Report 17-17
September 2017

# Wisconsin Retirement System Reporting for Participating Employers

## Calendar Year 2016

State of Wisconsin



Legislative Audit Bureau

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## OPINIONS PUBLISHED SEPARATELY

The employer schedules and our opinions on them are available on the Department of Employee Trust Funds' website

STATE OF WISCONSIN | Legislative Audit Bureau
22 East Mifflin St., Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

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 requested by the Department of Employee Trust Funds (ETF), we have completed an audit of the Schedule of Employer Allocations of the Wisconsin Retirement System (WRS), the Schedule of Collective Pension Amounts of the WRS, and the related notes to these schedules as of December 31, 2016. These schedules, and our unmodified opinions on them, may be found on ETF's website.

We have also audited the financial statements and related notes of the WRS as of and for the year ended December 31, 2016, and provided our unmodified opinion on them, as detailed in report 17-16, which we also published today. The fiduciary net position of the WRS, 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 of $1.6 billion, calculated 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 in accordance with generally accepted accounting principles. The proportionate share of the net pension liability for all State of Wisconsin agencies was $231.6 million, or 28.1 percent of the total net pension liability. Of this amount, $111.6 million related to the University of Wisconsin System. The net pension liability for the state agencies will be reported in the State's Comprehensive Annual Financial Report for the year ended June 30, 2017.

Because of an error made by ETF in preparing and presenting certain amounts in the Schedule of Collective Pension Amounts, we report a significant deficiency in internal control over financial reporting. ETF's process for preparing and reviewing the schedule did not include an adequate review of the accounting standards to ensure accurate presentation of the schedule. We recommend ETF annually review the accounting standards when compiling the schedule. A response from ETF follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/CS/jj

# Auditor's Report ■

STATE OF WISCONSIN | Legislative Audit Bureau
22 East Mifflin St., Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

Report 17-17

# 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

We have audited the Schedule of Employer Allocations of the Wisconsin Retirement System (WRS) as of and for the year ended December 31, 2016, and the related notes. We have also audited the totals for the columns titled Net Pension Liability (Asset), Total Deferred Outflows of Resources Excluding Employer Specific Amounts, Total Deferred Inflows of Resources Excluding Employer Specific Amounts, and Plan Pension Expense included in the Schedule of Collective Pension Amounts of the WRS as of and for the year ended December 31, 2016, and the related notes. We have issued our report on these schedules 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 schedules, we considered ETF's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the schedules, 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 schedules will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying Finding and Response Schedule that we consider to be a significant deficiency.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the WRS schedules 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 schedule 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 have also audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, the financial statements and related notes of the WRS as of and for the year ended December 31, 2016. We expressed an unmodified opinion, dated September 26, 2017, on those financial statements. In addition, we issued an Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, dated September 26, 2017, and included in report 17-16, related to the audit of the financial statements.

## Response to Finding

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

## Purpose of This Report

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

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

September 26, 2017

# FINDING AND RESPONSE SCHEDULE

## Finding 2017-001: Error in the Schedule of Collective Pension Amounts

*Criteria:*

The WRS is a cost-sharing, multiple-employer, defined benefit pension plan with almost 1,500 participating employers. Generally accepted accounting principles (GAAP) related to this type of public pension plan require each employer to report in its GAAP-based financial statements its proportionate share of the net pension liability of the WRS, other collective pension amounts for the WRS, and "employer specific" amounts.

As the plan administrator for the WRS, employers rely on ETF to provide accurate amounts, such as the collective pension amounts and the employer's proportionate share, in accordance with accounting standards. Accounting standards require that the differences between projected and actual investment earnings on pension plan investments be aggregated across periods and reported on a net basis, as either a deferred outflow of resources or a deferred inflow of resources.

*Condition:*

The Schedule of Collective Pension Amounts includes the collective pension amounts of Net Pension Liability (Asset), Total Deferred Outflows of Resources Excluding Employer Specific Amounts, Total Inflows of Resources Excluding Employer Specific Amounts, and Plan Pension Expense. One of the components of total deferred outflows or inflows of resources is the amount calculated for the differences between projected and actual investment earnings on pension plan investments. Each year an amount is calculated for this component, which is amortized into pension expense over a period of years, as defined in the accounting standards. Under this accounting method, the outstanding balance at the end of the year will include the unamortized amounts of deferred outflow or inflows of resources from several years.

During the calendar year 2016 audit, we identified an error in the presentation of the collective deferred outflow or inflow of resources resulting from the difference between actual and projected investment earnings on pension plan investments on the Schedule of Collective Pension Amounts. In preparing the schedule, ETF did not net the deferred inflow of resources calculated for the current year with the unamortized deferred outflow of resources from the prior year in the schedule. Instead ETF reported both a deferred outflow of resources and a deferred inflow of resources.

