From:	Frank Wolff
To:	ETF SMB Board Feedback
Subject:	ETF Financial Statements
Date:	Monday, December 4, 2023 1:47:21 PM
Attachments:	image.png

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The purpose of this email is to ensure that the ETF Board is aware of and is taking action with regard to the under-reporting of external investment expenses by the SWIB, especially with respect to the 2021 financial statements, and going forward. This is still relevant because the ETF has not yet issued the ACFR for 2022, so the 2021 report is the most recent report available. If the 2021 report is not modified, or the audit opinion qualified, it is the historical financial record for 2021.

In 2021 SWIB changed its accounting for external investment management fees to stop reporting the fees as an expense, but instead netting the expense from investment income. As a result, an uninformed reader could be led to believe that the investment management expense declined to $435 million from over $735 million in 2020.

> The Core Fund incurred $429.5 million in **Investment Expense** during 2021, representing a decrease of $305.3 million, or 42%, from the prior year. As noted, Investment Expense comprises several individual expense accounts on the financial statements. Investment Operating Expense accounted for $253.9 million, or 59%, of the Core Fund's total investment expenses for the year-ended Dec. 31, 2021. Investment Operating Expense increased by $45.3 million versus the prior year. Within Investment Operating Expense, Dividend expense increased by $47.1 million year-over-year as SWIB's equity short exposures increased over the course of 2021. Alternatively, interest expense paid to counterparties decreased $15.6 million as short-term interest rates remained low during 2021. This resulted in lower interest paid on reverse repurchase agreements. Reverse repurchase agreements are used to finance certain investment strategies.

The reality is that investment management expense including carried interest was about $1.963 billion in 2021, not $429 million, and this is an increase from 2020 of $1.0 billion, not a decrease of $305 million.

The SWIB reported to the Joint Committee on Finance that the Total Cost of Management for 2021 was $702 million, which is $1.3 billion less than the total reported by the Legislative

Audit Bureau.

Despite these discrepancies and the apparent violation of GAAP accounting for the investment management fees, the LAB issued a clean audit opinion.

In my opinion, as a former FDIC senior manager, and a Certificated CPA (State of Missouri Board of Accountancy, inactive), the 2021 financial statements should be re-issued to correct the unreported investment management expense, as is required by GAAP. As an alternative, the LAB should modify its audit opinion to note that the changes in reporting the external investment management fees do not comply with GAAP, which would require they be listed either in the changes in net financial position as an expense, or in the Notes to the Financial Statements (the Notes are an integral part of the financial statements and are covered by the audit opinion).

The purpose of GAAP of course, is to ensure that financial statements are not misleading and the management discussion in the 2021 SWIB report is clearly misleading in that it states that investment fees declined, when in fact they rose by $1 billion.

In my opinion, the root cause of this is that the LAB is not an independent public accounting firm, but is a sister agency of the State of Wisconsin to both the SWIB and the ETF.

My recommendation, to strengthen the oversight of the SWIB management of the WRS Assets, is that an independent accounting firm be hired to do the annual audit. The LAB should continue to do management audits that are outside the scope of the financial audit.

Thank you for your service.

Sincerely,

Frank Wolff
Lake Geneva, WI
[redacted]