

**Report 13-16
October 2013**

State Life Insurance Fund

Office of the Commissioner of Insurance

STATE OF WISCONSIN



Legislative Audit Bureau ■

State Life Insurance Fund

Office of the Commissioner of Insurance

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Joe Chrisman
State Auditor

October 18, 2013

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

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94 (1)(de), Wis. Stats., we have completed an audit of the financial statements of the Wisconsin State Life Insurance Fund for the years ended December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009. The Fund provides low-cost life insurance policies to Wisconsin residents, is self-funded through premiums and investment earnings, and is administered by the Office of the Commissioner of Insurance (OCI). As of December 31, 2012, it had 26,558 life insurance policies in effect and \$204.0 million of life insurance in force. The Fund operates under specific statutory restrictions, including a prohibition on employing insurance agents and a limitation on coverage of \$10,000 for any insured individual.

The Fund prepares its financial statements in accordance with insurance accounting practices prescribed by the Commissioner of Insurance, but not in accordance with generally accepted accounting principles. We found its financial statements to be fairly presented in accordance with the insurance accounting practices it follows.

State statutes require the Fund's net profits to be distributed annually as policy dividends and specify that, to the extent practicable, the ratio of the Fund's surplus to its assets is to be between 7.0 percent and 10.0 percent. However, the Fund's surplus-to-assets ratio was 11.0 percent as of December 31, 2012. OCI indicated it will take steps to bring the ratio within the statutorily specified range by the end of 2014.

We appreciate the courtesy and cooperation extended to us by OCI staff in completing our audit. OCI's response follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/BN/ss

Introduction ■

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

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

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

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

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

The number of policies has declined and was 26,558 as of December 31, 2012.

By statute, OCI is not allowed to advertise the Fund and the Fund is not permitted to use commissioned agents. The number of policies has been declining since December 31, 1996, when there were 31,361 policies. As shown in Table 1, there were 26,558 policies as of December 31, 2012. The amount of insurance in force has also declined and was \$204.0 million as of December 31, 2012. The number of new policies issued each year has been less than the number of death claims and the number of policies surrendered for other reasons, such as failure to pay the annual premium.

Table 1

State Life Insurance Policies

December 31	Number of Policies	Insurance in Force
1980	24,029	\$159,866,000
1985	28,036	193,211,000
1990	29,958	212,094,000
1995	30,980	225,335,000
2000	30,660	227,552,000
2005	29,467	222,329,000
2006	29,046	219,866,000
2007	28,615	217,295,000
2008	28,195	214,848,000
2009	27,822	212,402,000
2010	27,421	209,752,000
2011	27,011	207,029,000
2012	26,558	204,007,000

Surplus-to-Assets Ratio

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

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

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

The dividend scale was adjusted in 2005 and 2006 in an effort to increase the surplus-to-assets ratio, which had declined below the statutorily specified range of 7.0 percent to 10.0 percent. As a result of these adjustments, which we discussed in report 09-14, the ratio was within the statutorily specified range as of December 31, 2007.

The surplus-to-assets ratio was 11.0 percent as of December 31, 2012.

As shown in Table 2, the surplus-to-assets ratio has continued to increase and was 11.0 percent as of December 31, 2012. OCI indicated that it plans to adjust the dividend scale to reduce the surplus-to-assets ratio by the end of 2014.

Table 2

**State Life Insurance Fund
Surplus-to-Assets Ratio**

December 31	Ratio ¹
2005	4.6%
2006	5.8
2007	7.1
2008	7.3
2009	8.2
2010	9.1
2011	10.2
2012	11.0

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

Internal Controls over Financial Reporting

Our audit identified two internal control weaknesses, which we included in our internal control and compliance report on page 39.

We identified errors in the Fund's financial statements.

First, we found the need for a variety of audit adjustments to the financial statements. For example, the Fund's staff initially overstated the net realized capital gain account by \$1.1 million for 2012. In addition, the Fund's staff made other accounting errors that we believe should have been detected through routine review of the Fund's financial statements. We recommended that the Fund's staff more thoroughly review the financial statements to ensure they are reasonable and materially accurate.

Second, OCI should continue to strengthen its security over computer systems to reduce the risk that unauthorized users can access the Fund's data and transactions and the risk that equipment and data could be lost or stolen. We included a variety of recommendations in an interim audit communication to OCI.

■ ■ ■ ■

Audit Opinion ■



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Joe Chrisman
State Auditor

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

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

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

Report on the Financial Statements

We have audited the accompanying financial statements and the related notes of the Wisconsin State Life Insurance Fund as of and for the years ended December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management of the Fund is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting practices of the National Association of Insurance Commissioners (NAIC), which are the accounting practices prescribed by the State of Wisconsin Commissioner of Insurance. Management's responsibilities include the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, which is issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the

financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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

As described in Note 2 to the financial statements, the financial statements are prepared by the Fund on the basis of accounting practices prescribed by the State of Wisconsin Commissioner of Insurance. This is a basis of accounting other than accounting principles generally accepted in the United States of America.

