



STATE OF WISCONSIN
Legislative Audit Bureau
NONPARTISAN • INDEPENDENT • ACCURATE

Report 21-3
February 2021

Department of Employee Trust Funds Calendar Year 2019



**Department of
Employee Trust Funds**
Calendar Year 2019



STATE OF WISCONSIN

Legislative Audit Bureau

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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.

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Group Insurance Programs

Response

From the Secretary of the Department of Employee Trust Funds

OPINIONS PUBLISHED SEPARATELY

The financial statements and our opinions on them are included in the Department of Employee Trust Funds' CAFR for the calendar year ended December 31, 2019.



STATE OF WISCONSIN

Legislative Audit Bureau

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State Auditor

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February 12, 2021

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

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94 (1) (dd), Wis. Stats., and as requested by the Department of Employee Trust Funds (ETF), we have completed an audit of ETF's financial statements of 12 separate funds used to account for the financial position and activity of various benefit programs available to state and local government employees. ETF's 2019 Comprehensive Annual Financial Report (CAFR), which can be found on its website, includes the financial statements and our unmodified opinions on them.

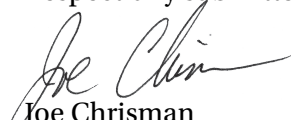
In July 2020, ETF determined that it would separately report the financial information for its sick leave programs. The timing of ETF's decision to alter its financial reporting for calendar year 2019 resulted in ETF separately issuing other reports that included financial statements for certain programs it administers. We audited these financial statements as they were prepared by ETF and provided information about these programs in reports we issued in September 2020 and December 2020. We provide this information again in this report to assist the users of the financial statements now presented in ETF's 2019 CAFR.

The Wisconsin Retirement System (WRS) is the largest program administered by ETF. The WRS fiduciary net position, which represents resources available to pay pension benefits, increased from \$96.7 billion as of December 31, 2018, to \$112.1 billion as of December 31, 2019, or by 15.9 percent. ETF calculated a net pension asset of \$3.2 billion as of December 31, 2019. As we identified in report 20-23, the Legislature could consider creating a statutory requirement for the State of Wisconsin Investment Board (SWIB) related to stress testing for the WRS. In recognition of ETF's responsibility to ensure the solvency and long-term future of the WRS, the Legislature could consider statutorily requiring ETF to work with SWIB on its efforts to perform stress testing.

ETF also administers other postemployment benefits (OPEB) plans for retired individuals. As of December 31, 2019, ETF calculated a net OPEB liability of \$683.1 million for the State Retiree Life Insurance program, a net OPEB liability of \$425.8 million for the Local Retiree Life Insurance program, and a net OPEB asset of \$151.8 million for the Supplemental Health Insurance Conversion Credit program.

We identified a material weakness in internal control over financial reporting related to ETF's liability for the basic Accumulated Sick Leave Conversion Credit program. We also reviewed ETF's efforts to implement recommendations we made in report 19-2 related to the administration and oversight of group insurance programs. As of November 2020, we found ETF had fully implemented 24 of the 30 recommendations and we recommend ETF continue its efforts.

Respectfully submitted,


Joe Chrisman
State Auditor

JC/LK/ss

Introduction

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

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

ETF administers the eight benefit programs shown in Table 1.

Table 1

Programs Administered by ETF

Program	Description
Retirement	
WRS	The WRS provides post-retirement financial benefits to participating employees, as well as disability and death benefits to participants and their beneficiaries. As of December 31, 2019, the WRS had 1,516 participating employers and a total membership of 648,486. Total membership includes 260,251 active participants, 215,070 retired participants or their beneficiaries who were receiving WRS benefits, and 173,165 inactive participants.
Milwaukee Retirement Systems	The Milwaukee Retirement Systems invests other retirement systems' funds with the WRS. Currently, funds from two Milwaukee Public Schools supplemental retirement plans are invested in this program.
Disability	
Duty Disability Insurance	This program offers special disability benefits to protective occupation members in the WRS, such as police officers, firefighters, and correctional officers. As of December 31, 2019, the State of Wisconsin and 501 local government employers participated in this program, and benefits were being provided to approximately 1,000 disabled members or their beneficiaries.
Income Continuation Insurance	This program offers short-term and long-term disability benefits for employees of the State of Wisconsin, including those employed by state agencies and authorities such as the University of Wisconsin (UW) Hospitals and Clinics Authority, and 250 local government employers, as of December 31, 2019. During 2019, benefits were provided to approximately 2,500 participants.
Health and Life	
Group Health Insurance ¹	This program offers health insurance coverage, including medical, pharmacy, and dental benefits, to active and retired employees of the State of Wisconsin, including those employed by state agencies and authorities such as the UW Hospitals and Clinics Authority, and 363 local government employers, as of December 31, 2019. Approximately 80,000 active employees and 29,000 retired employees were participating in the program as of December 31, 2019.
Group Life Insurance ²	This program offers group life insurance coverage for active and retired employees of the State of Wisconsin, including those employed by state agencies and authorities such as UW Hospitals and Clinics Authority, and 721 local government employers.
Other	
Sick Leave Programs	The basic Accumulated Sick Leave Conversion Credit (basic ASLCC) program provides for the conversion of the value of unused sick leave at the time of retirement into a balance to be used to pay for postemployment state group health insurance premiums for retired employees of the State of Wisconsin, including those employed by state agencies and authorities such as UW Hospitals and Clinics Authority. The Supplemental Health Insurance Conversion Credit (SHICC) program provides certain eligible employees additional sick leave hours at termination that increases the balance available to pay for health insurance premiums. As of December 31, 2019, approximately 17,500 retired employees and others were using these balances for the payment of health insurance premiums.
Employee Reimbursement Accounts/ Commuter Benefits	This program offers employees of the State pre-tax payroll deductions that are credited to an account for the reimbursement of qualifying medical costs, dependent care costs, and transportation expenses, such as bus passes, parking, and other transit costs. In 2019, approximately 21,000 employees had a medical account, 3,900 employees had a dependent care account, and 3,000 employees had a commuter benefit account.

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

² Includes the Life Insurance (not presented in the 2019 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

ETF Administration

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

The ETF Secretary and the governing boards oversee the administration of the programs reported in ETF's CAFR. The programs are administered by ETF using the services provided by multiple entities, including third-party administrators, actuaries, and the State of Wisconsin Investment Board (SWIB). Under s. 40.03, Wis. Stats., the 13-member ETF Board is responsible for the overall direction and oversight of ETF. Statutes specifically identify that, among other items, the ETF Board is responsible for:

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

The 2020 ETF Board members are shown in Appendix 1 and include:

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

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

The Group Insurance Board oversees the Group Health Insurance, Group Life Insurance, Employee Reimbursement Accounts/Commuter Benefits, and Income Continuation Insurance programs.

In addition to the ETF Board, the 11-member Group Insurance Board is responsible for setting policies and overseeing administration of the Group Health Insurance, Group Life Insurance, Employee Reimbursement Accounts/Commuter Benefits, and the Income Continuation Insurance programs. In this report, we analyzed ETF's efforts to implement recommendations we made in our audit of the administration and oversight of the group insurance programs (report 19-2). The 2020 Group Insurance Board members are shown in Appendix 2 and include:

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

Table 2 shows the programs that ETF administered and the board that had authority over the policies and administration of each program, as of December 31, 2019.

Table 2
ETF Board and Group Insurance Board Authority, by Program
As of December 31, 2019

Program	ETF Board	Group Insurance Board
Wisconsin Retirement System	✓	
Milwaukee Retirement Systems	✓	
Duty Disability Insurance	✓	
Income Continuation Insurance		✓ ¹
Group Health Insurance ²		✓
Group Life Insurance ³		✓
Sick Leave Programs ⁴	✓	
Employee Reimbursement Accounts/Commuter Benefits		✓

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

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

³ Includes the Life Insurance (not presented in the 2019 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

⁴ Includes the basic ASLCC program and the SHICC program.

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

The Secretary of ETF is charged with implementing the policies approved by each of the boards, and with managing the daily operations of ETF. Each program administered by ETF has its own unique requirements related to eligibility, contributions, benefit payment determination, and reporting. As of July 1, 2020, ETF was authorized 274.2 full-time equivalent positions. In addition, ETF uses third-party administrators to perform administrative functions for certain benefit programs, such as determining participant eligibility, processing participant claims, and making benefit payments to participants. For example, ETF uses a third-party administrator to determine eligibility for and pay benefits to participants in the Income Continuation Insurance program.

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

ETF also uses actuaries to perform actuarial calculations for several benefit programs it administers. Although the role of the actuary for each program varies due to the different program requirements, the duties generally include performing calculations to project future

benefit payments, determining a liability for costs that have been incurred but not reported, and comparing these liabilities against the projected assets that will be available. In addition, the actuaries may recommend changes to contribution rates intended to increase or decrease contribution revenues that provide future assets to fund projected liabilities.

As shown in Table 3, third-party administrators were used for four of the eight benefit programs and actuaries were used for six of the eight programs, as of December 31, 2019.

Table 3

ETF's Use of Third-Party Administrators and Actuaries, by Program

As of December 31, 2019

Program	Third-Party Administrator	Actuary
Wisconsin Retirement System		✓
Milwaukee Retirement Systems		
Duty Disability Insurance		✓
Income Continuation Insurance	✓	✓
Group Health Insurance ¹	✓	✓
Group Life Insurance ²	✓	✓
Sick Leave Programs ³		✓
Employee Reimbursement Accounts/Commuter Benefits	✓	

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

² Includes the Life Insurance (not presented in the 2019 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

³ Includes the basic ASLCC program and the SHICC program.

Except for the assets of the Group Life Insurance program, assets were invested in different funds by SWIB.

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

Table 4

Investments, by Program
As of December 31, 2019

Program	Core Fund ¹	Variable Fund ¹	State Investment Fund	Third-Party Administrator
Wisconsin Retirement System	✓	✓		
Milwaukee Retirement Systems	✓	✓		
Duty Disability Insurance	✓			
Income Continuation Insurance	✓			
Group Health Insurance ²	✓			
Group Life Insurance ³				✓
Sick Leave Programs ⁴	✓			
Employee Reimbursement Accounts/Commuter Benefits			✓	

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

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

³ Includes the Life Insurance (not presented in the 2019 ETF CAFR), State Retiree Life Insurance, and Local Retiree Life Insurance funds.

⁴ Includes the basic ASLCC program and the SHICC program.

The Core Fund is a fully diversified fund, or balanced fund, which provides less volatile investment returns and is invested for the long term in several types of investments. The Variable Fund is an equity fund, or stock fund, which provides returns that are typically more volatile than the Core Fund. The SIF invests the excess operating funds of the State and local governments with the objective of providing liquidity, safety of principal, and competitive rates of return. In report 20-9, we provided more information about the financial condition of the Core Fund and Variable Fund as of December 31, 2019. In report 20-26, we provided similar information for the SIF as of June 30, 2020. In report 20-23, we evaluated SWIB's investment performance, expenses, and staffing.

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

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

balance and end-of-year net asset balance for each program. Investment income or loss of the Variable Fund is allocated to the Milwaukee Retirement Systems on a monthly basis based upon the Milwaukee Retirement Systems' relative share of the Variable Fund and the monthly change in the fair value of the Variable Fund. Each program's share of the \$17.8 billion investment income in the Core Fund and the \$2.0 billion investment income for the Variable Fund for the year ended December 31, 2019, is shown in Table 5.

Table 5

Core Fund and Variable Fund Investment Income Allocation, at Fair Value
For the Year Ended December 31, 2019
(in millions)

Program	Core Fund	Variable Fund
Wisconsin Retirement System	\$17,095.8	\$1,953.0
Milwaukee Retirement Systems	30.1	4.8
Duty Disability Insurance	115.6	–
Income Continuation Insurance	21.4	–
Group Health Insurance ¹	41.8	–
Sick Leave Programs ²	459.8	–
Total	\$17,764.5	\$1,957.8

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

² Includes the basic ASLCC program, which was allocated \$279.5 million in investment income, and the SHICC program, which was allocated \$180.3 million.

The Employee Reimbursement Accounts/Commuter Benefits program reported investment income totaling \$168,697 from the SIF for the year ended December 31, 2019.

