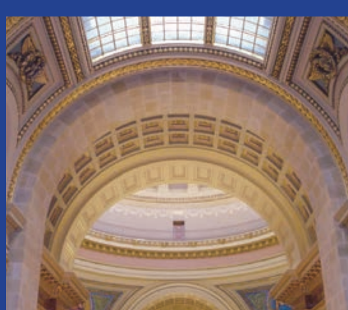
Report 17-16
September 2017

Wisconsin Retirement System
Calendar Year 2016

STATE OF WISCONSIN


Legislative Audit Bureau

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OPINION PUBLISHED SEPARATELY

The WRS financial statements and our opinion on them are available on the Department of Employee Trust Funds' website

STATE OF WISCONSIN | Legislative Audit Bureau
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Joe Chrisman
State Auditor

September 28, 2017

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., we have completed an audit of the 2016 financial statements of the Wisconsin Retirement System (WRS), which is administered by the Department of Employee Trust Funds (ETF). These financial statements and our unmodified opinion on them may be found on ETF's website. The WRS fiduciary net position, which represents resources available to pay pension benefits, increased from $88.5 billion as of December 31, 2015, to $92.6 billion as of December 31, 2016, or by 4.6 percent. This increase is primarily attributable to an increase in net investment income from a loss of $675.0 million in 2015 to a gain of $7.3 billion in 2016, or by 1,177.3 percent.

Accounting standards for pension funds, issued by the Governmental Accounting Standards Board, require the calculation of a net pension liability or net pension asset, which is represented by the difference between fiduciary net position reported in the financial statements and the total pension liability calculated by the actuary. ETF calculated a net pension liability for the WRS of $0.8 billion as of December 31, 2016. This represents an improvement in the net pension liability, which was $1.6 billion as of December 31, 2015.

Each of the almost 1,500 participating employers in the WRS is required to report its proportionate share of this net pension liability on its financial statements if prepared on the basis of generally accepted accounting principles. We have also audited the Schedule of Employer Allocations of the WRS, the Schedule of Collective Pension Amounts of the WRS, and the related notes, as of December 31, 2016, and provide our unmodified opinions as described in report 17-17, which we also published today.

We reported a significant deficiency in the prior audit (report 16-10) related to improvements needed to ETF's financial reporting process. Although, during the current audit, we noted certain improvements in ETF's financial reporting process, we continued to identify errors in the allocation of investment earnings and report this as an additional matter. The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters is included on page 25. A response from ETF follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/CS/ss

Introduction ▪

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

Created in January 1982, the Wisconsin Retirement System (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.

As of December 31, 2016, 622,123 individuals participated in the WRS, including:

- 257,285 (41.3 percent) active participants who were making contributions;
- 197,647 (31.8 percent) retired participants who were receiving WRS benefits; and
- 167,191 (26.9 percent) inactive participants, such as former employees, who were not yet receiving benefits and who were not required to make contributions.

ETF and SWIB work together to manage the WRS.

The WRS is one of the ten largest public pension plans in the United States. As of December 31, 2016, the WRS had a $92.6 billion fiduciary net position, 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. The State of Wisconsin Investment Board (SWIB) is responsible for managing WRS investments. ETF and SWIB work closely together to ensure the solvency and long-term future of the WRS.

Organizational Structure

ETF was created to manage employee benefit programs for participating state and local government employees, including managing the WRS. Under s. 40.03, Wis. Stats., the 13-member ETF Board is responsible for the overall direction and supervision of ETF. Statutes specifically identify that, among other items, this 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.

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 ETF Board members include:

- the Governor, or the Governor's designee on the Group Insurance Board;
- the Administrator of the Division of Personnel Management in 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 that must be either a technical college or school district educational support personnel employee, elected by participating employees who meet the same employment criteria.

The members of the Teachers Retirement Board and the Wisconsin Retirement Board represent a mix of state and local government employers and employees, annuitants, and the general public. The Secretary of ETF is charged with implementing the policies approved by the Board, and with managing the daily operations of ETF, including managing the WRS.

WRS Participating Employers

Section 40.21 (1), 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.