Although not reasonably determinable, the effects on the financial statements of the variances between the accounting practices prescribed by the State of Wisconsin Commissioner of Insurance and accounting principles generally accepted in the United States of America are presumed to be material. Therefore, auditing standards generally accepted in the United States of America require that we issue an adverse opinion on the financial statements based on accounting principles generally accepted in the United States of America.

Adverse Opinion—U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed above in "Basis for Adverse Opinion—U.S. Generally Accepted Accounting Principles," the financial statements referred to in the first paragraph do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Wisconsin State Life Insurance Fund as of December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009, or changes in financial position or cash flows thereof for the years then ended.

Opinion—Accounting Practices Prescribed by the State of Wisconsin Commissioner of Insurance

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Wisconsin State Life Insurance Fund as of December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009, and the respective changes in its financial position and its cash flows thereof for the years then ended, in accordance with the accounting practices described in Note 2 to the financial statements.

Emphasis of Matter

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

Other Matter

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Fund. The supplementary information included as Management's Discussion and Analysis on pages 13 through 20 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures to the information

that included inquiries of management about the methods of preparing the information. We further compared the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. However, we do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to do so.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated October 1, 2013, on our consideration of the Wisconsin State Life Insurance Fund's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Wisconsin State Life Insurance Fund's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

October 1, 2013

Management's Discussion and Analysis ■

Prepared by the Wisconsin State Life Insurance Fund's Management

This section presents management's discussion and analysis of the financial performance of the Wisconsin State Life Insurance Fund during the calendar years ended December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the Office of the Commissioner of Insurance, which manages the Fund.

Overview of the Fund

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

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

During the current audit period, the Fund took steps to bring the surplus-to-assets ratio back in compliance with s. 607.15, Wis. Stats., which requires, to the extent practicable, that the ratio of surplus to assets be between 7.0 percent and 10.0 percent. Steps included a reduction in dividends paid to policyholders and a decrease in the interest rate paid related to certain deposit-type contracts. The Fund is considering increasing dividends since the ratio is now above 10.0 percent.

Financial Statements

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

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

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

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

In this discussion and analysis, the reasons for the changes in financial activity for calendar years 2012, 2011, 2010, and 2009 are reviewed.

Assets

As shown in Table A, the largest portion of the Fund's assets, 92.3 percent as of December 31, 2012, is in the form of bonds invested through the State of Wisconsin Investment Board. Fund investments are managed by the State of Wisconsin Investment Board pursuant to statutory requirements and in accordance with established investment guidelines. All bonds are carried at amortized cost using the scientific method to amortize any premiums and discounts.

Table A

Fund Assets
As of December 31

	2012	2011	2010	2009	2008
Total Assets	\$96,761,176	\$94,493,848	\$92,060,302	\$89,601,520	\$87,839,710
Bonds	\$89,334,111	\$87,044,134	\$85,077,391	\$82,207,587	\$80,996,310
Percentage of Total Assets	92.3%	92.1%	92.4%	91.7%	92.2%

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

As required by the NAIC accounting standards, the Fund's Statement of Operations and Changes in Fund Surplus reported net realized capital losses on certain bond sales totaling \$289,439 in calendar year 2009, including realized losses of \$250,401 for Citigroup bonds and \$69,182 for General Motors bonds, and a realized gain of \$30,144 for Lehman Brothers bonds. Other realized gains and losses are accounted for in the interest maintenance reserve (IMR) and amortized into net investment income over the life of the bonds sold.

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

Liabilities

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

Table B

Fund Liabilities
As of December 31

	2012	2011	2010	2009	2008
Total Liabilities	\$86,123,844	\$84,901,878	\$83,699,447	\$82,225,721	\$81,410,998
Aggregate Reserves for Life Insurance Contracts	\$64,094,484	\$63,397,206	\$62,653,524	\$61,771,252	\$60,956,924
Percentage of Total Liabilities	74.4%	74.7%	74.9%	75.1%	74.9%

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

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

As shown in Table C, the liability for deposit-type contracts increased slightly in calendar years 2009 through 2012.

Table C

Deposit-type Contracts
As of December 31

	2012	2011	2010	2009	2008
Liability for Deposit-type Contracts	\$19,188,233	\$18,742,473	\$18,285,013	\$17,853,330	\$17,404,750
Percentage Change from Prior Year	2.4%	2.5%	2.4%	2.6%	1.1%

As shown in Table D, interest credited to deposit-type contracts has been fairly constant from December 31, 2008, through December 31, 2012.