Benefits Administration System

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

In 2010, ETF completed a business risk-assessment process that highlighted the need to replace its legacy systems and began an initiative to modernize the administration of the benefit programs. One component of this modernization project was the development of the Benefits Administration System (BAS), which began in 2014 and was expected to be implemented in three phases over several years. Although the first phase of the project was implemented in November 2015, work on the remaining phases of the project stopped

in March 2018 due to a contract dispute. ETF and the vendor were unable to resolve the dispute and, in March 2019, ETF filed a complaint in Dane County Circuit Court for damages suffered as a result of the contractor failing to fulfill the contract. The contractor subsequently filed a counterclaim in June 2019. As reported in Note 11 to the financial statements on page 102 of ETF's CAFR, both lawsuits are pending.

The information systems scheduled to be replaced with BAS continue to age and present risks for ETF to manage. ETF will need to continue to maintain these older systems to ensure effective administration of each benefit program. ETF reports annually to the Legislature's Joint Committee on Finance and the Secretary of DOA on the status of its progress in modernizing its business processes and integrating its information technology systems. On June 30, 2020, ETF reported that it had contracted with Naviant, Inc., to develop and replace the existing imaging and workflow system.

Sick Leave Programs

ETF administers two sick leave programs: the basic Accumulated Sick Leave Conversion Credit (basic ASLCC) program and the Supplemental Health Insurance Conversion Credit (SHICC) program. In administering the sick leave programs, ETF is responsible for maintaining balances for eligible participants, collecting required contributions from participating employers, and paying health insurance providers for participants receiving benefits. ETF also uses an actuary to perform actuarial calculations to project future benefit payments and recommend changes to contribution rates that employers pay to fund program benefits. Historically, the financial information of these programs was reported as one program in ETF's CAFR.

For calendar year 2019, ETF implemented GASB Statement Number 84, *Fiduciary Activities*, and reassessed the financial reporting for the sick leave programs. In July 2020, ETF determined that it would separately report the financial information for the basic ASLCC program and for the SHICC program. Because basic ASLCC program benefits are based on sick leave earned during an employee's years of service and are available to the employee during their employment, ETF determined that the liability for this program was a compensated absence and would be calculated under the requirements of GASB Statement Number 16, *Accounting for Compensated Absences*. However, because the SHICC program provides additional benefits that are provided only upon termination and are based on meeting certain requirements at termination, ETF determined that this program was an other postemployment benefits (OPEB) plan.

We report a material weakness in internal control over financial reporting related to the basic ASLCC program.

In preparing the financial statements for each separate sick leave program, ETF prepared various adjustments, which are further described in Note 2 to the financial statements on page 46 of ETF's CAFR. In our audit of the basic ASLCC program, we found ETF made material errors in calculating the compensated absence liability. ETF prepared an adjustment to correct the errors we identified. Late planning for implementation of GASB Statement Number 84, particularly related to making a decision for the reporting for the sick leave programs, contributed to ETF's errors for the basic ASLCC program. We report a material weakness in internal control over financial reporting and recommend ETF improve its calculation of the compensated absence liability by revising its policies; ensure that it completes its planning, review, and assessment process before the close of the financial reporting period affected by a change in financial reporting; and work with DOA on areas that affect the State's CAFR.

Audit Results

As required by Wisconsin Statutes, we have completed an audit of the financial statements and related notes of the 12 funds reported in ETF's CAFR as of and for the year ended December 31, 2019. The financial statements presented in ETF's CAFR include information related to the contributions, benefits, and investment income or loss of each program. The contribution and benefit requirements differ among the programs and are established by statute, administrative code, and board decisions. In addition, various tax laws may affect the administration of a program and the amount of contributions that may be collected or the benefits that may be provided.

We provided unmodified opinions on the financial statements of programs administered by ETF for the year ended December 31, 2019.

To complete our audit of the financial statements, we reviewed ETF's internal controls over financial reporting, tested financial transactions, and reviewed the financial statements, notes, and required supplementary information that were prepared by ETF management. We provided unmodified opinions on the financial statements and related notes as of and for the year ended December 31, 2019.

We also issued our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 51. As discussed in this report, our consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. However, as discussed, we identified a deficiency in internal control over ETF's calculation of the liability for the basic ASLCC program that we consider to be a material weakness. Because ETF's financial statements are also included in the State of Wisconsin's CAFR for the fiscal year ended June 30, 2020, this material weakness was also included in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters related to our audit of the State of Wisconsin's financial statements (report 20-30)

as Finding 2020-005. We also reported a significant deficiency in internal control at SWIB that we identified during our audit of the Retirement Funds Investment Activity (report 20-9). Because the amounts reported by SWIB are included in the WRS financial statements and in the notes to the financial statements, the internal control deficiency is also included in this report.

■ ■ ■ ■

Wisconsin Retirement System

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

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

As of December 31, 2019, 648,486 individuals participated in the WRS, including:

- 260,251 (40.1 percent) active participants who were making contributions;
- 215,070 (33.2 percent) retired participants or their beneficiaries who were receiving WRS benefits; and
- 173,165 (26.7 percent) inactive participants, such as former employees, who were not yet receiving benefits and who were not required to make contributions.

The WRS is one of the 10 largest public pension plans in the United States. As of December 31, 2019, the WRS had a fiduciary net position of \$112.1 billion, which represents resources available to pay pension benefits. ETF is responsible for managing the operations of the WRS that interact with employers and participants, including collecting contributions from and paying retirement benefits to WRS participants. ETF also uses an actuary to perform actuarial calculations such as projecting future benefit payments and establishing contribution rates.

ETF and SWIB work together to manage the WRS.

SWIB is responsible for managing the WRS investments. ETF and SWIB work closely together to ensure the solvency and long-term future of the WRS.

In September 2020, ETF separately issued reports that included the WRS financial statements, including the related notes, and a Schedule of Employer Allocations and Schedule of Collective Pension Amounts, as of and for the year ended December 31, 2019. We provided unmodified opinions on the financial statements and the employer schedules, which were included in ETF's reports. We further reported on the activity of WRS in report 20-14 and report 20-15, which included our reports on internal control over financial reporting and on compliance and other matters as well as the information in this chapter. We have provided the information again in order to assist the users of the financial statements included in ETF's CAFR. In addition, because it is relevant to ETF and the administration of the WRS, we also identify an issue for legislative consideration related to stress testing, which we included in report 20-23.

WRS Participating Employers

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

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

As of December 31, 2019, 1,516 employers were participating in the WRS.

As shown in Table 6, most of the 1,516 employers that participated in the WRS as of December 31, 2019, were local governments and school districts.

Table 6

Types of Employers Participating in the WRS
As of December 31, 2019

Type	Number
School Districts	421
Villages	274
Towns	272
Special Districts ¹	206
Cities	188
Counties	71
State Agencies, UW System, and Public Authorities	56
Wisconsin Technical College System Districts	16
Cooperative Educational Service Agencies	12
Total Employers	1,516

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

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

WRS Funding

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

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

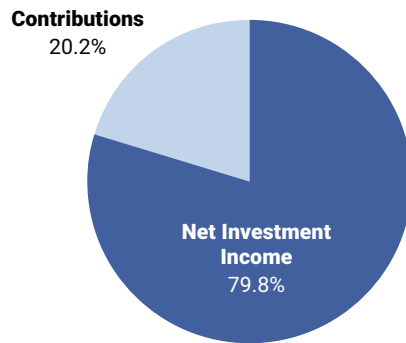
- ensure funds are adequate to pay benefits;
- maintain stable and predictable contribution rates for employers and employees; and
- maintain inter-generational equity to ensure the cost of the benefits is paid for by the generation that receives the benefits.

In 2019, net investment income for the WRS totaled \$19.0 billion and contributions from WRS employers and employees totaled \$2.0 billion. From 2010 through 2019, net investment income represented

79.8 percent of total funding for the WRS. Employer and employee contributions represented 20.2 percent of total funding for the WRS, as shown in Figure 1.

Figure 1

WRS Funding Sources
2010 through 2019



Net investment income increased from a loss of \$4.1 billion in 2018 to a gain of \$19.0 billion in 2019.

Net investment income, which is the sum of realized and unrealized gains and losses less SWIB’s investment expenses and amounts distributed to other benefit programs, increased by \$23.1 billion, from a loss of \$4.1 billion in 2018 to a gain of \$19.0 billion in 2019. The increase in net investment income reflects the increase in investment returns of the Core Fund and the Variable Fund. The gross investment return (gross of management fees) of the Core Fund increased from a negative 3.3 percent in 2018 to 19.9 percent in 2019, and the gross investment return of the Variable Fund increased from a negative 7.9 percent in 2018 to 28.6 percent in 2019.

The long-term expected rate-of-return assumption for the WRS is 7.0 percent.

As noted, WRS assets are invested by SWIB in the Core Fund and the Variable Fund. SWIB has a fiduciary responsibility to prudently invest the pension assets in a diversified manner to meet WRS funding needs while minimizing the risk of large losses. SWIB’s investment strategy is to meet the long-term expected rate-of-return assumption. From 2011 through 2018, the return assumption was 7.2 percent. The ETF Board approved a decrease in the long-term expected rate-of-return assumption to 7.0 percent in December 2018. As of December 31, 2019, SWIB’s 20-year return for the Core Fund, net of management fees was 6.1 percent, which is less than the long-term expected rate-of-return assumption of 7.0 percent. As of December 31, 2019, SWIB’s 30-year return for the Core Fund, net of management fees, was 8.3 percent.

Contribution rates, which include both an employer and an employee share, are actuarially determined as a percentage of an employee's earnings and are approved annually by the ETF Board. Contributions to the WRS from employers and employees increased by \$31.2 million, or 1.5 percent, to \$2.0 billion in 2019. As shown in Table 7, total contribution rates for general employees, which include teachers and most other employees, have increased from 11.8 percent of wages in 2012 to 13.5 percent in 2021.

Table 7

Total Contribution Rates for General Employees in the WRS

Calendar Year	Total Contribution Rate ¹
2012	11.8%
2013	13.3
2014	14.0
2015	13.6
2016	13.2
2017	13.6
2018	13.4
2019	13.1
2020	13.5
2021	13.5

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

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

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

In order to maintain steady contribution rates and comply with s. 40.04 (3) (am), Wis. Stats., the consulting actuary for the WRS uses the market recognition account (MRA) to smooth investment income or loss for the Core Fund investment activity over a five-year period. The MRA accumulates the difference between actual investment income or loss and expected investment income calculated at the long-term expected

rate-of-return assumption of 7.0 percent. The difference is then distributed into the calculated plan net assets over a five-year period so that the expected investment income is affected by portions of the amounts included in the MRA in the prior four years. Use of the MRA results in less volatility in net assets and, thus, less volatility in the calculation of the contribution rates for employers and employees.

Investment income or loss used for purposes of determining contribution rates differs from the investment income or loss recognized on the financial statements due to the use of the MRA. For example, the net investment income of the Core Fund for 2019 for financial reporting was \$17.8 billion based upon the fair value of the investments. Through the use of the MRA, the actuary recognized investment income of \$7.1 billion, which was the amount used in determining the actuarial value of the WRS assets as of December 31, 2019, and determining contribution rates for 2021.

WRS Benefits

Annuity payments are determined either by a formula based on the participant's service or the value of contributions and investment income.

The WRS is a defined-benefit plan that provides participants with lifelong monthly retirement annuity payments and, depending upon the annuity type selected, may also provide benefits to a beneficiary after the participant's death. Annuity payments are initially determined by either:

- a formula, which is based on the participant's years of service and final average salary; or
- a money purchase benefit, which is based on the participant's contributions, an employer's matching contributions, and investment income.

The method that yields the largest annuity payment is used to calculate a participant's initial annuity. A defined-benefit plan is in contrast to a defined-contribution plan, such as a 401(k) plan, in which benefits are based on the amounts contributed to a participant's account and investment gains or losses on those funds.

The average annual annuity paid decreased from \$25,893 in 2018 to \$25,645 in 2019, or by 1.0 percent.

