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Correspondence Memorandum

Date: March 17, 2017
To: Employee Trust Funds Board
From: Robert J. Conlin, Secretary
Cindy Klimke-Armatoski, Chief Trust Financial Officer
Subject: Abbreviated History of ETF's Financial Statement Preparation

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

Given the recent audit findings from the Legislative Audit Bureau (LAB) and the January hearing before the Legislature's Joint Audit Committee, I wanted to provide you some additional information to put these issues in a broader context. ETF's Chief Trust Financial Officer, Cindy Klimke-Armatoski, spent some time reviewing the relatively recent history of our financial reporting efforts stretching back to the year 2000. Timing and quality emerge as key themes in what follows.

Timeliness

When I began at ETF in 2006, we were producing our Comprehensive Annual Financial Report (CAFR) approximately one and a half to two years after the close of the calendar year covered by the report. For example, in September of 2006 we produced the 2004 CAFR. It appears that the timing of our CAFR production was significantly affected by the passage of, and subsequent litigation over, 1999 Wisconsin Act 11, the last major benefits improvement bill which became effective in December of 1999. Due to litigation that culminated in a Wisconsin Supreme Court decision, the Act could not be implemented until June of 2001. We did not publish a CAFR for 2000 or 2001 until June of 2003, when we published a combined CAFR covering those two years. [It is interesting to note that our 1999 CAFR was published just seven months after the close of the year, in July of 2000.]

ETF finally started getting caught up with our CAFR production in 2010. In that year we produced the 2008 CAFR in March and the 2009 CAFR in November. In 2011, we produced the 2010 CAFR in September, only nine months after the close of the year. Shortly thereafter, we got caught up again in the fallout from new legislation, this time 2011 Wisconsin Acts 10 and 32. One of the key features of this legislation was the requirement that most employees pay one-half of the required Wisconsin Retirement

Board	Mtg Date	Item #
ETF	3.23.17	5D

System (WRS) contribution. The operational challenge for ETF and employers participating in the WRS was that this requirement went into effect at different times depending on the employee classification and the status of any existing collective bargaining agreements. In effect, employers generally had to report pre-Act 10/32 earnings and contributions and post-Act10/32 earnings and contributions in 2011. Many employers struggled with this and our antiquated IT systems needed considerable reprogramming to allow for this reporting. It took us much longer to reconcile the employer reporting for 2011. We finally finished our financial reporting for 2011 in July of 2013 with the publication of the 2011 CAFR. The 2012 CAFR was published a few months later in December of 2013.

Our financial reporting for 2013 was elongated due to the implementation in April of 2014 of ETF's new general ledger system (referred to as the Financial Management Information System, or FMIS, which was a necessary first step for the Benefits Administration System (BAS) and a precursor to the State's STAR system). This added complexity to an already complex process. Ultimately, the CAFR for 2013 was produced in December of 2014. Also during 2014, our long-tenured Deputy Controller retired.

The financial reporting for 2014 was challenging as this was the first year in which we were required to produce the new GASB 67/68 calculations and reports. This work was occurring during 2015, at the same time the State was implementing the STAR system's general ledger components. The financial reporting for 2014 culminated with the production of our 2014 CAFR in January of 2016. Our 2015 CAFR is currently in production. The 2015 CAFR was the first report issued using the new State STAR general ledger. As you recall, we also saw considerable delays last fall as the Legislative Audit Bureau (LAB) sought certain audit assurances from the State Controller's Office concerning post-STAR cash reconciliations.

Quality

We have been able to identify five audit periods related to our CAFRs dating back to 2000 where no internal control deficiencies were reported by the LAB: the 2000-01 combined CAFR, the 2003 CAFR, and the 2010, 2011, and 2012 CAFRs.

In the other years certain themes are recurrent in the issues that LAB identified. In short, the majority of the LAB's findings stem from "a lack of oversight of the financial reporting process," including not having adequate procedures and documentation of those procedures and not providing sufficient attention to detail and oversight to ensure accuracy. Comments of this nature often accompany errors in which figures in disclosure notes do not match the data in the financial statement, or in which data in the financial statements do not match the source documentation, or in which figures in our reports are not updated from the previous year.