Table D

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

	2012	2011	2010	2009	2008
Interest Expense on Deposit-type Contracts	\$590,650	\$573,155	\$556,082	\$541,842	\$529,451
Percentage Change from Prior Year	3.1%	3.1%	2.6%	2.3%	1.1%

Revenues

The Fund's revenues include investment earnings, insurance premiums, and interest on policy loans. There were 26,558 life insurance policies in effect as of December 31, 2012, a decrease of 1,264 policies, or 4.5 percent, from the December 31, 2009 policy count of 27,822.

The decreases in revenue shown in Table E for calendar years 2010 and 2012 are due to the decline in insurance premium revenues resulting from fewer policies in effect.

Table E

Changes in Fund Revenues
Calendar Year Ended December 31

	2012	2011	2010	2009	2008
Revenue	\$6,998,945	\$7,040,903	\$6,982,103	\$7,236,340	\$7,148,702
Percentage Change from Prior Year	(0.6)%	0.8%	(3.5)%	1.2%	(1.2)%

Expenses

The Fund pays benefits to policyholders in the event of death, at maturity of the policy, upon surrender of the policy, or in the event the covered individual becomes disabled. The policy benefit claims experience of the Fund has been increasing due to the number of older policies maturing and the number of claims rising due to the aging of those insured by the Fund. Total policy benefits for each year are shown in Table F. In calendar years 2012, 2011, 2010, and 2009, the change in policy benefits was primarily related to an increase or decrease in the number of death claims and the number of policies that matured during the year.

Table F

Policy Benefits Calendar Year Ended December 31

	2012	2011	2010	2009	2008
Policy Benefits	\$1,978,572	\$1,822,654	\$1,802,627	\$1,850,526	\$1,871,948
Percentage Change from Prior Year	8.6%	1.1%	(2.6)%	(1.1)%	5.4%

General expenses are used to support the administration of the Fund. The Fund had an increase in general expenses in 2009, as shown in Table G, due to audit expenses incurred in calendar year 2009. In calendar year 2012, the Fund again had an increase in general expenses to upgrade its general ledger package and actuarial expenses to help establish rates for a new plan series for policies in accordance with changes to the non-forfeiture interest rate.

Table G

General Expenses Calendar Year Ended December 31

	2012	2011	2010	2009	2008
General Expenses	\$566,140	\$548,075	\$576,187	\$712,660	\$601,353
Percentage Change from Prior Year	3.3%	(4.9)%	(19.1)%	18.5%	10.1%

Dividends and Surplus

Annually, the Fund pays dividends on all active policies. According to state statute, "The net profits of the life fund shall be distributed annually among the policyholders, except that so far as is practicably possible, the ratio of surplus to assets shall be kept between 7% and 10%." Dividends paid over the last four years have been fairly constant and are reflected in Table H.

Table H

Dividends Calendar Year Ended December 31

	2012	2011	2010	2009	2008
Dividends	\$2,116,145	\$2,102,603	\$2,087,833	\$2,080,458	\$2,080,133
Percentage Change from Prior Year	0.6%	0.7%	0.4%	0.0%	0.7%

As shown in Table I, the surplus-to-assets ratio was within the statutorily specified range of 7.0 percent to 10.0 percent during calendar years 2009 and 2010, but was above the specified range as of December 31, 2011.

Table I

Surplus-to-Assets Ratio Calendar Year Ended December 31

	2012	2011	2010	2009	2008
Surplus	\$10,637,332	\$9,591,970	\$8,360,855	\$7,375,799	\$6,428,712
Total Assets	\$96,761,176	\$94,493,848	\$92,060,302	\$89,601,520	\$87,839,710
Surplus-to-Assets Ratio	11.0%	10.2%	9.1%	8.2%	7.3%

Fund management has been monitoring the increase of the surplus-to-assets ratio and anticipates adjusting the dividend scale in the near future to bring the surplus-to-assets ratio within the statutorily specified range of 7.0 percent to 10.0 percent by the end of calendar year 2014.

Contacting the Fund's Financial Management

The financial report is designed to provide the Legislature, the executive branch of government, policyholders, the public, and other interested parties with an overview of the financial results of the Fund's activities and to show the Fund's financial position. If you have questions about this report, or need additional information, contact the Wisconsin State Life Insurance Fund manager at the Office of the Commissioner of Insurance, 125 South Webster Street, Post Office Box 7873, Madison, Wisconsin 53707-7873.

General information relating to the Fund can be found at the Fund's website, <http://www.oci.wi.gov/slif.htm>.