WRS benefits provided to retired participants or their beneficiaries as annuity payments increased from \$5.5 billion in 2018 to \$5.6 billion in 2019, or by 1.8 percent. The number of retired participants increased from 209,059 as of December 31, 2018, to 215,070 as of December 31, 2019. The average annual annuity payment to retired participants in 2019 was \$25,645, which decreased from the average in 2018 of \$25,893, or by 1.0 percent.

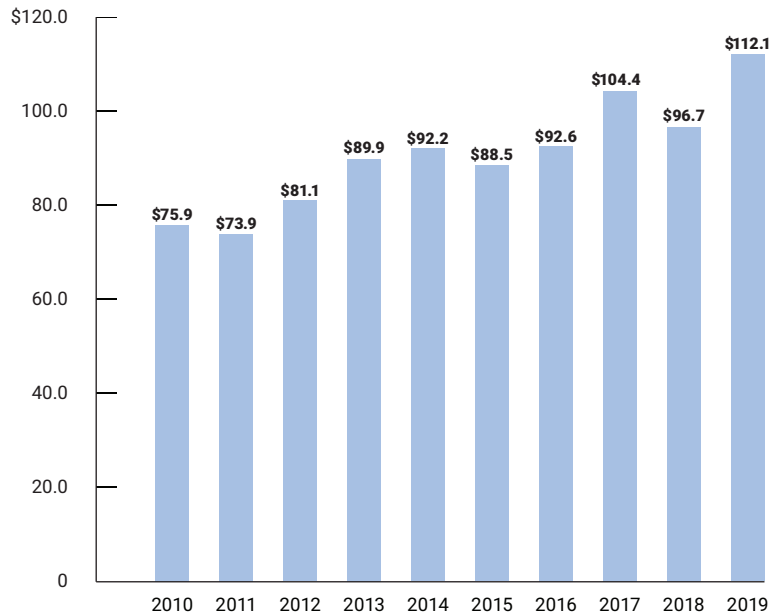
Financial Condition of the WRS

As of December 31, 2019, the fiduciary net position of the WRS was \$112.1 billion.

The Net Position Restricted for Pensions (fiduciary net position) of the WRS represents the value of the plan’s assets that are available to meet obligations as they become due. As of December 31, 2019, the WRS had a fiduciary net position of \$112.1 billion, which was a 15.9 percent increase from the prior year. This increase is primarily attributed to an increase in the fair value of investments as of December 31, 2019. From December 31, 2010, through December 31, 2019, the fiduciary net position of the WRS increased by \$36.2 billion, or by 47.7 percent, as shown in Figure 2.

Figure 2

Wisconsin Retirement System Fiduciary Net Position¹ As of December 31 (in billions)



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

WRS Reserves and Accounts

The fiduciary net position of the WRS primarily consists of three statutorily required reserves: the employer accumulation reserve (employer reserve), the employee accumulation reserve (the employee reserve), and the annuity reserve. The employer reserve consists of all

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

The employee reserve consists of employee-required contributions, contributions paid by the employer on behalf of the employee, any voluntary additional contributions, and investment earnings. A separate account is maintained in this reserve for each WRS participant. If a participant leaves service with a WRS employer before being eligible to receive a retirement annuity, the participant can receive the balance of the contributions and earnings included in the account.

The annuity reserve was \$63.7 billion as of December 31, 2019, and represented the largest share of the WRS fiduciary net position.

The annuity reserve consists of the amounts transferred from the employer and employee reserve, as well as investment earnings, and are used to provide annuity payments to retired participants. As shown in Table 8, the \$63.7 billion annuity reserve represented the largest share (56.8 percent) of the WRS fiduciary net position as of December 31, 2019.

Table 8

WRS Reserve and Account Balances
As of December 31, 2019
(in millions)

Reserve/Account	Balance	Percentage of Total
Employer Accumulation Reserve	\$ 23,389.5	20.9%
Employee Accumulation Reserve	19,487.2	17.4
Annuity Reserve	63,658.1	56.8
Market Recognition Account ¹	5,516.2	4.9
Other ²	41.8	<1
Total WRS Fiduciary Net Position	\$112,092.8	

¹ The balance in this account will fluctuate based on investment performance. A positive balance represents investment gains that will be allocated in future years.

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

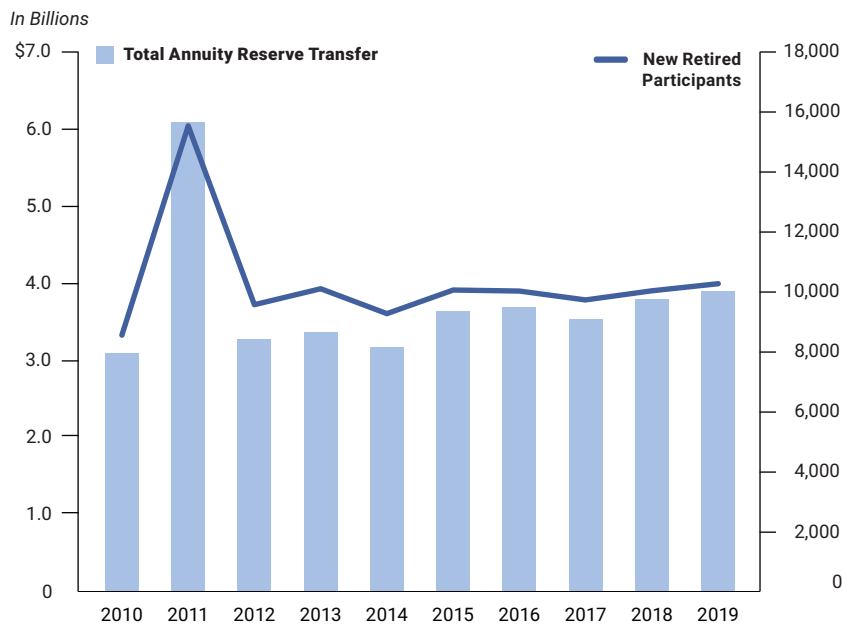
Transfers to the Annuity Reserve

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

Upon retirement, an amount is transferred from the employee reserve and the employer reserve to the annuity reserve to meet future benefit obligations. Annually, the actuary determines the amount to transfer to the annuity reserve based upon the participants and their beneficiaries that began to receive annuities in the past year. The total amount transferred into the annuity reserve will increase and decrease each year depending upon the number of participants that began receiving annuities during the year, as shown in Figure 3.

Figure 3

Wisconsin Retirement System Annuity Transfer Compared to New Retired Participants
2010 through 2019



The amount in a participant’s employee reserve is transferred to the annuity reserve upon retirement. The remaining actuarially determined amount, which is based upon the present value of expected future benefit payments, is transferred to the annuity reserve from the employer reserve. Because the amount transferred from the employee reserve is a fixed amount, the remaining amount needed to be transferred must come from the employer reserve. This transfer occurs regardless of the amount that the employer contributed during a participant’s years of service or any investment earnings that accumulated on those contributions.

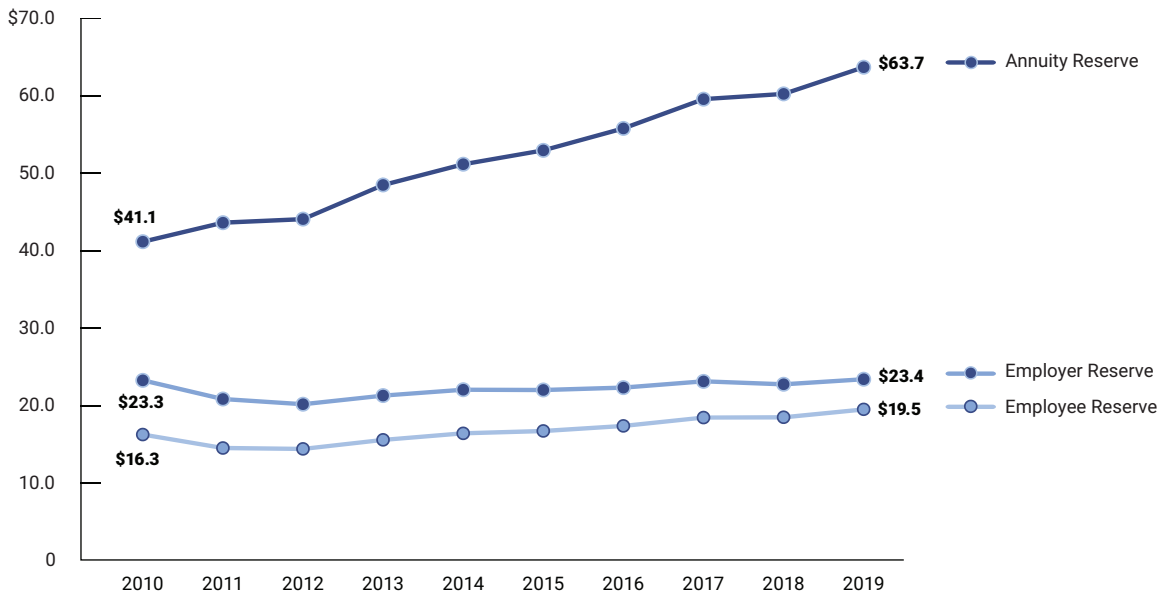
The employer reserve transfer amount may differ from the amounts that may have been accumulated because contribution rates were based upon actuarial estimates of the amounts needed to fund benefits earned by participants, which may differ from actual experience. As a result, the transfers from the employer reserve may be greater or less than the amounts accumulated because the WRS experiences may differ from actuarial estimates. In the long-term, the actuary considers these differences in developing future contribution rates.

As a result of a 38.1 percent increase in retired participants, the annuity reserve balance increased \$22.6 billion between 2010 and 2019.

From December 31, 2010, to December 31, 2019, the number of active and inactive participants increased from 416,444 to 433,416, or by 4.1 percent. As shown in Figure 4, both the employer and employee reserve have remained relatively stable since 2010. However, as a result of a 38.1 percent increase in the number of retired participants, the annuity reserve balance increased by \$22.6 billion between 2010 and 2019, or by 55.0 percent.

Figure 4

**Wisconsin Retirement System
Employer, Employee, and Annuity Reserve Balances
2010 through 2019
(in billions)**



Core Annuity Payments and Adjustments

The annuity reserve dedicated to Core Fund annuities was \$59.2 billion, or 92.9 percent of the annuity reserve as of December 31, 2019.

As noted, the annuity reserve is used to fund annuity payments, which include amounts that have been provided in a dividend adjustment to retired participants. The annuity reserve is further separated into amounts for Core Fund and Variable Fund annuities. All retired participants receive a Core Fund annuity payment. However, those retired participants who had elected participation in the Variable Fund and who do not elect to terminate their Variable Fund participation also receive a separate Variable Fund annuity. As of December 31, 2019, \$59.2 billion (92.9 percent) of the annuity reserve was invested in the Core Fund and used to fund Core Fund annuities. The remaining amount of the annuity reserve, or \$4.5 billion, was invested in the Variable Fund and used to fund Variable Fund annuities.

Annuity dividend adjustments are awarded each April. Under Wisconsin Statutes, positive or negative dividend adjustments are provided if the dividend increases or decreases annuities by at least 0.5 percent. The WRS actuary recommends and the ETF Board approves dividend adjustments for Core Fund annuities, which vary depending on:

- the investment income or loss from the prior calendar year;
- the recognized earnings, credited to the annuity reserve, which is referred to as the effective rate; and
- various other factors.

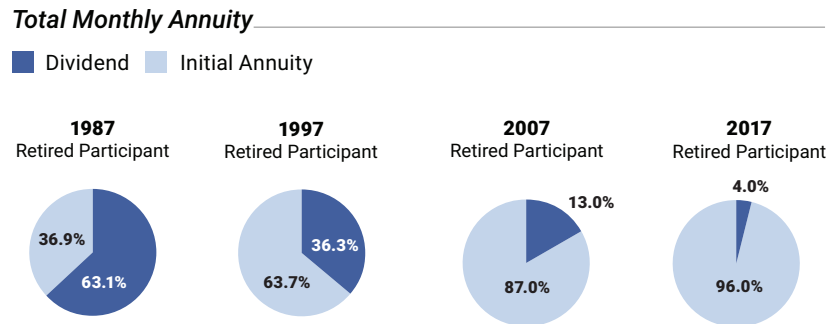
To ensure sufficient assets are available to fund the original annuity amounts, an assumed investment return of 5.0 percent is credited to the annuity reserve before Core Fund dividend adjustments are calculated. As a result, if the effective rate is below 5.0 percent, a negative dividend adjustment may be needed.