An Abbreviated History of Financial Report Production		
Calendar Year	CAFR Produced	LAB Findings
2015	In production	X
2014	January 2016	X
2013	December 2014	X
2012	December 2013	
2011	July 2013	
2010	September 2011	
2009	November 2010	X
2008	March 2010	X
2007	November 2009	X
2006	November 2008	X
2005	November 2007	X
2004	September 2006	X
2003	February 2005	
2002	July 2004	X
2000-01	June 2003	

Remediation

As you know, we've not been idle in addressing these issues. However, as you can see from the above history, some of the more systemic quality issues will not all be resolved overnight, but progress is being made. The Joint Audit Committee has directed that we report back to them in July on what we are doing to improve our financial reporting.

Prior to 2015, we would characterize most of our responses to many of the LAB's findings as "reactionary" in the sense that we would do what we thought was needed to fix a particular finding. What we did *not* do was implement a more holistic approach that would better get at some of the root causes of the findings. In our haste to get caught up on our financial reporting and CAFR production, I think we forgot the old adage that you "need to go slow to go fast"- to find the right balance of urgency and diligence. In 2015, that began to change.

In response to the LAB's findings on our 2014 statements, we engaged, in late 2015, CliftonLarsonAllen (CLA), an accounting consultancy, to review the operations of the Division of Trust Finance and make recommendations. We wanted them to assist in enhancing our internal controls to minimize the risk of material error, improve our closing process in order to enhance the timeliness of our financial statement preparation, and enhance the efficiency in how we prepare the financial statements. They delivered their final report to us early in 2016.

CLA reviewed our documentation and spent time interviewing ETF staff as well as auditors from the LAB. They focused on our human capital, communications with LAB, our use of technology, and our quality assurance review process. CLA made a number

of recommendations for improvement in each of these areas. Some of the key recommendations are listed below.

Human Capital

1. To enhance the knowledge and expertise of ETF staff, ETF should enhance staff training and development to include cross-training, documentation of current business processes, and continuing educational opportunities that meets the needs of the ever changing financial industry.
2. Provide additional training in the areas of process improvement, project management, Microsoft Office products and governmental/core accounting.
3. Modify managers' roles/responsibilities to include more detailed review of work processes performed by staff and less actual performance of daily processes.
4. Develop a detailed succession plan for Bob Willett in anticipation of his retirement.
5. Conduct a needs assessment to match ETF's needs with staff's current skill sets and career aspirations.

Communication

1. Only provide final financial statements/support documents as the basis for the LAB audit. Elevate schedule delays in providing final documentation to LAB to the Secretary's Office and the LAB.
2. Develop a communication protocol with LAB to ensure that all changes in ETF's financial systems are reflected in LAB audit files and accurately reflect the current operating environment.
3. Continue to conduct an annual audit preplanning kick-off meeting with the LAB to establish and set formal/regular update meetings to improve communication between the entities. Update meetings should occur regularly during all phases of the audit and include the LAB, ETF's CFO, ETF's Internal Audit, and ETF's financial managers. Minutes should be taken and agreed upon action items with due dates should be documented.
4. Develop an audit schedule that is flexible to account for date slippage due to delays.

Technology

1. ETF should consider a dedicated IT resource/liaison to assist with STAR issues and they should have more in-depth training.
2. ETF should provide additional employee training on report writing in the STAR system.
3. Enhance Excel spreadsheet documentation and utilization so that the function of each spreadsheet is clear and understandable and so that data can be better reviewed, sourced and validated.

Quality Assurance Reviews

1. All journal entries should have three levels of review.
2. All journal entry control sheets should have appropriate information, including a description and purpose of the journal entry, an indication of the appropriate sign-offs, and data source visibility for validation purposes.

Many of these recommendations have been implemented and all of them are in progress.

As I have discussed with you in the past, one of the ways we implemented our transition plan for Bob Willett was to hire his successor before he retired in order to give that successor an opportunity to learn the business at his side while also observing the people and processes first hand. Cindy Klimke-Armatoski joined ETF in June of 2016 after a long and successful career at SWIB. Cindy was well aware of the challenges she would face, but also well prepared to address them successfully. The CLA recommendations were available for her to work from but she also brought her own experience and expertise to the table. Her impact was felt immediately, and now that she has fully transitioned to CFO, she continues to make systemic improvements designed to improve our financial reporting over the long haul.

Cindy will be joining us at the Board meeting to discuss her observations over her first nine months at ETF, describe in more detail the types of changes she is implementing and give you a sense of the challenges that remain.