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Financial Statements ■

Balance Sheet—Statutory Basis

December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009

	<u>December 31, 2012</u>	<u>December 31, 2011</u>	<u>December 31, 2010</u>	<u>December 31, 2009</u>
ASSETS				
Bonds (Note 3)	\$ 89,334,111	\$ 87,044,134	\$ 85,077,391	\$ 82,207,587
Cash, Cash Equivalents, and Short-Term Investments (Note 3)	2,211,790	2,052,439	1,512,916	1,923,157
Contract Loans	3,601,236	3,772,903	3,856,227	3,852,111
Investment Income Receivable	1,526,820	1,532,805	1,517,253	1,487,746
Deferred Premiums and Uncollected Premiums (Note 9)	87,219	91,567	96,515	130,919
TOTAL ASSETS	<u>\$ 96,761,176</u>	<u>\$ 94,493,848</u>	<u>\$ 92,060,302</u>	<u>\$ 89,601,520</u>
LIABILITIES AND FUND SURPLUS				
Aggregate Reserves for Life Insurance Contracts (Note 7)	\$ 64,094,484	\$ 63,397,206	\$ 62,653,524	\$ 61,771,252
Liability for Deposit-type Contracts (Note 8)	19,188,233	18,742,473	18,285,013	17,853,330
Contract Claims (Note 2)	181,434	148,000	196,455	173,355
Dividends Due and Unpaid, Plus Those Payable in the Following Year (Note 5)	2,151,449	2,144,749	2,134,490	2,129,427
Premiums Received in Advance	31,810	34,486	41,368	43,522
Interest Maintenance Reserve (Note 2)	39,652	31,042	73,196	57,168
General Expenses Payable	42,966	51,832	42,784	37,793
Asset Valuation Reserve (Note 2)	252,554	201,739	109,647	0
Other Liabilities	141,262	150,351	162,970	159,874
Total Liabilities	86,123,844	84,901,878	83,699,447	82,225,721
Fund Surplus (Note 5)	10,637,332	9,591,970	8,360,855	7,375,799
TOTAL LIABILITIES AND FUND SURPLUS	<u>\$ 96,761,176</u>	<u>\$ 94,493,848</u>	<u>\$ 92,060,302</u>	<u>\$ 89,601,520</u>

**Statement of Operations and Changes in Fund Surplus—Statutory Basis for the Years Ended
December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009**

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
REVENUES				
Premiums (Note 2)	\$ 1,622,053	\$ 1,699,427	\$ 1,688,902	\$ 1,907,326
Net Investment Income (Note 4)	5,369,567	5,299,106	5,195,865	5,129,902
Amortization of Interest Maintenance Reserve	4,806	42,155	83,320	199,112
Miscellaneous Income	2,519	215	14,016	0
Total Revenues	6,998,945	7,040,903	6,982,103	7,236,340
OPERATING EXPENSES				
Benefits:				
Death Benefits	1,236,643	1,085,971	1,090,665	1,086,757
Matured Endowments	259,000	197,000	150,500	212,500
Surrender Benefits	472,643	529,713	550,788	540,557
Disability Benefits	10,286	9,970	10,674	10,712
Interest and Adjustments on Contract or Deposit-type Contract Funds	590,650	573,155	556,082	541,842
Increase in Aggregate Reserves for Life Insurance Contracts	697,278	743,682	882,272	814,328
Total Benefits	3,266,500	3,139,491	3,240,981	3,206,696
General Expenses	566,140	548,075	576,187	712,660
Total Operating Expenses	3,832,640	3,687,566	3,817,168	3,919,356
Net Income from Operations before Dividends and Net Realized Capital Gain (Loss)	3,166,305	3,353,337	3,164,935	3,316,984
Dividends to Policyholders (Note 5)	(2,116,145)	(2,102,603)	(2,087,833)	(2,080,458)
Net Realized Capital Gain (Loss)	0	0	0	(289,439)
NET INCOME (LOSS)	\$ 1,050,160	\$ 1,250,734	\$ 1,077,102	\$ 947,087
CHANGES IN FUND SURPLUS				
Surplus at Beginning of Period	\$ 9,591,970	\$ 8,360,855	\$ 7,375,799	\$ 6,428,712
Net Income (Loss)	1,050,160	1,250,734	1,077,102	947,087
Change in Asset Valuation Reserve	(50,816)	(92,094)	(109,646)	0
Change in Net Unrealized Capital Gain (Loss)	46,018	72,475	17,600	0
NET CHANGE IN SURPLUS ACCOUNT	1,045,362	1,231,115	985,056	947,087
Surplus at End of Period	\$ 10,637,332	\$ 9,591,970	\$ 8,360,855	\$ 7,375,799

The accompanying notes are an integral part of this statement.