Participants who have been retired for a longer period are receiving a larger portion of their total annuity payment from dividend adjustments.

The annual Core Fund dividend adjustments are applied and compound each year. This results in dividend adjustments being applied to the total annuity payment, including dividend adjustments from prior years. As a result of positive dividend adjustments in years prior to 2008, participants who have been retired for a longer period are receiving a larger portion of their total annuity payment from dividend adjustments compared to those participants who retire in more recent years, as shown in Figure 5.

Figure 5

Dividend as a Percentage of Total Core Fund Annuity¹ By Retirement Year



¹ Estimated based on historical dividend adjustments.

Statutes do not permit negative dividend adjustments to reduce Core Fund annuities below the original amount at retirement.

Core Fund dividend adjustments differ from the prior year's investment performance due to the use of the MRA to smooth the investment gains and losses to determine the effective earnings rate, as well as other factors. In addition, there is a statutory limitation on reducing Core Fund annuities below the original amount at retirement, which is referred to as the "floor." A unique feature of the WRS is that retired participants share in both the investment gains and losses and receive no automatic cost of living increases. Because of this risk-sharing provision, the statutory floor limitation provides a guarantee of a minimum payment for retired participants.

Participants with a larger accumulation of dividend adjustments are allocated a greater percentage of losses during an economic recession because of Core Fund annuities at the floor.

The result of the floor is that a Core Fund annuity is reduced when there are negative dividend adjustments, but only to the extent there is a sufficient accumulation of prior years' positive dividends. Any further reduction is not permitted if applying a negative dividend adjustment would reduce the annuity payment below the original annuity payment calculated at retirement. However, to ensure the annuity reserve maintains sufficient assets to fund the original annuity payments, the WRS actuary further adjusts the dividend percentage to accommodate for those participants whose Core Fund annuities are at the floor. As a result, other participants with more accumulation of dividend adjustments receive a larger percentage reduction. For example, in 2012, a negative dividend adjustment was reduced by an additional 6.6 percent to account for those participants whose Core Fund annuity was at the floor.

As of December 31, 2019, 31.8 percent of Core Fund annuities had 10 percent or less of their annuity payment from dividend adjustments.

The number of Core Fund annuities at the floor may increase during economic recessions. In 2008, which was the first year the investment losses of the 2008 recession affected dividend adjustments, 5.5 percent of Core Fund annuities were at the floor. By December 2013, or five years after the 2008 recession, 62.7 percent of Core Fund annuities were at the floor. Due to positive dividend adjustments in recent years, the

percentage of Core Fund annuities at the floor was 9.2 percent as of December 31, 2019. However, when also considering the effect of newly retired participants in recent years, 31.8 percent of Core Fund annuities as of December 31, 2019, had either 10 percent or less of the annuity funded by dividend adjustments or were already at the floor. This further increases the risk of the Core Fund annuities being reduced to the floor if there were to be an economic recession.

Future negative dividend adjustments could result in certain retired participants reaching their respective floors more quickly.

From 1986 through 2007, there were no negative dividend adjustments for the Core Fund. As shown in Table 9, from 2008 through 2012, the Core Fund experienced negative dividend adjustments, which were largely caused by the 2008 recession. These adjustments left many of the more recent retired participants with a lower accumulation of dividend adjustments. The number of participants who retired from 2008 through 2019 account for 54.5 percent of the total number of retired participants as of December 31, 2019. Because these retired participants have not had the opportunity to accumulate significant positive dividend adjustments, future negative dividend adjustments could result in these retired participants reaching their respective floors more quickly and also may result in larger reductions to participants that have been retired for longer.

Table 9

Core Fund Annual Investment Performance and Dividend Adjustments

Year	Investment Income (Loss)	Effective Rate	Dividend Adjustment Increase (Decrease)	Effective Year Dividend Applied
2019	19.9%	7.7%	1.7%	2020
2018	(3.3)	5.0	0.0	2019
2017	16.2	8.5	2.4	2018
2016	8.6	7.9	2.0	2017
2015	(0.4)	6.4	0.5	2016
2014	5.7	8.7	2.9	2015
2013	13.6	10.9	4.7	2014
2012	13.7	2.2	(9.6)	2013
2011	1.4	1.5	(7.0)	2012
2010	12.3	4.8	(1.2)	2011
2009	22.4	4.2	(1.3)	2010
2008	(26.2)	3.3	(2.1)	2009

Trends in the Core Fund Dividend Reserve

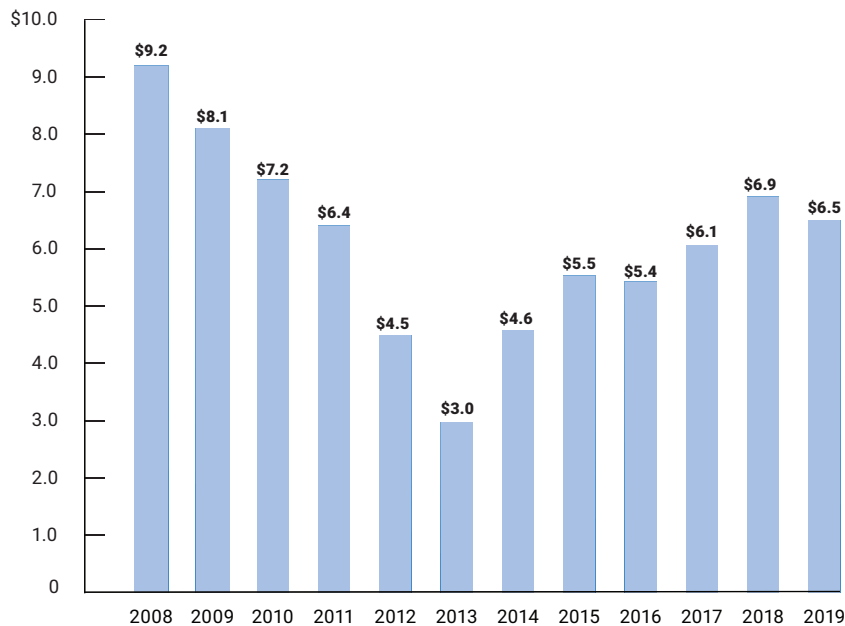
The WRS actuary determines the liability for the dividend adjustments that have been provided to participants in prior years. Assets are accumulated in the annuity reserve to fund this liability, which is referred to as the dividend reserve. Positive dividend adjustments increase the dividend reserve, while negative dividend adjustments reduce the reserve. A dividend reserve of zero would reflect that all retired participants have reached their floor and are receiving their original annuity amount. Current statutes do not address a potential situation where negative dividend adjustments cannot be applied because all retired participants have reached their floor.

As of December 31, 2019, the Core Fund dividend reserve is \$2.7 billion lower than it was before the 2008 recession.

As shown in Figure 6, the negative dividend adjustments resulting from the 2008 recession reduced the Core Fund dividend reserve from \$9.2 billion as of December 31, 2008 to \$3.0 billion as of December 31, 2013, or by \$6.2 billion. As of December 31, 2019, the Core Fund dividend reserve reported by the actuary has increased to \$6.5 billion. However, the dividend reserve is lower than the reserve that existed prior to the 2008 recession. This increases the risk that certain market conditions that result in future investment losses could deplete the dividend reserve.

Figure 6

Core Fund Dividend Reserve¹
As of December 31
(in billions)



¹ The dividend reserve is part of the WRS annuity reserve.

Among the different scenarios presented during a March 2020 ETF Board meeting, ETF estimated that if an investment loss of 12 percent occurred in 2020 and returns of 7.0 percent occurred in the subsequent three years, zero or negative dividend adjustments could occur in 2021 through 2023. As of December 31, 2020, the preliminary year-to-date Core Fund investment return reported by SWIB was 15.2 percent.

Subsequent to the 2008 recession, ETF and SWIB implemented changes to the Core Fund investment strategy and asset allocation in an effort to reduce investment volatility particularly in large market downturns. These changes are also intended to reduce negative dividend adjustments and the risk of depleting the Core Fund dividend reserve at the rate experienced following 2008.

ETF worked with the WRS actuary and ETF Board to explore options to address the potential depletion of the Core Fund dividend reserve.

ETF also worked with the WRS actuary and the ETF Board to explore several options to address the potential for future investment volatility and negative dividend adjustments to deplete the Core Fund dividend reserve. For example, in December 2016, the WRS actuary presented the ETF Board two potential options to change the dividend adjustment process to reduce the risk of depleting the Core Fund dividend reserve. At that time, the actuary reported that based upon a series of simulations under the current dividend adjustment process, there was a 26 percent likelihood of depleting the Core Fund dividend reserve after 10 years, with the likelihood of depletion slowly declining in subsequent years.

Since 2012, and at least annually thereafter, the WRS actuary has provided information on this component of the overall annuity reserve. In March 2020, the WRS actuary reiterated to the ETF Board that should an economic recession occur that is similar to the one in 2008, the Core Fund dividend reserve could be entirely depleted.

We recommended in report 20-14 that ETF work with the ETF Board to address risks regarding future negative dividend adjustments.

Although ETF has communicated to the ETF Board the risks that are present if future negative dividend adjustments occur, in report 20-14 published in September 2020, we recommended ETF work with the ETF Board to:

- continue to analyze the risk of depleting the Core Fund dividend reserve, the effect on the annuity reserve, and the effect on dividend adjustments on individual retired participants;
- develop a written plan to address the level of risk identified;
- implement the written plan and seek statutory changes, if necessary; and
- report to the Joint Legislative Audit Committee by February 26, 2021, on its efforts to implement these recommendations.

In its response to report 20-14, ETF reported that the ETF Board has been monitoring and periodically discussing the health of the dividend reserve since 2012 and plans for continued monitoring and discussions with staff and the consulting actuary. ETF reported that they will provide an update to the Joint Legislative Audit Committee as recommended.

Pension Accounting Standards

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

Calculating the Total Pension Liability

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

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

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

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

The total pension liability for the WRS was \$108.9 billion as of December 31, 2019.

To determine the total pension liability for the WRS as of December 31, 2019, ETF's actuary performed an actuarial valuation as of December 31, 2018, and adjusted for changes in assumptions, interest earned, contributions paid,

benefits paid, and dividend adjustments during 2019. The total pension liability for the WRS was \$108.9 billion as of December 31, 2019.

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

The discount rate is a critical factor in calculating a pension plan liability, and it can have a significant effect on the amount of the total pension liability. The discount rate, or interest rate, is used to calculate the present value of projected benefit payments and is specifically defined under the accounting standards. ETF used the long-term expected rate-of-return assumption for the WRS, which is 7.0 percent, as the discount rate because current and projected future plan assets are expected to cover the projected benefit payments for the WRS. Increasing or decreasing the discount rate can have a significant effect on the total pension liability. For instance, a one percentage point decrease in the discount rate (6.0 percent) would increase the total pension liability to \$120.4 billion.

Calculating a Net Pension Liability or Asset

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

ETF reported a net pension asset of \$3.2 billion for the WRS as of December 31, 2019.

As of December 31, 2019, the WRS had a fiduciary net position of \$112.1 billion and a total pension liability of \$108.9 billion, which resulted in a net pension asset of \$3.2 billion. A net pension asset indicates that, as of December 31, 2019, the assets of the WRS were sufficient to cover the projected liability for benefit payments to employees under the financial reporting standards. This represents an improvement from the net pension liability of \$3.6 billion, reported as of December 31, 2018. An increase in the value of the investments of the Core Fund and the Variable Fund from December 31, 2018, to December 31, 2019, was the primary cause of the \$15.4 billion increase in the fiduciary net position and resulted in the reporting of a net pension asset as of December 31, 2019. In report 20-9, we reported on the investment activity of the Core Fund and Variable Fund.