There were 1,495 employers participating in the WRS as of December 31, 2016.

Table 1 shows the number and type of public employers that participated in the WRS as of December 31, 2016. Most of the 1,495 employers that participated in the WRS were local governments and school districts. The City of Milwaukee does not participate because it maintains its own retirement system.

Table 1

Types of Employers Participating in the WRS
As of December 31, 2016

Type	Number
School Districts	422
Villages	266
Towns	254
Special Districts[1]	208
Cities	152
Counties	71
State Agencies, UW System, and Public Authorities	58
Fourth-Class Cities[2]	36
Wisconsin Technical College System Districts	16
Cooperative Educational Service Agencies	12
Total Employers	**1,495**

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

[2] Defined as cities with populations of less than 10,000.

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

WRS Funding

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

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

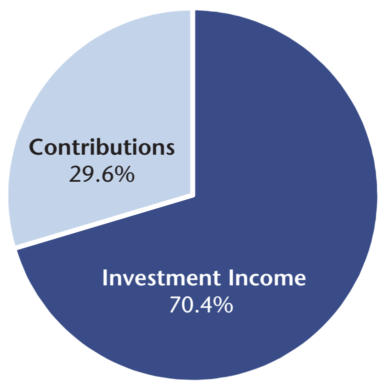
- ensure funds are adequate to pay benefits;
- maintain stable and predictable contribution rates for employers and employees; and

- maintain inter-generational equity to ensure the cost of the benefits is paid for by the generation that receives the benefits.

From 2007 through 2016, investment income represented 70.4 percent of total funding for the WRS, and employer and employee contributions represented 29.6 percent of total funding for the WRS, as shown in Figure 1.

Figure 1

WRS Funding Sources
2007 through 2016



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. As shown in Table 2, total contribution rates for "general employees," which includes teachers and most other employees, ranged from a low of 10.4 percent for calendar year (CY) 2009 to a high of 14.0 percent for CY 2014.

Table 2

Total Contribution Rates for General Employees in the WRS

Calendar Year	Total Contribution Rate[1]
2009	10.4%
2010	11.0
2011	11.6
2012	11.8
2013	13.3
2014	14.0
2015	13.6
2016	13.2
2017	13.6
2018	13.4

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

The assets of the WRS are invested by SWIB in two funds. The Core Retirement Investment Trust Fund (Core Fund) is a fully diversified or balanced fund, which provides less volatile investment returns and is invested for the long term in several types of investments. The Variable Retirement Investment Trust Fund (Variable Fund) is an equity fund, or stock fund, which provides returns that are typically more volatile than the Core Fund.

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.

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, which is 7.2 percent. 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. As of December 31, 2016, SWIB's 20-year return for the Core Fund was 7.2 percent, net of investment expense, which equals the long-term expected rate of return assumption of 7.2 percent.

WRS Benefits

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

Financial Condition of the WRS

As required by statutes, we have completed an audit of the financial statements and related notes of the WRS as of and for the year ended December 31, 2016. Our audit of the financial statements and related notes of the other employee benefit programs administered by ETF for the year ended December 31, 2016, is ongoing. The financial statements of the WRS and of the other employee benefit programs will be presented in ETF's Comprehensive Annual Financial Report (CAFR), as well as in the State's CAFR, which is published by DOA.

The WRS financial statements were prepared by ETF using generally accepted accounting principles (GAAP) prescribed by the Governmental Accounting Standards Board (GASB). To complete our audit of the financial statements of the WRS, 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 an unmodified opinion on the financial statements of the WRS for the year ended December 31, 2016.