Statement of Cash Flows—Statutory Basis for the Years Ended December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
CASH FROM OPERATIONS				
Premiums Collected Net of Reinsurance	\$ 1,626,031	\$ 1,697,947	\$ 1,746,657	\$ 1,847,190
Net Investment Income	5,438,195	5,336,732	5,213,123	5,156,319
Miscellaneous Income	2,519	215	14,012	0
Total Receipts	<u>7,066,745</u>	<u>7,034,894</u>	<u>6,973,792</u>	<u>7,003,509</u>
Benefit and Loss Related Payments	2,535,788	2,444,296	2,335,609	2,447,013
Commissions, Expenses Paid, and Aggregate Write-ins for Deductions	577,445	539,044	596,449	698,386
Dividends Paid to Policyholders	2,109,445	2,092,344	2,082,770	2,076,320
Total Benefits and Expenses	<u>5,222,678</u>	<u>5,075,684</u>	<u>5,014,828</u>	<u>5,221,719</u>
Net Cash Provided by Operating Activities	<u>1,844,067</u>	<u>1,959,210</u>	<u>1,958,964</u>	<u>1,781,790</u>
CASH FROM INVESTMENTS				
Cash Received from Sale of Bonds	3,834,649	1,036,583	2,317,420	6,798,797
Cash Paid for Purchase of Bonds	(6,127,834)	(2,984,029)	(5,117,040)	(8,551,205)
Decrease (Increase) in Contract Loans	171,667	83,324	(4,116)	(62,596)
Net Cash Used in Investing Activities	<u>(2,121,518)</u>	<u>(1,864,122)</u>	<u>(2,803,736)</u>	<u>(1,815,004)</u>
CASH FROM FINANCING AND MISCELLANEOUS SOURCES				
Net Deposits on Deposit-type Contract and Other Insurance Liabilities	445,760	457,460	431,683	448,580
Other Cash Provided (Applied)	(8,958)	(13,025)	2,848	(13,866)
Net Cash Provided by Financing and Miscellaneous Activities	<u>436,802</u>	<u>444,435</u>	<u>434,531</u>	<u>434,714</u>
NET CHANGE IN CASH, CASH EQUIVALENTS, AND SHORT-TERM INVESTMENTS	<u>159,351</u>	<u>539,523</u>	<u>(410,241)</u>	<u>401,500</u>
Cash, Cash Equivalents, and Short-Term Investments at January 1	<u>2,052,439</u>	<u>1,512,916</u>	<u>1,923,157</u>	<u>1,521,657</u>
Cash, Cash Equivalents, and Short-Term Investments at December 31	<u>\$ 2,211,790</u>	<u>\$ 2,052,439</u>	<u>\$ 1,512,916</u>	<u>\$ 1,923,157</u>

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ■

1. DESCRIPTION OF THE FUND

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

The Fund's operation is similar to that of a mutual life insurance company, and the Fund is subject to the same regulatory requirements as any life insurance company licensed to operate in Wisconsin. The Fund is also subject to unique statutory restrictions, such as a prohibition on employing agents and a maximum coverage of \$10,000, which are designed to limit the competitive advantage the Fund may have over private insurance companies. The Fund offers two basic policies: whole life insurance and term life insurance. As of December 31, 2012, the Fund had 26,558 life insurance policies in effect, including 24,707 whole life insurance policies and 1,851 term life insurance policies. The total amount of insurance in force as of December 31, 2012, was \$204,007,353.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Accounting Practices

The financial statements present the financial position and results of operations of only the activity of the State Life Insurance Fund and are not intended to present the financial activity for the State of Wisconsin

as a whole. The Fund's financial statements are presented on the basis of statutory accounting practices prescribed by the State of Wisconsin Commissioner of Insurance. The National Association of Insurance Commissioners' (NAIC's) *Accounting Practices and Procedures Manual* (commonly referred to as the Codification) has been adopted by the State of Wisconsin Commissioner of Insurance as the prescribed practices for the Fund, as permitted by s. 623.02, Wis. Stats. The accounting practices and procedures prescribed by the State of Wisconsin Commissioner of Insurance vary in some respects from accounting principles generally accepted in the United States. The following table shows the most significant differences between the codified statutory accounting practices and generally accepted accounting principles.

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

B. Use of Estimates

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

C. Accounting Policies

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

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

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

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

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

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

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

3. CASH AND INVESTMENTS

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

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

The book and fair values of the Fund's investments as of December 31, 2012, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer Obligations	\$32,230,246	\$ 44,805,692
Mortgage-backed and Asset-backed	<u>1,123</u>	<u>1,266</u>
Total Government	32,231,369	44,806,958
Industrials and Miscellaneous	<u>57,102,740</u>	<u>69,378,319</u>
Total	\$89,334,109	\$114,185,277

The book and fair values of the Fund's investments as of December 31, 2011, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer Obligations	\$32,211,737	\$ 44,483,191
Mortgage-backed and Asset-backed	<u> 1,358</u>	<u> 1,549</u>
Total Government	32,213,095	44,484,740
Industrials and Miscellaneous	<u>54,831,040</u>	<u>64,285,266</u>
Total	\$87,044,135	\$108,770,006