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

Table 10

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

	2015	2016	2017	2018	2019
Fiduciary Net Position	\$88.5	\$92.6	\$104.4	\$ 96.7	\$112.1
Total Pension Liability	(90.1)	(93.4)	(101.4)	(100.3)	(108.9)
Net Pension Asset (Liability)	\$ (1.6)	\$ (0.8)	\$ 3.0	\$ (3.6)	\$ 3.2

Employer Reporting

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

As noted, the WRS is a cost-sharing, multiple-employer, defined-benefit pension plan with 1,516 participating employers. In this type of pension plan, the contributions are combined and the benefits are paid out of a common pool of assets. By participating in the WRS, employers have made a commitment to provide pension benefits to employees, and they are obligated to make contributions into the future to ensure that sufficient resources are available to make the benefit payments. Therefore, because the employers participating in the WRS have ultimate responsibility for the resulting pension obligations, each participating employer is required to report its proportionate share of the net pension liability or asset in its GAAP-based financial statements.

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

To assist employers participating in the WRS in determining the employer's proportionate share of these amounts, ETF has prepared a Schedule of Employer Allocations and a Schedule of Collective Pension Amounts as of and for the year ended December 31, 2019. We audited these schedules and provided unmodified opinions on them in report 20-15. Because the WRS has calculated a net pension asset for the year ended December 31, 2019, each employer participating in the WRS must report its proportionate share of the net pension asset in its GAAP-based financial statements.

The proportionate share of the net pension asset for State of Wisconsin agencies as of December 31, 2019, was \$896.0 million, of which \$430.5 million related to UW System. The net pension asset for the state agencies is included in the State's GAAP-based financial statements, which were published in December 2020, in the State of Wisconsin's CAFR as of and for the year ended June 30, 2020.

Comparison to Other Pension Plans

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

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

We collected information from other cost-sharing, multiple-employer, defined-benefit plans that were part of the WRS peer group defined by an annual study performed by a private firm. At 103.0 percent, the WRS had the highest funded ratio in comparison to these plans, as shown in Table 11.

Table 11

Comparison of Selected Pension Plans Based on Financial Reporting Methodology^{1,2} (in billions)

Pension Plan	Total Pension Liability	Fiduciary Net Position	Net Pension Asset	Net Pension Liability	Funded Ratio
Wisconsin Retirement System ³	\$108.9	\$112.1	\$3.2	n/a	103.0%
New York State and Local Employees' Retirement System ⁴	223.9	215.2	n/a	\$8.8	96.1
Iowa Public Employees Retirement System	39.8	34.0	n/a	5.8	85.5
Ohio Public Employees Retirement System ³	111.4	91.8	n/a	19.6	82.4
Oregon Public Employees Retirement System	87.5	70.2	n/a	17.3	80.2
Indiana Public Retirement System—Public Employees Retirement Fund	16.6	13.3	n/a	3.3	80.1
State Teachers Retirement System of Ohio	97.8	75.7	n/a	22.1	77.4
Virginia Retirement System—Teachers Retirement System	49.7	36.5	n/a	13.2	73.5
Arizona State Retirement System	54.4	39.8	n/a	14.6	73.2
California State Teachers' Retirement System	329.2	238.9	n/a	90.3	72.6

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

² Unless otherwise noted, for the plan year ended June 30, 2019.

³ For the plan year ended December 31, 2019.

⁴ For the plan year ended March 31, 2019.

WRS Stress Testing

Analyzing the effects of varied investment performance can provide pension plan managers important information in making decisions.

The WRS funding policy established by the ETF Board requires ETF to engage the WRS actuary to undertake stress testing or review the results of stress testing performed by SWIB to understand the potential effects of major risks that may affect the WRS. Although adjustments to contribution rates and dividend adjustments to annuitants are determined by ETF, SWIB contracts with the WRS actuary biennially to analyze the effects of varied investment returns on contribution rates and dividend adjustments. Analyzing the effects of varied investment performance can provide pension plan managers important information in making decisions. In May 2018, a research project conducted by Pew Charitable Trusts and published by Harvard University recommended that public pension plans complete “stress testing” to better understand the effect of various market and other conditions.

The most recent stress testing performed by SWIB was presented to SWIB’s Board of Trustees in 2019. ETF also worked with the WRS actuary in 2020 to perform a one-time stress test to analyze the impacts of a potential large market downturn that could have resulted from the public health emergency, including the impact on the dividend reserve. However, ETF indicated that it does not perform recurring stress testing in addition to the analyses biennially performed by SWIB.

In report 20-23, we found that the results of the stress testing ETF and SWIB perform are not easily accessible.

A panel convened by Harvard University and the Pew Charitable Trusts recommended in 2019 that risk reporting for public pension plans assist budget officials and legislators in assessing the effect of investment risk on government budgets and pension solvency by including metrics that are accessible to all stakeholders. In report 20-23, we found that the results of the stress testing ETF and SWIB perform are not easily accessible. For example, although the WRS actuary provided a presentation to the ETF Board on its stress testing results in 2020 and a presentation to SWIB’s Board of Trustees on its stress testing results in 2019, it did not submit written reports.

Legislative Consideration

The Legislature could create a statutory requirement for ETF to work with SWIB on stress tests of the WRS.

There is not currently a statutory requirement for the performance of stress testing, generally, or any stress test, specifically, for the WRS. As we noted in report 20-23, the Legislature could consider creating a statutory requirement for SWIB to biennially perform stress tests and include analyses that show the effects of a large sustained market downturn on contribution rates and dividend adjustments over a sustained period, consider statutorily requiring SWIB to submit a written report to the Legislature that clearly reports the results of its stress tests, and consider statutorily requiring SWIB to make its written report easily accessible on its website. In making this consideration, we recognize that ETF has responsibility to ensure the solvency and

long-term future of the WRS and will need to work with SWIB in performing and reporting on results of the stress testing and the Legislature could require ETF to work with SWIB in meeting these requirements. We note that, as of October 2020, the National Conference of State Legislatures indicates that ten states have statutorily required their large public pension plans to conduct stress testing.

■ ■ ■ ■

Other Postemployment Benefits (OPEB) Plans

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

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

Trusted and Non-Trusted OPEB Plans

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

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

- plan assets must be dedicated to providing benefits to plan members according to the benefit terms; and
- plan assets must be legally protected from creditors of the employer, employees, and ETF.

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

ETF administers five OPEB plans for retired individuals.

ETF administers five separate OPEB plans for retired individuals: the State Retiree Life Insurance program, the Local Retiree Life Insurance program, and the SHICC program, all of which are considered trusted OPEB plans; and the State Retiree Health Insurance program and the Local Retiree Health Insurance program, both of which are considered non-trusted OPEB plans. The assets accumulated for the State Retiree Life Insurance program, the Local Retiree Life Insurance program, and the SHICC program represented by the fiduciary net position, are reported by ETF in the Statement of Fiduciary Net Position for each program. The State Retiree Health Insurance program and the Local Retiree Health Insurance program are considered non-trusted OPEB plans because the programs do not accumulate assets dedicated to providing benefits to plan members. The OPEB liability for the State Retiree Health Insurance program was reported in the State of Wisconsin's CAFR for the year ended June 30, 2020. In report 20-19, we provided information on the calculation of the OPEB liability for the State Retiree Health Insurance program.

In September 2020, ETF separately issued reports for the State Retiree Life Insurance program and for the Local Retiree Life Insurance program that included the financial statements, including the related notes, and that included a Schedule of Employer Allocations and Schedule of Collective OPEB Amounts, as of and for the year ended December 31, 2019. In December 2020, ETF separately issued reports for the SHICC program that included the financial statements, including the related notes, and the Schedule of Employer Allocations and the Schedule of Collective OPEB Amounts, as of and for the year ended December 31, 2019. We provided unmodified opinions on the financial statements and the employer schedules included in ETF's report for each program. We further reported on the activity of the State Retiree Life Insurance and the Local Retiree Life Insurance programs in reports 20-16, 20-17, and 20-18, and on the activity of the SHICC program in reports 20-24 and 20-25. These reports included our reports on internal control over financial reporting and on compliance and other matters as well as the information in this chapter. We have provided the information again in order to assist the users of the financial statements included in ETF's CAFR.

Retiree Life Insurance

Administered under the provisions of s. 40.70, Wis. Stats., the State Retiree Life Insurance program and the Local Retiree Life Insurance program provide postemployment life insurance coverage to all eligible employees of participating employers. The State of Wisconsin, including state agencies, such as UW System, and state authorities, such as the UW Hospitals and Clinics Authority, participates in the State Retiree Life Insurance program. There were 721 local government employers participating in the Local Retiree Life Insurance program as of December 31, 2019.

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

Calculating the Total OPEB Liability

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

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

As of December 31, 2019, the total OPEB liability was \$1.0 billion for the State Retiree Life Insurance program and \$682.2 million for the Local Retiree Life Insurance program.

ETF's actuaries performed actuarial valuations as of January 1, 2019, and adjusted for changes such as interest earned, contributions paid, and benefits paid during 2019 to determine the total OPEB liability for the State Retiree Life Insurance program and for the Local Retiree Life Insurance program as of December 31, 2019. Based on these valuations, the total OPEB liability for the State Retiree Life Insurance program was \$1.0 billion as of December 31, 2019, and the total OPEB liability for the Local Retiree Life Insurance program was \$682.2 million as of December 31, 2019.

The discount rate is a critical factor in calculating the total OPEB liability, and it can have a significant effect on the amount of the total OPEB liability. The discount rate, or interest rate, used to calculate the present value of projected benefit payments is specifically defined under the accounting standards. Because the assets accumulated for the State Retiree Life Insurance program and the Local Retiree Life Insurance program are projected to be insufficient to make all projected future benefit payments of current active and retired eligible employees, ETF was required to use a blended discount rate in calculating the total OPEB liability for each program. The long-term expected rate-of-return of 4.25 percent was blended with the municipal bond rate of 2.74 percent as of December 31, 2019, using the Bond Buyer GO 20-Bond Municipal Bond Index. The blended discount rate for the State Retiree Life Insurance program was 2.84 percent, and the blended discount rate for the Local Retiree Life Insurance program was 2.87 percent. As a result, the OPEB liability calculated for each program is larger than if the long-term expected rate-of-return of 4.25 percent was used.

The discount rate can have a significant effect on the amount of the total OPEB liability for the retiree life insurance programs.

Increasing or decreasing the discount rate can have a significant effect on the total OPEB liability. For instance, a one percentage point decrease in the discount rate would increase the total OPEB liability for the State Retiree Life Insurance program to \$1.3 billion and the Local Retiree Life Insurance program to \$844.4 million. A one percentage point increase in the discount rate would decrease the total OPEB liability for the State Retiree Life Insurance program to \$854.8 million and the Local Retiree Life Insurance program to \$558.8 million.

Calculating the Net OPEB Liability or Asset

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

As of December 31, 2019, the net OPEB liability was \$683.1 million for the State Retiree Life Insurance program and \$425.8 million for the Local Retiree Life Insurance program.

As of December 31, 2019, the State Retiree Life Insurance program and the Local Retiree Life Insurance program each reported a net OPEB liability. The State Retiree Life Insurance program had a fiduciary net position of \$348.0 million and a total OPEB liability of \$1.0 billion, which resulted in a net OPEB liability of \$683.1 million as of December 31, 2019. The Local Retiree Life Insurance program had a fiduciary net position of \$256.4 million and a total OPEB liability of \$682.2 million, which resulted in a net OPEB liability of \$425.8 million as of December 31, 2019. As shown in Table 12, this represents an increase from the net OPEB liability reported as of December 31, 2018, for both programs. This increase can be primarily attributed to a decrease in the discount rate of 1.36 percent and

1.35 percent for the State Retiree Life Insurance program and the Local Retiree Life Insurance program, respectively.

Table 12

**Net OPEB Asset (Liability) for the State Retiree Life Insurance Program
and the Local Retiree Life Insurance Program**

As of December 31
(in millions)

	State Retiree Life Insurance		Local Retiree Life Insurance	
	2018	2019	2018	2019
Fiduciary Net Position	\$ 344.0	\$ 348.0	\$ 244.9	\$ 256.4
Total OPEB Liability	(775.5)	(1,031.1)	(502.9)	(682.2)
Net OPEB Asset (Liability)	\$(431.5)	\$(683.1)	\$(258.0)	\$(425.8)

A net OPEB liability for the retiree life insurance programs indicates that, at that point in time, the projected liability for benefit payments to employees exceeded the assets of the program.

