislature have been adjusted to reflect recommended audit adjustments. The effect of these adjustments on net income and Fund surplus for 2008, 2007, 2006, and 2005 include:

Account Balance	Unaudited Balance	Audited Balance	Difference
Net Income (Loss)			
2008	$ 539,548	$ (35,496)	$(575,044)
2007	1,365,549	1,356,038	(9,511)
2006	1,230,069	1,127,868	(102,201)
2005	1,887,298	1,739,669	(147,629)
Fund Surplus			
2008	6,440,837	6,428,712	(12,125)
2007	6,209,152	6,186,952	(22,200)
2006	4,910,267	4,904,135	(6,132)
2005	3,828,170	3,827,208	(962)

▪ ▪ ▪ ▪

Report on Internal Control and Compliance ■

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the Wisconsin State Life Insurance Fund as of and for the years ended December 31, 2008, 2007, 2006, and 2005, and have issued our report thereon dated November 12, 2009. 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*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Wisconsin State Life Insurance Fund's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Wisconsin State Life Insurance Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Wisconsin State Life Insurance Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified two deficiencies in internal control that we consider to be material weaknesses and one deficiency that we consider to be a significant deficiency.

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 or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or combination of control deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the Wisconsin State Life Insurance Fund's financial statements will not be prevented or will not be detected and corrected on a timely basis. We consider the following two deficiencies to be material weaknesses.

Financial Reporting

The Fund's financial statements are based on the Annual Statement, which the Fund, as well as any company offering life insurance, is statutorily required to prepare and submit to the Office of the Commissioner of Insurance by March 1. Preparation of the Annual Statement and, therefore, the financial statements subject to audit, is challenging because of complex accounting and reporting requirements. In addition, the Fund's staff face tight time deadlines to prepare the Annual Statement.

The Fund's staff took some steps to address our prior audit recommendation for improved financial reporting. For example, staff determined the quality ratings of bonds held in the bond portfolio at the end of each calendar year and involved the Fund's actuary in the calculation of the interest maintenance reserve and asset valuation reserve.

However, we found during our current audit that the Fund's staff did not fully implement our prior audit recommendations to ensure accurate financial reporting. For example, they did not consult with Regulation and Enforcement Division staff to ensure accurate accounting and financial reporting for the Fund. As a result, we again identified significant financial reporting errors during our current audit that needed to be corrected to ensure the audited financial statements are fairly presented. For example:

- Investment income was understated by $146,666 for 2005 and by $200,325 for 2008 because there was an error in the formula used to calculate net investment income.

- The general expenses account for 2006 was understated by $53,302 because certain expenses were inadvertently excluded from the electronic spreadsheet used to calculate general expenses.

- The dividends to policyholders account was overstated by $795,852 for 2008 because staff entered an incorrect amount into the exhibit included in the Annual Statement used to calculate dividends.

- The net realized capital gain (loss) account was understated by $755,864 in 2008 because staff improperly reported a loss on an investment in General Motors bonds as an unrealized loss. Because these bonds were assigned an NAIC credit rating of 6, staff should have reported the decline in value as a realized loss.

At least some of the errors occurred because the Fund's staff do not have a complete understanding of accounting and financial reporting. In addition, most of the errors would have been detected through a more thorough review of the Fund's Annual Statement and financial statements. After our discussions, the Fund's staff corrected the audited financial statements.

In response to our recommendations, the Fund's management indicated that staff will strive to complete the Annual Statement and the financial statements as accurately as possible and will seek to engage staff from the Regulation and Enforcement Division to provide an additional review of the Annual Statement. Management also indicated that in the event the financial statements do not properly balance and adjustments are needed, staff will pursue and resolve matters with the assistance of Regulations and Enforcement Division examiners.

Cash Reconciliation

The Fund's accounting transactions are recorded both in WiSMART, the State's central accounting system that, among other things, generates checks, and on the Fund's general ledger, which is used to prepare the Fund's financial statements. However, the Fund's staff do not reconcile the cash balance recorded in WiSMART to the cash balance recorded on the Fund's general ledger. As a result, any variances between the two accounting systems are not identified and investigated.