The book and fair values of the Fund's investments as of December 31, 2010, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer Obligations	\$31,278,499	\$37,142,935
Mortgage-backed and Asset-backed	<u> 1,665</u>	<u> 1,948</u>
Total Government	31,280,164	37,144,883
Industrials and Miscellaneous	<u>53,797,232</u>	<u>57,868,581</u>
Total	\$85,077,396	\$95,013,464

The book and fair values of the Fund's investments as of December 31, 2009, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer Obligations	\$29,206,936	\$33,204,609
Mortgage-backed and Asset-backed	<u> 2,547</u>	<u> 2,925</u>
Total Government	29,209,483	33,207,534
Industrials and Miscellaneous	<u>52,998,102</u>	<u>54,736,086</u>
Total	\$82,207,585	\$87,943,620

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

The book and fair values of bonds, by contractual maturity, at December 31, 2012, follows. Actual maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Book Value</u>	<u>Fair Value</u>
Due in One Year or Less	\$ 2,502,081	\$ 2,540,030
Due after One Year through Five Years	4,971,696	5,623,590
Due after Five Years through Ten Years	8,184,080	9,842,619
Due after Ten Years	<u>73,676,252</u>	<u>96,179,038</u>
Total	\$89,334,109	\$114,185,277

Proceeds from the sales of securities were \$3.8 million in 2012, \$1.0 million in 2011, \$2.3 million in 2010, and \$6.8 million in 2009. The sales resulted in gross realized gains of \$324,742 in 2012, \$0 in 2011, \$123,359 in 2010, and \$109,006 in 2009, and gross realized losses of \$311,325 in 2012, \$0 in 2011, \$24,010 in 2010, and \$564,161 in 2009. Realized investment gains and losses are determined by specific identification. Generally, realized gains and losses are credited or charged to the IMR and amortized into income over the remaining life of the investments sold. However, realized gains and losses related to bonds that had certain changes in their credit ratings are reported in the financial statements in the year that the bonds are sold.

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

4. NET INVESTMENT INCOME

Net investment income for calendar years 2012, 2011, 2010, and 2009 was generated from the following sources:

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Bonds and Private Placements	\$5,149,173	\$5,053,835	\$4,965,747	\$4,880,882
Contract Loans	256,496	263,957	265,405	263,520
State Investment Fund	<u>(6,981)</u>	<u>(7,107)</u>	<u>(5,646)</u>	<u>393</u>
Subtotal	5,398,688	5,310,685	5,225,506	5,144,795
Less Investment Expenses	<u>29,121</u>	<u>11,579</u>	<u>29,641</u>	<u>14,893</u>
Net Investment Income	\$5,369,567	\$5,299,106	\$5,195,865	\$5,129,902

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

5. SURPLUS AND POLICYHOLDERS' DIVIDEND RESTRICTIONS

The Fund pays dividends on all active policies. The estimated dividends payable in the following year are charged to current operations. Of the amounts reported on the Balance Sheet, the amounts paid out between January 1 and March 31 of the following year were \$551,294 for 2012; \$550,176 for 2011; \$566,113 for 2010; and \$543,585 for 2009.

Section 607.15, Wis. Stats., requires that the surplus be maintained at a level between 7.0 percent and 10.0 percent of assets, insofar as is practicably possible. The dividend formula was last changed in 2006 in order to decrease dividends paid on each unit of insurance to allow the Fund to be in compliance with s. 607.15, Wis. Stats. The Fund's surplus-to-assets ratio was 11.0 percent as of December 31, 2012; 10.2 percent as of December 31, 2011; 9.1 percent as of December 31, 2010; and 8.2 percent as of December 31, 2009.

6. REINSURANCE

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

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

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

<u>As of:</u>	<u>Total Life Insurance in Force</u>	<u>Reinsurance Ceded</u>
December 31, 2012	\$204,007,353	\$2,292,500
December 31, 2011	207,029,222	2,356,500
December 31, 2010	209,752,108	2,469,500
December 31, 2009	212,401,608	2,461,500

The Fund is contingently liable with respect to ceded insurance should the reinsurer be unable to meet its assumed obligations. Commencing in 2007, the Fund started applying a reserve credit based on the reinsurance ceded life insurance to its aggregate reserve calculation. The reinsurance credit was \$22,577 for 2012; \$23,085 for 2011; \$24,475 for 2010; and \$23,962 for 2009.