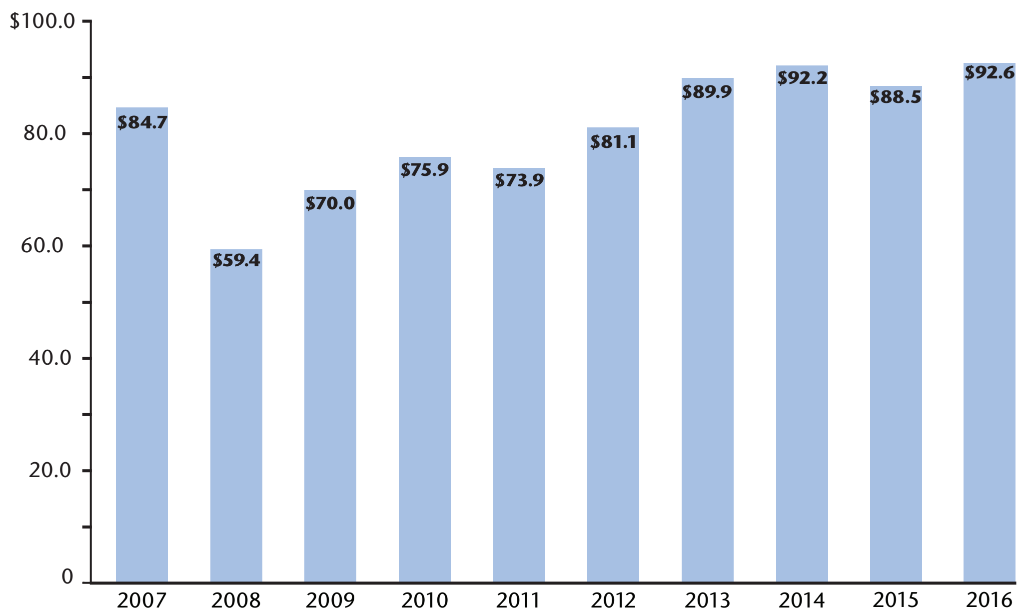
In addition to providing an unmodified opinion on the financial statements and related notes of the WRS for the year ended December 31, 2016, we have issued our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is on page 25.

The fiduciary net position of the WRS as of December 31, 2016, was $92.6 billion.

The Net Position Restricted for Pensions (fiduciary net position) of the WRS represents the value of the plan's assets that are currently available to make benefit payments. As of December 31, 2016, the WRS had a fiduciary net position of $92.6 billion, which was a 4.6 percent increase from the prior year. From December 31, 2007, through December 31, 2016, the fiduciary net position of the WRS increased by $7.9 billion (9.9 percent), as shown in Figure 2. The significant decline in fiduciary net position in 2008 reflects the effect of the economic recession that began in December 2007.

Figure 2

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



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

Net investment income increased from a loss of $675.0 million in 2015 to a gain of $7.3 billion in 2016.

Contributions to the WRS from employers and employees remained relatively stable at $1.9 billion in 2015 and in 2016. Net investment income, which is the sum of realized and unrealized gains and losses less SWIB's investment expenses, increased from a loss of $675.0 million in 2015 to a gain of $7.3 billion in 2016, or by 1,177.3 percent. The increase in net investment income reflects the increase in investment returns realized by the Core and Variable Funds. As reported by SWIB, the gross investment return of the Core Fund increased from a loss of 0.4 percent in 2015 to a gain of 8.6 percent in 2016, and the investment return of the Variable Fund increased from a loss of 1.2 percent in 2015 to a gain of 10.6 percent in 2016.

Total WRS benefit payments provided to retired participants or their beneficiaries increased from $4.8 billion in 2015 to $5.0 billion in 2016, or by 3.6 percent. The number of retired participants increased from 191,795 as of December 31, 2015, to 197,647 as of December 31, 2016. The average annual annuity paid decreased from $24,780 in 2015, to $24,725 in 2016, or by 2.2 percent.

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Pension Accounting Standards ▪

Accounting standards for public pension plans are promulgated by GASB. These standards 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 almost 1,500 employers that participate in the plan.

The pension accounting standards require ETF to calculate the total pension liability and the net pension liability or asset for the WRS, and disclose them in the notes and in the required supplementary information to the WRS financial statements. Under these standards, ETF calculated a net pension liability of $0.8 billion for the WRS as of December 31, 2016, which will be reported by each participating employer based upon its proportionate share of this net pension liability, as well as pension expense and other amounts, in its own financial statements if prepared under GAAP.