A net OPEB liability indicates that, at that point in time, the projected liability for benefit payments to employees exceeded the assets of the program. Based upon the calculation of the total OPEB liability and the fiduciary net position, the State Retiree Life Insurance program had a funded ratio of 33.8 percent and the Local Retiree Life Insurance program had a funded ratio of 37.6 percent as of December 31, 2019. Because GASB did not create the financial reporting methodology to be used for funding purposes, the existence of a net OPEB liability for the State Retiree Life Insurance program and the Local Retiree Life Insurance program should not be used to support a change in contribution rates for the programs. The Group Insurance Board has an approved funding policy for both the State Retiree Life Insurance program and the Local Retiree Life Insurance program and uses this policy, in addition to future liability calculations provided by the third-party administrator, in establishing contribution rates.

Supplemental Health Insurance Conversion Credit Program

The SHICC program, established in 1995, is administered under the provisions of ss. 40.95, and 230.12 (9), Wis. Stats. In July 2020, ETF determined that the SHICC program should be considered an OPEB plan, which resulted in the calculation of a new OPEB liability under accounting standards. The SHICC program provides certain eligible employees additional sick leave hours at the time of termination that increases the balance available to pay for health insurance premiums.

The State of Wisconsin, UW System, and certain state authorities, including the UW Hospital and Clinics Authority, participate in the SHICC program. The SHICC program is funded through annual participating employer contributions and investment earnings. Employer contribution rates are paid as a percentage of payroll determined by the consulting actuary and approved by the ETF Board. For calendar year 2019, the contribution rate for most participating employers was 0.3 percent.

Calculating the Total OPEB Liability

*As of December 31, 2019,
the SHICC program total
OPEB liability was
\$932.6 million.*

As noted, the total OPEB liability is the sum of amounts needed to pay for the OPEB benefits earned by each participant as of the date of the actuarial valuation. A liability exists because the employers participating in the OPEB plan have committed to providing the benefit at some point in the future. ETF's actuaries performed actuarial valuations as of December 31, 2019, to determine the total OPEB liability for the SHICC program as of December 31, 2019. Based on these valuations, the total OPEB liability for the SHICC program was \$932.6 million as of December 31, 2019, compared to \$949.8 million as of December 31, 2018.

The health care cost trend rate, which measures the rate of change in per capita health costs over time, is also significant in the calculation of the total OPEB liability and was assumed to be 3.2 percent. A one percentage point increase in the health care cost trend rate (4.2 percent) increases the total OPEB liability to \$993.1 million, and a one percentage point decrease in the health care cost trend rate (2.2 percent) decreases the total OPEB liability to \$868.9 million.

The discount rate is also a critical factor in calculating the total OPEB liability, and it can have a significant effect on the amount of the total OPEB liability. Because the assets accumulated for the SHICC program are projected to be sufficient to make all projected future benefit payments of current active and retired eligible employees, ETF used the SHICC long-term expected rate-of-return assumption, which is 7.0 percent as the discount rate for the program. Increasing or decreasing the discount rate can have a significant effect on the total OPEB liability. For instance, a one percentage point decrease in the discount rate (6.0 percent) would increase the total OPEB liability to \$1.0 billion and a one percentage point increase in the discount rate (8.0 percent) would decrease the total OPEB liability to \$853.2 million.

Calculating the Net OPEB Liability or Asset

As of December 31, 2019, the net OPEB asset was \$151.8 million for the SHICC program.

To determine the net OPEB liability or asset, the accounting standards require the total OPEB liability be subtracted from the OPEB plan's fiduciary net position. As shown in Table 13, the SHICC program had a fiduciary net position of \$1.1 billion and a total OPEB liability of \$932.6 million, which resulted in a net OPEB asset of \$151.8 million as of December 31, 2019. A net OPEB asset indicates that, at that point in time, the assets of the program exceeds the projected liability for benefit payments.

Table 13

Net OPEB Asset (Liability) for the SHICC Program

As of December 31, 2019
(in millions)

	Amount
Fiduciary Net Position	\$1,084.4
Total OPEB Liability	(932.6)
Net OPEB Asset (Liability)	\$ 151.8

Employer Reporting

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

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

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

Employers participating in the State Retiree Life Insurance program and the SHICC program includes state agencies, such as UW System, and the various authorities that participate in the program, such as the UW Hospitals and Clinics Authority. To assist the State of Wisconsin and those agencies and authorities that are part of the State's financial reporting entity but that prepare separately issued

financial statements, ETF prepared a Schedule of Employer Allocations and a Schedule of Collective OPEB Amounts as of and for the year ended December 31, 2019, for each of these OPEB programs. We audited these schedules and provided unmodified opinions on them in report 20-17 and report 20-25. The net OPEB liability for the State Retiree Life Insurance program and the net OPEB asset for the SHICC program were included in the State's GAAP-based financial statements, which were published in December 2020 in the State of Wisconsin's CAFR for the year ended June 30, 2020.

To assist local employers participating in the Local Retiree Life Insurance program in determining the employer proportionate share of the net OPEB liability, ETF also prepared a Schedule of Employer Allocations and a Schedule of Collective OPEB Amounts as of and for the year ended December 31, 2019, for the Local Retiree Life Insurance program. We audited these schedules and provided unmodified opinions on them in report 20-18. Each local government that participates in the Local Retiree Life Insurance program must report its proportionate share of the net OPEB liability in its GAAP-based financial statements.

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Administration and Oversight of Group Insurance Programs

GIB oversees group insurance programs that ETF administers. In report 19-2, we reviewed the administration and oversight of the following programs: Group Health Insurance, Income Continuation Insurance, Group Life Insurance, and Long-term Disability Insurance, which was closed to new claims in January 2018. In report 19-2, we made 30 recommendations to ETF to improve the administration of group insurance programs in the areas of contract administration, program reserves, and governance. On November 22, 2019, ETF reported to the Joint Legislative Audit Committee on the status of ETF's efforts to implement our recommendations.

Status of Recommendations

As of November 2020, we found ETF had fully implemented 24 recommendations, partially implemented 5 recommendations, and had not implemented one recommendation.

During our current audit, we followed up on the status of the 30 recommendations we made in report 19-2. Our follow-up procedures included reviewing GIB meeting materials, attending GIB meetings, interviewing certain ETF staff, and reviews of other materials provided. As of November 2020, ETF had fully implemented 24 of the 30 recommendations, partially implemented 5 recommendations, and had not implemented one recommendation, as shown in Table 14. Recommendations were considered partially implemented when ETF implemented some aspects of the recommendation or, for certain recommendations, implemented alternative actions. The one recommendation that was not implemented related to providing GIB a summary of the audit for the program administrator for the Income Continuation Insurance program. Because the next audit of the program administrator will not occur until 2021, ETF cannot yet implement this recommendation. We will continue to monitor ETF's implementation of this recommendation in future audit work.

Table 14

Status of ETF's Efforts to Implement Recommendations in Report 19-2, By Issue¹
As of November 2020

Issue	Fully Implemented	Partially Implemented	Not Implemented	Total
Expenditures and Staffing		1		1
Group Health Insurance Program	6			6
Group Health Insurance Program Reserves	6			6
Disability Insurance Programs	2		1	3
Group Life Insurance Program	2	2		4
Information Technology Security	3			3
Governance Issues	5	2		7
Total	24	5	1	30

¹ A complete list of the recommendations and summary information on ETF's actions is included in Appendix 3.

We do not make additional or continued recommendations for three of the five partially implemented recommendations because, as we describe in Appendix 3, ETF took the following alternative actions in response to our recommendations:

- Expenditures and Staffing—We recommended that ETF require staff to track time charged to group insurance programs on an ongoing basis. Instead, ETF updated its process to require quarterly estimates of time spent, but did not require staff to track actual time spent on these programs. We will continue to monitor ETF's estimation in future audit work.
- Group Life Insurance program—We recommended that ETF work with GIB to establish target ranges for program reserves for the state and local components of the Group Life Insurance program, as well as a strategy and timeline for achieving them. ETF presented these target ranges to GIB. However, GIB was not involved in setting the target ranges, such as by review of various options, but did approve the premium rates set using the target ranges presented. As a result, approval of the target range could be implied.

- Governance Issues—We recommended that ETF work with GIB and the ETF Board to determine the maximum duration of contracts with program administrators, actuaries, and auditors. ETF worked with GIB to determine the maximum duration for program administrators. However, contracts that allow for indefinite annual renewals were established for actuaries and auditors under the contracting authority provided to the ETF Secretary by GIB and the ETF Board. We will continue to monitor ETF's contracting practices in future audit work.

ETF should either continue its efforts or take additional steps to implement our recommendations.

For the two remaining partially implemented recommendations, which related to recommendations for the Group Life Insurance program and Governance Issues, ETF should either continue its efforts or take additional steps to implement our recommendations.

Group Life Insurance Program

In report 19-2, we reviewed the administration and oversight of the Group Life Insurance program, and found that GIB did not establish target ranges for program reserves. We recommended that ETF work with GIB to establish target ranges for program reserves for the state and local components of the program, and a timeline and strategy for achieving them. We also recommended that ETF work with GIB to establish a policy requiring periodic reviews of the target ranges and provide GIB with the results of these reviews.

ETF should establish a written policy requiring periodic reviews of target ranges for the Group Life Insurance program reserves.

In August 2019, ETF included target ranges for all program reserves in its memorandum to GIB and worked with GIB to develop a timeline and strategy for achieving the targeted program reserves. ETF did not work with GIB in establishing the target ranges, such as by presenting various options for GIB's consideration. However, because GIB approved the premium rates that were projected to meet the target ranges within the established timeline, GIB approval of the target ranges could be implied. Unlike the actions taken in November 2020 related to the Group Health Insurance program, ETF has not developed a written policy requiring periodic reviews of the target ranges for the Group Life Insurance program. ETF indicated that the annual review of the reserves includes a review of the target ranges, but this was not included in a written policy. As noted, requiring periodic reviews of the target ranges of reserves in a written policy and providing GIB the results of its reviews allow GIB members to ensure that the target ranges continue to be appropriate and assist GIB in making informed programmatic decisions.

☑ Recommendation

We recommend the Department of Employee Trust Funds:

- *work with the Group Insurance Board to establish a written policy requiring periodic reviews of the target ranges for reserves for the Group Life Insurance program, and provide the results of these reviews to the Group Insurance Board; and*
- *report to the Joint Legislative Audit Committee by June 30, 2021, on its efforts to implement this recommendation.*

Governance Issues

ETF should provide GIB with information related to the performance of program auditors.

In report 19-2, we found that ETF did not consistently provide GIB with information on the performance of program administrators, actuaries, or auditors, including the extent to which these firms achieved key performance measurement goals. We recommended ETF compile additional information about the performance of these firms involved in administering the group insurance programs and provide this information to GIB and the ETF Board. During our current audit, we found that ETF compiled and provided additional performance information to GIB and the ETF Board for program administrators and program actuaries. However, ETF did not do so for the program auditors. Although there would be fewer outcomes to report, ETF should provide information to GIB and the ETF Board on the performance of program auditors.

☑ Recommendation

We recommend the Department of Employee Trust Funds:

- *compile additional information about the performance of program auditors and provide this information to the Group Insurance Board and the Employee Trust Fund Board; and*
- *report to the Joint Legislative Audit Committee by June 30, 2021, on its efforts to implement this recommendation.*

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Auditor's Report



STATE OF WISCONSIN
Legislative Audit Bureau

Report 21-3

Joe Chrisman
State Auditor

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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

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

We have audited the financial statements and related notes of the following fiduciary funds administered by the State of Wisconsin Department of Employee Trust Funds (ETF) as of and for the year ended December 31, 2019: Wisconsin Retirement System, Supplemental Health Insurance Conversion Credit (SHICC), Employee Reimbursement Accounts/Commuter Benefits, State Retiree Life Insurance, Local Retiree Life Insurance, Milwaukee Retirement Systems, and Local Retiree Health Insurance. In addition, we have audited the following proprietary funds administered by ETF as of and for the year ended December 31, 2019: Duty Disability Insurance, Health Insurance, Income Continuation Insurance, Accumulated Sick Leave Conversion Credit, and State Retiree Health Insurance. We have issued our report thereon dated February 10, 2021. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, which is issued by the Comptroller General of the United States. The financial statements and related auditor's report have been included in ETF's 2019 CAFR.