*Context:*

ETF prepares the Schedule of Employer Allocations and the Schedule of Collective Pension Amounts of the WRS to provide each of the approximately 1,500 employers participating in the WRS with information needed to prepare its GAAP-based financial statements.

*Effect:*

Total Deferred Outflows of Resources Excluding Employer Specific Amounts and Total Deferred Inflows of Resources Excluding Employer Specific Amounts were each overstated by $609.8 million at the time of our review. After we brought these concerns to its attention, ETF corrected the Schedule of Collective Pension Amounts for this error. If these errors had not been corrected, each employer relying on the schedule may have reported inaccurate amounts in its GAAP-based financial statements.

*Cause:*

ETF's process for preparing and reviewing the Schedule of Collective Pension Amounts did not include an adequate review of the accounting standards to ensure accurate presentation of the schedule.

### ☑ Recommendation

*We recommend the Department of Employee Trust Funds annually review the accounting standards when compiling the Schedule of Collective Pension Amounts to ensure accurate presentation of the schedule in accordance with accounting standards.*

**Response from the Department of Employee Trust Funds:** Thank you for the opportunity to review and comment on the finding related to the Schedule of Collective Pension Amounts of the WRS.

The most recently issued pension accounting standards are complex and include several very technical requirements that may or may not apply depending on specific situations. ETF staff spent a lot of time reviewing these standards and refer to them in their on-going work. ETF will review the relevant accounting standards when compiling the Schedule of Collective Pension Amounts. ETF agrees the accounting standards state collective deferred outflows of resources and deferred inflows of resources arising from differences between projected and actual pension plan investment earnings in different measurement periods should be aggregated and included as a net collective deferred outflow of resources related to pensions or a net collective deferred inflow of resources related to pensions. Calendar year 2016 was the first time this situation occurred for the WRS.

Although the said deferrals were not presented in aggregate in the original schedule, ETF would like to clarify the amount of the collective deferred outflow and inflow was accurate. Furthermore, this had no effect on the WRS plan level financial statements for which ETF is responsible. Employers are solely responsible for their financial statements and for evaluating the information used to recognize and disclose pension amounts in their financial statements in accordance with accounting standards. As such, employers are to verify and recalculate the information provided. Employers could easily net deferred inflows and outflows of resources if presented separately on the schedule provided by ETF. Based on past discussions with some employer auditors, ETF believes the risk of each employer reporting incorrectly is very low.

As noted in the finding, ETF staff updated the schedule to present the collective deferred inflows and outflows of resources arising from differences between projected and actual pension plan investment earnings as a net amount. In addition, ETF requested that the actuary update the report it provides ETF to show these deferrals net. This report is the source of data for the Schedule of Collective Pension Amounts.

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# Response ■

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

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Madison WI 53707-7931

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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 Wisconsin Retirement System (WRS) Employer Schedules

Dear Mr. Chrisman,

Thank you for the opportunity to review and comment on the audit of the Schedule of Employer Allocations of the WRS, the Schedule of Collective Pension Amounts of the WRS, and the related notes to these schedules as of December 31, 2016.

The most recently issued pension accounting standards are complex and include several very technical requirements that may or may not apply depending on specific situations. ETF agrees the accounting standards state collective deferred outflows of resources and deferred inflows of resources arising from differences between projected and actual pension plan investment earnings in different measurement periods should be aggregated and included as a net collective deferred outflow of resources related to pensions or a net collective deferred inflow of resources related to pensions. Calendar year 2016 was the first time this situation occurred for the WRS.

Although the said deferrals were not presented in aggregate in the original Schedule of Collective Pension Amounts, ETF would like to emphasize the amount of the collective deferred outflow and deferred inflow was accurate. This also had no effect on the WRS plan level financial statements for which ETF is responsible.

Employers are solely responsible for their financial statements and for evaluating the information used to recognize and disclose pension amounts in its financial statements in accordance with accounting standards. As such, employers need to understand the applicable accounting standards and the effect on their financial reporting. In addition to the audited schedules, ETF staff provide employers specific employer amounts which in aggregate total the amounts on the Schedule of Collective Pension Amounts. The AICPA Audit and Accounting Guide states employers are to verify and recalculate the information provided. Employers could net deferred inflows and outflows of resources if presented separately on the schedules provided by ETF. Based on past discussions with some employer auditors, we believe the risk of each employer reporting incorrectly is very low. Given the above, we believe the severity of this deficiency is not significant.

As noted in the audit report, ETF staff updated the schedule to present the collective deferred inflows and outflows of resources arising from differences between projected and actual pension plan investment earnings as a net amount. In addition, we requested our actuary to update the report they provide ETF to show these deferrals net. This report is the source of data for the Schedule of Collective Pension Amounts.

Thank you for bringing this matter to management's attention and for the courtesy and professionalism of LAB staff during the audit.

Sincerely,

Robert J. Conlin
Secretary