Prior to the implementation of these standards, financial reporting was based on the pension plan's funding principles. Under these principles, a pension liability was reported only when a government did not make its annual required contributions to the pension plan for current or prior service costs, which represent the present value of projected pension benefits earned by employees in the current year or prior years. Under the pension accounting standards, a pension liability is established based on the present value of projected pension benefits that have not yet been funded for service already provided, and a pension expense is recorded during the period in which the employee earned the pension benefit.

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 $93.4 billion as of December 31, 2016.

To determine the total pension liability for the WRS as of December 31, 2016, ETF's actuary performed an actuarial valuation as of December 31, 2015, and adjusted for changes such as interest earned, contributions paid, benefits paid, and dividend adjustments during CY 2016. Based on this valuation and the adjustments, the total pension liability for the WRS was $93.4 billion as of December 31, 2016.

The discount rate is the rate used to calculate the present value of projected benefit payments.

The discount rate, or interest rate, used to calculate the present value of projected benefit payments, which is used to determine the total pension liability, is specifically defined under the pension accounting standards. ETF used the long-term expected rate of return assumption for the WRS, which is 7.2 percent, as the discount rate because current and projected future plan assets are expected to cover the projected benefit payments for the WRS. If the current and projected future plan assets of the WRS had not been sufficient to cover the projected benefit payments, the pension accounting standards would have required ETF to blend the index rate for 20-year municipal bonds (3.78 percent as of December 31, 2016) with its long-term expected rate of return assumption (7.2 percent as of December 31, 2016). In such circumstances, the blended discount rate would have been lower and would have resulted in a larger total pension liability.

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. Under the pension accounting standards, ETF is required to calculate the sensitivity of the total pension liability to a one percentage point decrease or increase in the discount rate. At 7.2 percent, the total pension liability for the WRS was $93.4 billion as of December 31, 2016. However, a one-percent decrease in the discount rate (6.2 percent) increases the total pension liability as of December 31, 2016, to $103.4 billion, and a one-percent increase in the discount rate (8.2 percent) decreases the total pension liability to $85.7 billion.

Calculating a Net Pension Liability or Asset

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

ETF reported a net pension liability of $0.8 billion for the WRS as of December 31, 2016.

As of December 31, 2016, the WRS has a fiduciary net position of $92.6 billion. When the total pension liability of $93.4 billion is subtracted from the fiduciary net position of the WRS, a net pension liability of $0.8 billion results as of December 31, 2016. As shown in Table 3, this represents an improvement in the net pension liability, which was $1.6 billion as of December 31, 2015.

Table 3

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

	2015	2016	Increase (Decrease)
Fiduciary Net Position	$88.5	$92.6	$4.1
Total Pension Liability	(90.1)	(93.4)	(3.3)
Net Pension Asset (Liability)	**$(1.6)**	**$(0.8)**	**$0.8**

An increase in the value of the investments of the Core and Variable Funds from December 31, 2015, to December 31, 2016, was the primary cause of the $4.1 billion increase in the fiduciary net position and resulted in the reporting of a smaller net pension liability as of December 31, 2016.

Calculating Other Collective Amounts

In addition to the calculation of the total pension liability and the calculation of the net pension liability or asset, the pension accounting standards require public pension plans to calculate pension expense, as well as amounts that are considered deferred for the plan. Pension expense is the net increase or decrease in the net pension liability or asset, with certain adjustments. Reporting of pension expense under the pension accounting standards more closely aligns the pension expense with the periods during which the pension benefits are earned by the employees. For the year ended December 31, 2016, pension expense for the WRS was $2.1 billion. Deferred outflows of resources, which primarily represents the difference between projected and actual investment earnings, was $5.3 billion. Deferred inflows of resources, which represents the difference between expected and actual experience, was $2.6 billion.

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 almost 1,500 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, as well as other collective amounts including pension expense, on its GAAP-based financial statements.

For the year ended December 31, 2016, each WRS participating employer was allocated its proportionate share of the net pension liability.

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 for the year ended December 31, 2016. We audited and provided unmodified opinions on these schedules in report 17-17. Because the WRS has calculated a net pension liability for the year ended December 31, 2016, each employer participating in the WRS must report its proportionate share of this net pension liability on its GAAP-based financial statements. A net pension liability indicates that, at that point in time, the assets of the WRS were not sufficient to cover the projected liability for benefit payments to employees.