Internal Control over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified certain deficiencies in internal control that we consider to be a material weakness or a significant deficiency. We consider the finding related to compiling an estimated liability for the basic Accumulated Sick Leave Conversion Credit (basic ASLCC) program, described in the accompanying Finding and Response Schedule, to be a material weakness. Because ETF's financial statements are also included in the State of Wisconsin's CAFR for the fiscal year ended June 30, 2020, this material weakness was also included in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters related to our audit of the State of Wisconsin's financial statements (report 20-30) as Finding 2020-005.

We also identified a deficiency in internal control that we considered to be a significant deficiency related to information provided by the State of Wisconsin Investment Board (SWIB) to support note disclosures for unfunded commitments. These disclosures were provided to ETF for preparation of the financial statements. The note disclosures were corrected. This deficiency was communicated to SWIB in report 20-9. We did not request a response from the management of ETF since SWIB is responsible for corrective action.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements are free from material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

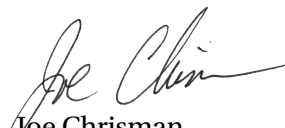
ETF Response to Finding

ETF's written response to the finding identified in our audit is included in the accompanying Finding and Response Schedule. ETF's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

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

LEGISLATIVE AUDIT BUREAU


Joe Chrisman
State Auditor

February 10, 2021

FINDING AND RESPONSE SCHEDULE

Accumulated Sick Leave Conversion Credit Program Liability

Background:

ETF administers employee benefit programs for participating state employees, including two sick leave programs: the basic ASLCC program and the SHICC program. The State of Wisconsin, including the University of Wisconsin (UW) System, and certain state authorities such as the UW Hospital and Clinics Authority, participate in the sick leave programs. In implementing Governmental Accounting Standards Board (GASB) Statement Number 84, *Fiduciary Activities*, ETF, in consultation with the Department of Administration (DOA) State Controller's Office, determined that the sick leave programs would not be reported in ETF's calendar year 2019 financial statements or in the State of Wisconsin's CAFR for fiscal year 2019-20 as a fiduciary activity as they had historically been reported. In July 2020, ETF determined that it would report the financial information for the basic ASLCC program separately from the SHICC program. Historically, these two programs were reported together as one fiduciary fund.

The basic ASLCC program allows eligible employees to convert earned but unused sick leave balances for use in paying postemployment premiums for state group health insurance coverage. Because basic ASLCC benefits are based on sick leave earned during an employee's years of service and are available to the employee during their employment, ETF determined that the activity for this program would be presented in ETF's financial statements as an internal service fund and that the liability for the benefits to be provided would be considered a compensated absence.

Criteria:

GASB Statement Number 16, *Accounting for Compensated Absences*, establishes the requirements for calculating a compensated absence liability for activity such as ETF's basic ASLCC program. Under GASB Statement Number 16, a liability should be calculated based on the sick leave accumulated as of the end of the reporting period by those employees who were currently eligible to receive benefits. In addition, a liability should also be calculated for employees who were expected to become eligible in the future based on policies established to estimate the probability that employees will become eligible in the future. Although the liability calculated using the methodology in GASB Statement 16 is an estimate, this estimate should provide a reasonable basis for determining the State's liability.

Condition:

ETF calculated a compensated absence liability estimate of \$2.7 billion for the basic ASLCC program. However, in performing this calculation, ETF did not have a reasonable basis for estimating the probability of employees becoming eligible in the future to receive basic ASLCC benefits. In addition, ETF did not adjust the liability balance for deceased participants' accounts or for accounts that were closed.

Context:

We reviewed ETF's methodology for calculating the compensated absence liability estimate for the basic ASLCC program. We also interviewed ETF staff about its methodology, the assumptions used to estimate the probability of future benefits, and the calculation of the liability. Finally, we analyzed available data for employees who were determined to be eligible or who may be eligible to receive benefits in the future under the basic ASLCC program.

Questioned Costs:

None.

Effect:

The financial statements related to the basic ASLCC program were materially misstated. The noncurrent liability account, Noncurrent Portion of Compensated Absences, on the Statement of Net Position, and Benefit Expense on the Statement of Revenues, Expenses, and Changes in Fund Net Position were overstated by \$425.4 million. ETF prepared adjustments to correct the errors we identified.

Cause:

ETF's policies were inadequate to provide a reasonable basis for accurately calculating the basic ASLCC compensated absence liability estimate. For example, ETF did not use available data on employees participating in the basic ASLCC program to reasonably estimate the probability that employees who were not currently eligible for the basic ASLCC benefit will become eligible to receive benefits in the future.

Further, ETF's policies were inadequate to provide a reasonable basis for accurately calculating the liability estimate because ETF did not sufficiently plan for its implementation of GASB Statement Number 84, which was issued in January 2017. On October 5, 2018, we wrote to ETF to foreshadow the important effects GASB Statement Number 84 would have on ETF's calendar year 2019 financial report. On February 14, 2019, we met with ETF and DOA to discuss the status of efforts to implement the financial reporting changes resulting from GASB Statement Number 84. On September 27, 2019, we wrote to ETF to reiterate the need for it to work collaboratively with DOA to ensure consistent reporting of the fiduciary activities administered by ETF in differing financial reports, including the State's CAFR for the year ended June 30, 2020. As noted, ETF did not determine that it would separate the financial information for the two sick leave programs until July 2020, which was subsequent to the date on which ETF had planned to provide draft financial statements for the sick leave programs to the Legislative Audit Bureau for audit purposes.

 Recommendation

We recommend the Department of Employee Trust Funds:

- *improve its calculation of the compensated absence liability estimate for the basic Accumulated Sick Leave Conversion Credit program by revising its policies by April 30, 2021, and implementing them for the 2020 financial statements; and*
- *ensure when implementing changes to financial reporting that it completes its planning, review, and assessment process before the close of the affected financial reporting period, and works with the Department of Administration, State Controller's Office on areas that affect the State's CAFR.*

Response from the Department of Employee Trust Funds: The Department of Employee Trust Funds (ETF) agrees that the initial calculation of the basic ASLCC liability resulted in overstating the Noncurrent portion of the liability and agrees with the importance of planning and assessing changes to financial reporting, including working with the Department of Administration, State Controller's Office (SCO). However, ETF respectfully disagrees with the characterization of its efforts undertaken to accurately report the financial activities of the programs, in compliance with accounting standards, and believes the finding lacks important context to the actions it took.

Appendices

Appendix 1

Employee Trust Funds Board Membership 2020

Name	Affiliation	Board Member Since
Wayne Koessl, Chair	Appointed by the Wisconsin Retirement Board	1996
John David, Vice Chair	Appointed by the Wisconsin Retirement Board	2008
Robert Niendorf, Secretary	Appointed by the Teachers Retirement Board	1992
Stephen Arnold	Appointee of the Governor, with advice and consent of Senate, representing the public	2019
Malika Evanco	Administrator, Division of Personnel Management, Department of Administration	2019
William Ford	Elected by retired Wisconsin Retirement System (WRS) participants, and is a WRS annuitant	2011
Chris Heller	Appointed by Teachers Retirement Board	2019
Michael Langyel	Appointed by Teachers Retirement Board	2009
Katy Lounsbury	Designee of the Governor	2020
Leilani Paul	Elected by participating employees of either technical college or school district educational support personnel, and is an active WRS participant	2015
Roberta Rasmus	Appointed by the Teachers Retirement Board	2012
Steven Wilding	Appointed by the Wisconsin Retirement Board	2019
Vacant	Appointed by the Wisconsin Retirement Board	

Appendix 2

Group Insurance Board Membership 2020

Name	Affiliation	Board Member Since
Herschel Day, Chair	Appointee of the Governor, insured participant in WRS who is a teacher	2013
Nathan Houdek, Vice Chair	Designee of the Commissioner of Insurance	2019
Nancy Thompson, Secretary	Appointee of the Governor, chief executive or member of the governing body of a local unit of government that participates in the WRS	2012
Harper Donahue IV	Appointee of the Governor, insured participant in WRS who is an employee of a local unit of government	2019
Malika Evanco	Administrator, Division of Personnel Management, Department of Administration	2019
Dan Fields	Appointee of the Governor, insured participant in WRS who is a retiree	2019
Walter Jackson	Appointee of the Governor, insured participant in WRS who is not a teacher	2019
Katy Lounsbury	Designee of the Governor	2020
Brian Pahnke	Designee of the Secretary, Department of Administration	2019
Bob Wimmer	Designee of the Attorney General	2018
Vacant	Appointee of the Governor	

Appendix 3

Status of Recommendations Related to Group Insurance Programs¹

Recommendation	Fully Implemented	Partially Implemented	Not Implemented	Additional Explanation
Expenditures and Staffing				
1		<input checked="" type="checkbox"/>		During 2019, the Department of Employee Trust Funds (ETF) estimated the amount of staff time spent completing work for individual group insurance programs on a quarterly basis rather than the annual basis previously used. We consider this recommendation to be partially implemented because ETF updated the frequency of the process. We will continue to monitor ETF's estimation in future audit work.
Group Health Insurance Program				
2	<input checked="" type="checkbox"/>			In November 2019, ETF provided GIB with the results of its written analyses of recommendations from consultants. ETF also created a template to use for future memoranda, which ETF used for a GIB meeting in May 2020.
3	<input checked="" type="checkbox"/>			ETF worked with GIB to establish intended outcomes for significant changes to the Group Health Insurance program.
4	<input checked="" type="checkbox"/>			ETF assessed progress toward achieving intended outcomes for significant changes to the group insurance programs and provided results of the assessments to GIB.
5	<input checked="" type="checkbox"/>			ETF specified how to calculate performance measures in third-party administrator contracts. The contracts for auditors that assess the performance measures of the third-party administrators reference the third-party administrator contracts.

Recommendation	Fully Implemented	Partially Implemented	Not Implemented	Additional Explanation
<p>Group Health Insurance Program (Continued)</p>				
<p>6 Consistently determine whether firms achieved contractually specified performance measure goals and assess contractually specified financial penalties when firms do not achieve these goals.</p>	<input checked="" type="checkbox"/>			<p>ETF created a spreadsheet to track performance of the health insurers and documented its decisions on when to assess penalties, determined whether other firms achieved performance measure goals, and assessed penalties when they did not.</p>
<p>7 Report to GIB on the financial penalties assessed.</p>	<input checked="" type="checkbox"/>			<p>ETF reported to GIB on the financial penalties it assessed in four of the last six meetings since May 2019. In the remaining two meetings, ETF reported that it assessed no financial penalties.</p>
<p>Group Health Insurance Program Reserves</p>				
<p>8 Require the program actuary to take investment income into account when recommending the amount of reserves to spend.</p>	<input checked="" type="checkbox"/>			<p>In August 2019 and August 2020, the program actuary took investment income into account when recommending the amount of reserves to spend.</p>
<p>9 Require the program actuary to annually explain why the change in program reserves differed from the amount GIB had voted to spend.</p>	<input checked="" type="checkbox"/>			<p>In May 2020, the actuary explained why the change in program reserves as of December 2019 differed from the amount GIB had voted to spend.</p>
<p>10 Require the program actuary to provide GIB with calendar year information on program reserves.</p>	<input checked="" type="checkbox"/>			<p>In August 2019 and August 2020, the program actuary provided GIB with calendar year information on program reserves.</p>
<p>11 Work with GIB to establish a policy requiring periodic reviews of the target ranges for Group Health Insurance program reserves and provide the results of these reviews to GIB.</p>	<input checked="" type="checkbox"/>			<p>In November 2020, ETF worked with GIB to establish a policy for the target ranges for program reserves that requires the target ranges to be reviewed at least every three years.</p>
<p>12 Consistently prepare and provide GIB with the results of written analyses of key information about program reserves that was provided by the actuary.</p>	<input checked="" type="checkbox"/>			<p>In August 2019 and August 2020, ETF provided GIB with memoranda that included the results of analyses of key information from the actuary.</p>