During our audit, we identified a $40,937 variance as of December 31, 2008, between the cash balance recorded in WiSMART and the cash balance recorded on the Fund's general ledger. Because this variance had not been investigated, there is increased risk that unauthorized or inappropriate cash transactions were processed in WiSMART and remain undetected. In addition, because staff use the general ledger to prepare the Fund's financial statements, the reported cash balance could be misstated.

In response to our recommendations, the Fund's staff indicated that they will reconcile on a monthly basis the cash activity recorded on the Fund's general ledger to the cash activity recorded in WiSMART. Fund management note that as of November 2009, staff have reconciled the cash activity for the months January 2009 through July 2009.

A *significant deficiency* is a deficiency or 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. We consider the following deficiency to be a significant deficiency.

Security over Computer Systems

Controlling access to computer systems is important to ensure that computer programs and data are protected from improper access and use. If access is not limited to appropriate staff, computer programs and data may be intentionally or unintentionally damaged or manipulated, and there is an increased risk of unauthorized accounting transactions.

However, we identified the following concerns over security and access to the Fund's computer programs and data:

- The Fund continues to allow computer programmers to have excessive access to the Flexible Insurance, Marketing, Management, and Administration System (FIMMAS), which is used to account for and manage the Fund's insurance policies. As a result, the Fund is at increased risk of unauthorized or inappropriate changes to data or programs.

- The Office of the Commissioner of Insurance has inadequate password standards, which increase the risk that unauthorized users can gain access to computer resources, including FIMMAS, and make unauthorized transactions.

- The Office of the Commissioner of Insurance allows excessive access to the room used to secure the computer that processes FIMMAS transactions and does not sufficiently safeguard computer back-up tapes. As a result, the Fund is at increased risk of lost, stolen, or damaged computer resources.

Staff in the Office of the Commissioner of Insurance indicate that they have already taken steps to address some of our concerns. They indicate that the Office has a plan for strengthening password standards that will mirror the statewide password security policies currently being finalized by the Department of Administration and will make the Office's password requirements more secure. They expect that the Office's standards will be in place by the end of calendar year 2009. The Office has also worked with the Department of Administration to reduce by nearly 50 percent the number of Department of Administration employees with access to the computer room. Finally, the Office indicates that it recently filed a plan with the Department of Administration to have the computer server upon which FIMMAS runs be consolidated in the next several months with other computer servers at the Department of Administration's data center. This move will also eliminate the need for staff of the Office of the Commissioner of Insurance to be responsible for computer back-up tapes, because back-up will be the responsibility of the Department of Administration. However, the Fund's management will continue to allow two computer programmers to have access to FIMMAS so that changes requested by the Fund's staff can be readily made.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Wisconsin State Life Insurance Fund's financial statements are free of material misstatement, we performed tests of its 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 one instance of noncompliance that is required to be reported under *Government Auditing Standards*. As discussed in the report narrative in the section titled "Surplus-to-Assets Ratio," s. 607.15, Wis. Stats., requires that, to the extent feasible, the ratio of the Fund's surplus to its assets be between 7.0 percent and 10.0 percent. However, the actual surplus-to-assets ratio was 4.6 percent as of December 31, 2005, and 5.8 percent as of December 31, 2006, both of which were lower than the required minimum. The Fund's management worked with the Fund's actuary to implement a new dividend policy effective August 2005, with additional adjustments to the policy effective January 2006. In addition, the Fund's management reduced the interest the Fund pays on certain deposit-type contracts. Because of these efforts, the surplus-to-assets ratio increased and was above the required minimum as of December 31, 2007, and December 31, 2008.

The Wisconsin State Life Insurance Fund's written responses to the findings identified in our audit are described in the preceding paragraphs. We did not audit the Wisconsin State Life Insurance Fund's responses and, accordingly, express no opinion on them.

In a separate letter to the Commissioner of Insurance dated November 12, 2009, we discuss in more detail the internal control deficiencies included in this report, as well as a certain additional matter related to authorizing payments of claims.

This independent auditor's report is intended for the information and use of the Wisconsin State Life Insurance Fund's management and the Wisconsin Legislature. This report is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Wisconsin State Life Insurance Fund's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

November 12, 2009 by Bryan Naab

Bryan Naab
Deputy State Auditor for Financial Audit