The ten largest WRS participating employers were allocated a total of $341.9 million, or 41.5 percent of the $0.8 billion net pension liability as of December 31, 2016. In comparison, these same participating employers were allocated $669.9 million, or 41.2 percent of the $1.6 billion net pension liability as of December 31, 2015. The proportionate share of the net pension liability for State of Wisconsin agencies as of December 31, 2016, was $231.6 million, of which $111.6 million related to the University of Wisconsin (UW) System. The net pension liability for the state agencies will be included in the State's GAAP-based financial statements, which will be published in the State's CAFR for the year ended June 30, 2017.

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Funding and GASB Financial Reporting Methodologies

ETF uses a funding methodology to establish required contribution rates for employers and employees and to measure the plan's unfunded liabilities. For financial reporting purposes, ETF is required to use the GASB pension accounting standards. GASB did not intend for the financial reporting methodology to be used for funding purposes. Instead, GASB intended the financial reporting methodology to enhance transparency of pension-related information in financial reports and to be a tool to allow for comparisons across public pension systems. Each methodology results in a different measure of the funded status of the WRS. Under the funding methodology, the WRS is nearly 100.0 percent funded as of December 31, 2016, and under the GASB financial reporting methodology, the WRS is 99.1 percent funded.

Comparing Methodologies

There are similarities in the actuarial assumptions used in calculating the projected future benefit payments under the funding and financial reporting methodologies, including assumptions related to mortality rates, salary increases, and disability rates. However, there are several differences in how the liability is calculated under each methodology, which creates a differing determination of the financial status of the pension plan. One of the key differences in the calculations is the consideration of investment income or loss.

Under the funding methodology, ETF's actuary uses a smoothing mechanism for investment income or loss, known as the market recognition account (MRA) for the Core Fund investment activity.

This account accumulates the difference between actual investment income or loss and expected investment income calculated at the long-term expected rate of return assumption of 7.2 percent. The difference is then distributed into the calculated plan net assets over a five-year period so that the expected investment income is affected by portions of the previous five years' amounts included in the MRA to determine the plan net assets. This results in less volatility in the plan net assets under the funding methodology, and thus, less volatility in the calculation of the contribution rates for employers and employees.

Under the GASB financial reporting methodology, WRS investments are valued at fair value.

Under the financial reporting methodology, 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.

Relationship to Contribution Rates

ETF seeks to set contribution rates that allow employers to better plan and meet contribution requirements.

The WRS is an irrevocable trust and all funds remain in the trust and can only be used to fund pension benefits. ETF's funding policy for the WRS has the goal of establishing steady contribution rates that allow employers to better plan and meet contribution requirements. Contribution rates are set to provide for the benefits earned by employees during the year. In setting these rates, one of the most significant factors considered is investment performance. However, while the investment performance of the Core and Variable Funds affects the setting of contribution rates, the full effect of a particular year's investment gain or loss is smoothed through the use of the MRA, so that contribution rates are gradually increased or decreased over time.

Although the net pension liability or asset calculated under the GASB pension standards is an indication of the financial health of the system, it should not be used as a mechanism to determine if contribution rates should be increased or decreased. Under the pension accounting standards, GASB separated the funding and financial reporting methodologies. If ETF were to adjust contribution rates based on the financial reporting methodology, more pronounced fluctuations in the rates could result, primarily because the fair value of investments at a point in time would be used. The volatility of using the fair value of investments to adjust contribution rates could be difficult for employers and employees to anticipate and manage.

Comparison to Other Pension Plans

GASB anticipated that the pension accounting standards would allow for comparability across public pension plans since plans are required to use the same GASB financial reporting methodology and are required to value plan investments at fair value when calculating the net pension liability or net pension asset.

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

Although pension plans will follow the same accounting standards in reporting the pension liability, differences such as plan structures, planned asset allocations, and investment strategies will make comparisons across pension plans imperfect. 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 affect comparability.