Recommendation	Fully Implemented	Partially Implemented	Not Implemented	Additional Explanation
Group Health Insurance Program Reserves <i>(continued)</i>				
13 Indicate in writing to GIB if the actuary makes a recommendation that is inconsistent with a prior GIB decision.	<input checked="" type="checkbox"/>			In August 2019, ETF verbally indicated to GIB that the actuary made a recommendation that was inconsistent with GIB's program reserves policy, but ETF did not indicate this in writing. In August 2020, ETF indicated to GIB in writing that the actuary made a recommendation that was inconsistent with GIB's program reserves policy.
Disability Insurance Programs				
14 Consistently provide GIB with audit reports of the performance of the Income Continuation Insurance program administrator and memoranda that accurately summarize these audit reports.		<input checked="" type="checkbox"/>		ETF contracts for audits of the Income Continuation Insurance program administrator to be performed every three years. The most recent audit was provided to GIB in November 2018. Because ETF signed a memorandum of understanding in April 2019 with an audit firm to perform the next audit in 2021, ETF cannot yet implement this recommendation.
15 Work with GIB to establish target ranges for program reserves for the state and local components of the Income Continuation Insurance program, as well as a strategy and a timeline for achieving them.	<input checked="" type="checkbox"/>			In November 2019, ETF worked with GIB to establish a policy for the target ranges for program reserves for the state and local components of the Income Continuation Insurance program, and in May 2020, GIB approved premiums and a strategy to reach the target ranges.
16 Work with GIB to establish a policy requiring periodic reviews of the target ranges for Income Continuation Insurance program reserves and provide the results of these reviews to GIB.	<input checked="" type="checkbox"/>			In November 2019, ETF worked with GIB to establish a policy for the target ranges for program reserves that requires the target ranges to be reviewed at least every three years.
Group Life Insurance Program				
17 Provide sufficiently detailed information in memoranda to GIB regarding the annual financial reports from the Group Life Insurance program administrator.	<input checked="" type="checkbox"/>			In August 2019 and August 2020, ETF provided GIB with memoranda that contained sufficiently detailed information regarding the Group Life Insurance annual financial reports.

Recommendation	Fully Implemented	Partially Implemented	Not Implemented	Additional Explanation
Group Life Insurance Program <i>(continued)</i>				
18 Work with GIB to establish target ranges for program reserves for the state and local components of the Group Life Insurance program as well as a strategy and timeline for achieving them.		<input checked="" type="checkbox"/>		In August 2019 and August 2020, ETF presented information on the target ranges for Group Life Insurance program reserves. However, it did not work with GIB to establish the target ranges. As part of the meetings, ETF worked with GIB to establish a strategy and timeline for achieving the presented target ranges. We consider this recommendation to be partially implemented because ETF did not work with GIB in setting the target ranges, such as by providing GIB options for consideration. However, because the target ranges were used in setting premium rates, which were approved by GIB, we do not make a further recommendation to ETF.
19 Work with GIB to establish a policy requiring periodic reviews of the target ranges for Group Life Insurance program reserves and provide the results of these reviews to GIB.		<input checked="" type="checkbox"/>		ETF indicated that the target ranges for Group Life Insurance program reserves are reviewed annually when life insurance rates are established. However, ETF and GIB did not establish a written policy requiring periodic reviews of the target ranges. As a result, we have included additional recommendations to ETF on page 48.
20 Assess whether the program administrator or the State of Wisconsin Investment Board (SWIB) should invest Group Life Insurance program reserves and provide the results of this assessment to GIB.	<input checked="" type="checkbox"/>			In November 2019, ETF provided GIB with a memorandum that summarized its assessment of whether the program administrator or SWIB should invest the Group Life Insurance program reserves and concluded that the program reserves should remain with the program administrator.
Information Technology Security				
21 Work with GIB to establish sufficient policies pertaining to audits of information technology (IT) controls.	<input checked="" type="checkbox"/>			ETF established sufficient policies pertaining to audits of IT controls, however it did not work with GIB. Because the policies pertain to more than just the group insurance programs, ETF's process of working with a cybersecurity firm to develop these policies appears appropriate.

Recommendation	Fully Implemented	Partially Implemented	Not Implemented	Additional Explanation
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Information Technology Security
(continued)

22	Collect all contractually required audits of IT controls, review all submitted audits, and provide results of the reviews to GIB.	<input checked="" type="checkbox"/>		ETF collected and reviewed all contractually required audits of IT controls. However, it did not provide the results of all of its reviews to GIB. In August 2020, ETF provided an overview of the results of its review of health insurers for the Group Health Insurance program to GIB and, in November 2020, met with GIB in closed session to discuss the audits of both health insurers and other program administrators.
23	Ensure that the security awareness training ETF provides staff adequately addresses appropriate ways to securely communicate confidential information.	<input checked="" type="checkbox"/>		ETF provided documentation of training it provided to staff that addresses appropriate ways to securely communicate confidential information.

Governance Issues

24	Consistently provide GIB with programmatic information at least one week before meetings.	<input checked="" type="checkbox"/>		In February, May, and August 2020, all programmatic information provided to GIB was dated at least one week before meetings.
25	Post on the ETF website at least one day before a given GIB meeting all nonconfidential information GIB will consider at that meeting.	<input checked="" type="checkbox"/>		In February, May, and August 2020, all nonconfidential information GIB considered was posted on ETF's website at least one day before the meeting.
26	Compile additional information about the performance of program administrators, actuaries, and auditors and provide this information to GIB and the ETF Board.	<input checked="" type="checkbox"/>		ETF compiled additional information about the performance of program administrators and program actuaries and provided this information to GIB, but it had not done so for the program auditors. As a result, we have included additional recommendations to ETF on page 48.

Recommendation	Fully Implemented	Partially Implemented	Not Implemented	Additional Explanation
Governance Issues (continued)				
27		☑		ETF has worked with GIB to determine the maximum duration of contracts with program administrators. For program actuaries and auditors, ETF has implemented "evergreen contracts," which allow for indefinite annual renewals until either party gives notice of their intent to cancel the contract. We consider this to be partially implemented because ETF did not establish a maximum duration for these contracts. However, because GIB and the ETF Board has authorized the ETF Secretary to execute contracts with auditors and actuaries, we do not make a further recommendation to ETF. We will continue to monitor ETF's contracting practices in future audit work.
28	☑			ETF requested and obtained approval from GIB and the ETF Board to delegate authority to the ETF Secretary to execute contract amendments for actuarial services.
29	☑			ETF established a written plan to periodically contract for actuarial audits for group insurance program actuaries and provided GIB with the audit results.
30	☑			In November 2019, ETF provided GIB with a strategy to improve oversight of the Group Health Insurance program, and in May 2020, ETF provided GIB with options to improve oversight in response to the public health emergency.

¹ Status reported as of November 2020.

Response



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

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of Employee Trust Funds
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etf.wi.gov

February 10, 2021

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

Dear Mr. Chrisman,

Thank you for the opportunity to review and comment on the audit of the Department of Employee Trust Funds (ETF) Comprehensive Annual Financial Report (CAFR) for the year ended December 31, 2019. ETF will follow-up on the recommendations in the report, including providing the Joint Legislative Audit Committee updates on our progress.

The Wisconsin Retirement System (WRS) is often cited as a model governmental defined benefit plan. The continued due diligence of the governing boards and staff administering the program, oversight by policymakers, and sound funding principles contribute to the WRS' ability to pay promised benefits long into the future. The success of the WRS can be measured by its contributions to the Wisconsin economy, its strong financial position, and the effective oversight and administration of the various employee benefit programs.

Contributions to the Wisconsin Economy

The WRS not only supports retired and disabled public employees and their families, it also helps boost Wisconsin's economy. The WRS paid more than \$5.6 billion in benefits during 2019 – a large portion of this money gets spent in Wisconsin by the more than 85% of retirees who live here. Approximately 80% of those benefits was derived from investment income.

The WRS is low cost to taxpayers compared to peer retirement systems. Wisconsin state and local government taxpayers spend far less on public pensions as a percentage of total government direct general spending compared to other states. According to the National Association of State Retirement Administrators (NASRA), average state and local government spending on pensions is 4.7% nationally. In Wisconsin, that figure is less than half, at 2.0%.

Strong Financial Position

As noted in the report, the WRS continues to be in a strong financial position with a funding ratio of 103 percent, calculated using the methodology prescribed by the

Governmental Accounting Standards Board (GASB). The WRS is one of the few fully funded pension systems in the United States. The funding percentage is a reliable metric indicating the WRS will meet its financial objective, which is to fully fund the long-term cost of benefits provided by statute, through disciplined and timely accumulation of sufficient assets. The median funded level of US public pension plans in 2019 was 72.4%, according to the NASRA. Furthermore, as noted in LAB's report comparing defined-benefit plans, the WRS compares very favorably to the other plans noted by the LAB.

Strong investment performance significantly contributes to the WRS funding level. As noted above, 80% of funding comes from investment earnings. As of December 31, 2020, the WRS Core Fund had 5-, 10-, 20- and 30-year net of external manager fee returns of 10.74%, 8.51%, 6.94% and 8.83%, respectively. The 15.21% net of fee return in 2020 is projected to result in a Core Fund annuity adjustment of nearly 5 percent.

The strong funding position of the WRS can also be attributed to risk sharing features in the plan design, such as the absence of a guaranteed cost of living adjustment and the ability to increase annuities (or decrease annuities up to an amount of previously granted increases) depending on investment performance. As a result, one of the inherent risks in this plan design is all previously granted post-retirement Core Fund adjustments (commonly referred to as dividends) can be revoked if investment losses are significant enough. The Board has been monitoring and periodically discussing the health of the 'dividend reserve', which GRS, the WRS consulting actuary, estimates to increase to around \$10 billion after the 2021 annuity adjustment. This is higher than the \$9.2 billion level that existed prior to the 2008 recession.

Moreover, 1,516 WRS employers and 260,251 active employees benefit from stable and predictable contribution rates, which allow for better management of budgets. Contribution rates are generally split evenly between employers and employees and adjusted annually based on an actuarial valuation, ensuring full funding of future benefits. Investment returns, legislative changes, and changes in mortality assumptions have had the largest impact on contribution rates. According to GRS, contribution rates have been remarkably stable – much more stable than other plans because of the WRS' unique risk sharing structure.

Effective Oversight and Administration

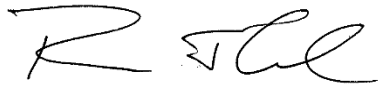
The ETF Board and the SWIB Board of Trustees oversee and monitor the WRS trust fund to ensure the WRS is being managed prudently and meets the goals of the WRS funding policy. GRS conducts annual actuarial valuations to recommend contribution rates and annuity adjustments. Additionally, experience studies are conducted every three years to determine if the actuarial assumptions used in the valuations are reasonable compared to actual plan experience. These reports are presented to the ETF Board. The WRS also undergoes stress testing every two years, as well as additional stress testing as warranted. For example, additional stress testing was performed as a result of the 2008 Great Recession and in 2020 during the COVID-19 pandemic. GRS presents the detailed results and analysis of the stress testing to the SWIB Trustees and ETF Board in a comprehensive PowerPoint format, which is made available to the public via the board meeting materials as well as easily accessible on

SWIB's website. SWIB and ETF find these tests quite valuable in carrying out their fiduciary duties and will continue to conduct them.

Finally, ETF is committed to implementing, maintaining, and monitoring internal controls to safeguard the assets of the trust funds, ensure compliance with applicable laws and regulations, and ensure effective administration of benefit programs. This includes exercising due diligence in applying accounting standards to ensure reliable and transparent financial reporting. While we provided the LAB a lengthy response to the finding related to the implementation of GASB Statement Number 84 as part of the State CAFR audit, we also continue to assess the need for additional resources to ensure we are able to accurately and timely implement any required new standards.

Again, we appreciate the efforts of your staff in conducting the financial audit of the WRS and identifying areas we can make the WRS and our operations even stronger.

Sincerely,

A handwritten signature in black ink, appearing to read "R Conlin". The signature is fluid and cursive, with the first letter "R" being particularly large and stylized.

Robert J. Conlin
Secretary