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

	<u>Premiums</u>	<u>Claims</u>
2012	\$45,704	\$11,922
2011	31,768	30,960
2010	41,925	7,435
2009	40,182	2,573

7. RESERVES FOR LIFE INSURANCE CONTRACTS

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

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

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

The State Life Insurance Fund had the following amounts of insurance in force for which gross premiums were less than net premiums determined according to the standard valuation set by the State of Wisconsin, and the following amounts of reserves to cover this deficiency as of December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009:

	<u>Dec. 31, 2012</u>	<u>Dec. 31, 2011</u>	<u>Dec. 31, 2010</u>	<u>Dec. 31, 2009</u>
Insurance in Force for Which Gross Premiums Were Less than Net Premiums	\$19,948,500	\$20,447,500	\$20,981,500	\$21,487,500
Portion of Aggregate Reserves to Cover Deficiency	107,134	114,748	124,075	133,356

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

8. LIABILITY FOR DEPOSIT-TYPE CONTRACTS

All of the deposit-type contracts of the Fund are subject to discretionary withdrawal without adjustment. They are reported at book value and are not affected by reinsurance. The liability accounts reported as of December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009, include:

	<u>Dec. 31, 2012</u>	<u>Dec. 31, 2011</u>	<u>Dec. 31, 2010</u>	<u>Dec. 31, 2009</u>
Supplementary Contracts				
without Life Contingencies	\$ 1,604,773	\$ 1,326,926	\$ 1,106,656	\$ 1,049,445
Dividends Left to Accumulate	15,919,738	15,649,460	15,435,985	15,053,973
Accrued Deposits	<u>1,663,722</u>	<u>1,766,087</u>	<u>1,742,372</u>	<u>1,749,912</u>
Total Liability for Deposit-type Contracts	\$19,188,233	\$18,742,473	\$18,285,013	\$17,853,330

9. DEFERRED PREMIUMS AND UNCOLLECTED PREMIUMS

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Gross Premium:				
Ordinary New Business	\$ 723	\$ 1,325	\$ 322	\$ 1,124
Ordinary Renewal	<u>105,774</u>	<u>111,826</u>	<u>117,943</u>	<u>177,050</u>
Total	<u>\$106,497</u>	<u>\$113,151</u>	<u>\$118,265</u>	<u>\$178,174</u>
Net Premium:				
Ordinary New Business	\$ 73	\$ 288	\$ 47	\$ 235
Ordinary Renewal	<u>87,146</u>	<u>91,279</u>	<u>96,468</u>	<u>130,685</u>
Total	<u>\$ 87,219</u>	<u>\$ 91,567</u>	<u>\$ 96,515</u>	<u>\$130,920</u>

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

10. EMPLOYEE RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS

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

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

The retirement plan currently requires employee contributions equal to specified percentages of qualified earnings based on the employee classification, plus employer contributions at a rate determined annually.

Both employee and employer contributions are included as part of general expenses each year. The State Life Insurance Fund’s contributions to the plan were \$21,789 for 2012, \$30,920 for 2011, \$34,290 for 2010, and \$31,028 for 2009. The relative position of the State Life Insurance Fund in the Wisconsin Retirement System is not available, since the system is a statewide, multiple-employer plan.

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

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

11. AUDIT ADJUSTMENTS

The unaudited financial statements presented in the Commissioner of Insurance’s annual reports to the Governor and the Legislature have been adjusted to reflect recommended audit adjustments. The effect of these adjustments on net income and Fund surplus for 2012, 2011, 2010, and 2009 include:

<u>Account Balance</u>	<u>Unaudited Balance</u>	<u>Audited Balance</u>	<u>Difference</u>
Net Income (Loss)			
2012	\$1,055,553	\$1,050,160	\$ (5,393)
2011	1,255,765	1,250,734	(5,031)
2010	1,079,551	1,077,102	(2,449)
2009	920,294	947,087	26,793
Fund Surplus			
2012	10,586,599	10,637,332	50,733
2011	9,572,657	9,591,970	19,313
2010	8,336,510	8,360,855	24,345
2009	7,349,006	7,375,799	26,793

Auditor's Report ■



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Legislative Audit Bureau

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Joe Chrisman
State Auditor

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

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

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

We have audited the financial statements and the related notes of the Wisconsin State Life Insurance Fund as of and for the years ended December 31, 2012, December 31, 2011, December 31, 2010, and December 31, 2009, and have issued our report thereon dated October 1, 2013. 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. Our opinion was modified because the Fund's financial statements are presented on the basis of accounting practices prescribed by the State of Wisconsin Commissioner of Insurance.

Internal Control over Financial Reporting

Management of the Fund 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 the Fund's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund'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 the Fund's financial statements will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. *A significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control related to financial reporting and security over computer systems that we consider to be significant deficiencies.

Financial Reporting

The Fund's financial statements are based on the Annual Statement, which the Fund is statutorily required to prepare and submit to the Office of the Commissioner of Insurance by March 1 of each year. Preparation of the Annual Statement and, therefore, the financial statements subject to audit, is challenging because of complex accounting and reporting requirements. The Fund has contracted with its actuary to complete the financial reporting related to reserves. In addition, the Fund's staff face tight time deadlines to prepare the Annual Statement.

