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Correspondence Memorandum

Date: December 12, 2017

To: Audit Committee

From: Cindy Klimke-Armatoski
Chief Trust Financial Officer

Subject: 2016 Annual Financial Reports

This memo is for informational purposes only. No Committee action is required.

The 2016 financial statements and related notes for the Wisconsin Retirement System (WRS) and other benefit plans have been prepared and audited by the Legislative Audit Bureau (LAB). The *WRS Financial Report*, *WRS Reporting for Participating Employers* and ETF's *Comprehensive Annual Financial Report* (CAFR) have been published.

The report confirms the WRS continues to be well funded, with a funding value-based ratio near 100% as of December 31, 2016. The fair value-based ratio, calculated in accordance with standards issued by the Governmental Accounting Standards Board, is 99.1%. This is a slight increase from 98.2% reported as of December 31, 2015, and is the highest-funded ratio in our peer group.

Over the past year, ETF has been diligently working on improvements to the financial reporting processes. I am pleased LAB noted improvements and did not report significant deficiencies in its audit of the WRS and other benefit program financial statements and related notes. LAB did identify an error in the allocation of investment earnings and reported this as an additional matter. ETF subsequently determined this error was introduced in the calendar year 2015 calculation. Although LAB staff questioned it at that time, the discussion occurred with only one person at ETF 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;
- 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.

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It is also worth noting that at the beginning of the audit we initiated a communication protocol with LAB, in which we requested LAB staff copy ETF management on email correspondence with ETF staff. This step mitigates the risk of issues not being properly addressed.

ETF also prepares -- and LAB audits -- a Schedule of Employer Allocations of the WRS, a Schedule of Collective Pension Amounts of the WRS, and the related notes to these schedules. Accounting standards require the calculation of a net pension liability or net pension asset, for which participating employers are required to report their proportionate share on their financial statements. These schedules provide employers with the necessary information for their reporting.

While auditing the employer schedules, LAB identified the deferred inflow of resources and the deferred outflow of resources resulting from the difference between actual and projected investment earnings; these were separately presented on the schedule rather, than netted as accounting standards require. LAB reported this as a significant deficiency. While we agree with this required correction, we do not believe the severity of this deficiency is significant. Employers are solely responsible for their financial statements and for evaluating the information used to recognize and disclose pension amounts in 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 provides 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.

Staff will be at the committee meeting to answer any questions.