We collected information from other cost-sharing, multiple-employer, defined-benefit plans that were part of the WRS peer group defined by a study performed by CEM Benchmarking Inc. In comparison to these plans, the WRS had the highest funded ratio of 99.1 percent, as shown in Table 4.

Table 4

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 (WRS)[3]	$ 93.4	$ 92.6	n/a	$ 0.8	99.1%
New York State and Local Employees' Retirement System[4]	172.3	156.3	n/a	16.0	90.7
Iowa Public Employees Retirement System	34.6	28.3	n/a	6.3	81.8
Oregon Public Employees Retirement System	77.1	62.1	n/a	15.0	80.5
Ohio Public Employees Retirement System[3]	99.8	77.1	n/a	22.7	77.3
California State Teachers' Retirement System	270.0	189.1	n/a	80.9	70.0
Virginia Retirement System—Teachers Retirement System	44.2	30.2	n/a	14.0	68.3
Arizona State Retirement System	49.0	32.9	n/a	16.1	67.1
State Teachers Retirement System of Ohio	100.8	67.3	n/a	33.5	66.8
Pennsylvania Public School Employees' Retirement System	99.4	49.8	n/a	49.6	50.1

[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 a study performed by CEM Benchmarking Inc.

[2] For the plan year ended June 30, 2016, unless otherwise noted.

[3] For the plan year ended December 31, 2016.

[4] For the plan year ended March 31, 2016.

Auditor's Report

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Joe Chrisman
State Auditor

Report 17-16

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 Wisconsin Retirement System (WRS) as of and for the year ended December 31, 2016, and have issued our report thereon dated September 26, 2017. 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.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the WRS'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*.

We reported a significant deficiency in the prior audit (report 16-10) related to improvements needed to ETF's financial reporting process. Although, during the current audit, we noted certain improvements in the financial reporting process, we continued to identify errors in the allocation of investment earnings. We reported this concern to ETF.

Purpose of This Report

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

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

September 26, 2017

Response ■

State of Wisconsin
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

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September 26, 2017

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

Re: Audit of the 2016 Financial Statements of the Wisconsin Retirement System

Dear Mr. Chrisman,

Thank you for the opportunity to review and comment on the audit of the 2016 financial statements of the Wisconsin Retirement System (WRS). The WRS continues to be in a strong financial position due to its unique design and fiscal discipline. The funding ratio of nearly 100% under the funding methodology demonstrates this. Also, as noted in your report, the funding ratio calculated under the Governmental Accounting Standards Board (GASB) financial reporting methodology of 99.1% was the highest funded ratio of a WRS peer group and increased from 98.2% the prior year.

ETF has made improvements to its financial reporting process this year and I am pleased LAB staff have recognized this. On July 7, 2017, we reported our progress on improvement initiatives to the Joint Legislative Audit Committee. Staff have made significant progress on these which have included better management of the financial reporting process, training staff, implementing analytical reviews and reconciliations of account balances, enhancing documentation of spreadsheets, reconciliations, statements and schedules, and performing more reviews of staff work. This is an on-going process of continual improvement that will deliver sustainable lasting change.

The error identified in the investment earnings allocation was introduced in the calendar year 2015 calculation. Although LAB staff questioned it at that time, the discussion occurred with only one ETF staff member who did not follow through with the proper analysis and correction. After ETF management was advised of the error this year the following steps were taken:

- the error was corrected;
- additional checks on the amounts were implemented including making sure they agree to the market recognition account source documentation;
- documentation was updated to ensure this is understood in future years; and
- staff were instructed to bring these matters to the attention of management in the future.

Also worth noting, at the beginning of the calendar year 2016 audit, we initiated a communication protocol with LAB where we requested LAB staff copy ETF management on email correspondence with ETF staff. This mitigates the risk of issues not being properly addressed.

In addition, management created an audit adjustment log at the beginning of the audit. Staff have been directed to document issues and adjustments made throughout the audit in the log. This will be reviewed at the end of the audit as well as the beginning of the subsequent audit to ensure we have addressed any needed changes to procedures, calculations and spreadsheets.

In closing, we appreciate the time and effort provided by the audit team as well as the professional working relationship.

Sincerely,

Robert J. Conlin
Secretary