The Fund's staff have taken some steps to address a recommendation discussed in report 09-14 for improved financial reporting. For example, staff consulted with examiners in the Office of the Commissioner of Insurance's (OCI's) Division of Regulation and Enforcement, reconciled the general ledger to the Annual Statement, and transitioned preparation of portions of the Annual Statement from the insurance program manager to the Fund's accountant.

Although Fund staff have taken steps to improve financial reporting, we again identified deficiencies in the Fund's accounting and financial reporting procedures during our current audit. For example, we identified the following financial reporting errors, which were also included in the Annual Statement:

- The interest maintenance reserve was overstated by \$26,793 as of December 31, 2009, \$24,345 as of December 31, 2010, \$19,313 as of December 31, 2011, and \$13,919 as of December 31, 2012, because the actuary inadvertently fully amortized a calendar year 2009 realized loss of \$26,607 in 2009 instead of over 27 years, as it should have been.
- The asset valuation reserve was overstated by \$36,814 as of December 31, 2012, because the actuary inadvertently included an unrealized gain in the calculation used to determine the asset valuation reserve.

In addition, we identified deficiencies in the efforts of the Fund's staff to transfer the amounts reported in the Annual Statements to the financial statements we audited. For example:

- The 2012 Annual Statement appropriately reported \$0 for the net realized capital gain (loss) account, but the Fund's staff reported \$1,101,571 in the financial statements provided to us for audit.
- The Fund's staff understated the net unrealized capital gain (loss) account by \$17,600 for 2010, \$72,474 for 2011, and \$46,018 for 2012 because staff improperly reported a realized gain when they should have reported an unrealized gain.

We also identified a variety of less significant errors that also required adjustments to Management's Discussion and Analysis and the notes to the financial statements. For example, the discussion describing the change in the deposit-type contracts in Management's Discussion and Analysis was not reflective of the changes in the account during our audit period. In addition, the pension and other postemployment benefit note was lacking discussion related to other postemployment benefits.

We note that the majority of these errors appear to relate to oversight by the Fund's staff, particularly in regard to the financial statements prepared for our audit.

In response to our recommendations, the Fund's staff corrected the audited financial statements and informed the Fund's actuary of the errors made. In addition, OCI indicated that the Fund's staff will implement procedures to ensure that Management's Discussion and Analysis and the notes to the financial statements accurately present the changes in the statements. Finally, the Fund will continue to solicit help from examiners in OCI's Division of Regulation and Enforcement, as appropriate.

Security over Computer Systems

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

However, we identified various concerns over security and access to the Fund's computer programs and data. In response to our recommendations, OCI identified a corrective action plan and is evaluating whether it is practical to fully implement corrective actions in one area.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, as discussed on page 4, the Fund's surplus-to-assets ratio was above the statutorily specified range of 7.0 percent to 10.0 percent and was 11.0 percent as of December 31, 2012. OCI indicated it will take steps to bring the ratio within the statutorily specified range by the end of 2014.

Wisconsin State Life Insurance Fund's Response to Findings

The Fund's written response to the findings identified in our audit is described in the preceding paragraphs. The Fund'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

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 the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

October 1, 2013



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, Governor
Theodore K. Nickel, Commissioner

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September 25, 2013

Joe Chrisman, State Auditor
Legislative Audit Bureau
22 East Mifflin, Suite 500
Madison, WI 53703

Dear Mr. Chrisman:

Thank you for providing a draft copy of the financial audit report for the State Life Fund for review and comment. Overall, we are quite pleased with the results of the audit. The State Life Fund staff has taken initiatives to address past Legislative Audit Bureau recommendations, and we will continue to do so. The Fund recognizes the value that is added to the operations of a program due to the review of internal controls. Your review will assist in our continuing efforts to enhance these operations.

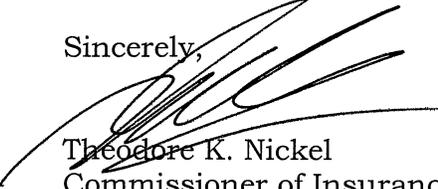
We appreciate the acknowledgement of the steps Fund staff has taken to improve the reporting of financial information. As we move forward, Fund staff will establish and implement additional procedures to ensure further the accuracy of the financial information provided for the audit, as well as changes to the financial statements. Our new Program Manager and Accountant have both been Financial Examiners, and we anticipate that their skill and experience will help facilitate these additional improvements.

The audit identified several other findings, including concerns over the security of the computer systems and the Fund's current high "surplus to assets" ratio. We appreciate the acknowledgement of the intent of the Fund to address these findings. We affirm this commitment.

In closing, we appreciate the courtesy staff extended during the audit. We also appreciate and recognize the substantial time and effort provided by the audit team.

Thank you for the opportunity to respond to the audit. Please contact me if you have any questions.

Sincerely,



Theodore K. Nickel
Commissioner of Insurance