From: [redacted]
To: ETF SMB Board Feedback
Subject: Re: 2023 WRS Investment Report
Date: Thursday, April 4, 2024 12:14:29 PM
Attachments: [redacted]

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Dear Kathryn,

Thank you for including my report in the last Board Meeting, however, since it wasn't presented I'm not sure anyone actually read it.

Attached is a memo regarding the treatment of investment management fees on the ACFR. Would you be able to forward this to Sec. Voelker, Director of Division Trust Finance Cindy Klimke-Armatoski, Office of Internal Audit Yikchau Sze, and Office of Legal Services Dian Felsmann?

Thank you and I would be happy to answer any questions or comments about my memo.

Thank you,

Frank Wolff
[redacted]

On Fri, Feb 23, 2024 at 8:31 AM ETF SMB Board Feedback <ETFSMBBoardFeedback@etf.wi.gov> wrote:

> Hello, Mr. Wolff.
>
> Thank you for your inquiry. We have forwarded this to SWIB and will include a copy of your message to the ETF board at its next meeting.
>
> Best,
>
> Kathryn
>
> ---
>
> [redacted]>
> **Sent:** Wednesday, February 14, 2024 10:58 AM
> **To:** ETF SMB Board Feedback <ETFSMBBoardFeedback@etf.wi.gov>
> **Subject:** 2023 WRS Investment Report

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To: Secretary Voelker, Secretary Wilding, Secretary Wathke, Secretary Ancel, Secretary Thompson

All,

Attached is a summary report which I have prepared to provide context and historical data regarding the posted 2023 preliminary returns for the WRS investment funds.

This report is meant to be for the benefit of the WRS annuitants, participants, and those providing oversight to the WRS system.

I have made every effort to ensure that the returns and other data in this report accurately reflect data published online and/or are publicly available.

I would welcome any feedback regarding this report, or if there is any opportunity for me to join a board or the ETF and contribute to the WRS on an official basis.

Thank you!

Frank Wolff

[redacted]

[redacted]

WRS PENSION WATCH 2 April 2024

Frank Wolff

BA Political Science, Vassar College
MBA-Finance, SIU Carbondale
Certificated CPA No. 8300, State of Missouri Board of Accountancy (Inactive)

RE: Investment Expense Financial Reporting

Dear Sec. Voelker, Director Klimke-Armatoski, et al.:

The purpose of this memo is to notify you that in my opinion the ACFR(s) 2022 and prior as presented by the ETF are not in compliance with GAAP with respect to the reporting of investment expenses and with the failure to disclose the reason for the accounting change in 2021 which served to further conceal investment expenses.

I'm not sure that most Wisconsin taxpayers realize that they pay just more than 50% of the total contributions to the pension plan on an annual basis, in the form of tax levies against their real estate including their personal residences. And we know that failure to pay these RE taxes could result in the loss of their homes and other real estate. In 2022, the taxpayers paid $1,175,881,000 ($1.2 billion) towards the pension system.

As a result, the taxpayers are entitled to full, transparent, and honest disclosure of what the money is being spent on. In the case of the SWIB, it is now over $1 billion per year in external investment management fees with no disclosure as to whom these payments are being made. This is more than 30 times the operating budget for the EFT/WRS.

I have not been able to find a single public pension plan other than the ETF that does not disclose the external investment managers that they engage or how much is paid to and a description of the assets being managed. Public perception is that when a government agency conceals its activities, there if the appearance that they are hiding something or doing something wrong.

In 2021, the SWIB and the WRS announced changes in accounting policy. The change was to certain external investment management expenses. Instead of reporting these as expenses, they were netted out of investment income and no longer disclosed on the Statement of Changes in Fiduciary Net Position.

GAAP requires that if investment expenses are identifiable that they be disclosed as a line item.

Also, GAAP requires that the reason for the accounting change be explained and the reason the new method is preferred over the old method.

s.

Excerpt from ASC 250-10-50-1

An entity shall disclose all of the following in the fiscal period in which a change in accounting principle is made:

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.

In 2021, neither the reason for the change nor an explanation of why the new principle was preferable was disclosed. Although this is a violation of GAAP, the LAB did not note this or qualify their accounting opinion.

Furthermore, in its management discussion, the SWIB stated that investment expense had declined from $742 million in 2020 to $429 million in 2021. This statement is false and misleading, as the accounting treatment changed, but the expenses increased substantially.

> 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

In the 2022 WRS Statement of Changes in Fiduciary Net Position, the external management fees are not disclosed however Investment Expense of (778,521) is reported. ($778.5 million). This would lead the financial statement reader to think the investment expense was $778.5 million, when in fact it was much higher and more likely to be $1.8 billion in total.

Again, the LAB has given these statements a clean opinion without noting that this treatment does not comply with GAAP.

The policy of not disclosing some investment expenses while disclosing other investment expenses within the same Statement of Changes in Fiduciary Net Position is misleading and confusing. This is not made right by providing confusing explanations as to which expenses are disclosed and which are netted out of the Change in the Fair Value of Investments. GAAP requires that all expenses be disclosed at the time they are incurred. This is basic accrual accounting. In other words, if performance fees or 'carried interest' have been incurred they need to be disclosed regardless of whether they have been paid yet.

The proper treatment is to disclose the identifiable investment expenses. It could be listed as a deduction from Investment Income or as an Investment Expense. It cannot be netted out of Investment Income and not disclosed.

And even worse, it cannot be partially disclosed and partially concealed which on its surface implies that the investment expenses are less than actual.

WRS Statement of Changes in Fiduciary Net Position for the Year Ended December 31, 2022 (In thousands)

	Per ACFR		Suggested	
Additions				
Contributions				
Employer Contributions	$	1,175,881	$	1,175,881
Member Contributions	$	1,082,040	$	1,082,040

Total Contributions	**$**	**2,257,921**	**$**	**2,257,921**
Investment Income:				
Net Increase(Decrease) in Fair Value of Investments	$	(21,239,109)	$	(20,909,746)
Interest, Dividend, and Other Investment Income	$	2,606,477	$	2,606,477
Securities Lending Income	$	140,328	$	140,328
Less				
Investment Income Distributed to Other Benefit Programs	$	644,371	$	644,371
Investment Expense	$	(778,521)	$	(1,886,405)
Securities Lending Fees	$	(76,178)	$	(76,178)
Interest of Prior Service Receivable	$	384	$	384
Net Investment Income (Loss)	**$**	**(16,444,327)**	**$**	**(16,444,327)**
Net Position				
Beginning of Year	$	141,847,701	$	141,847,701
End of Year	$	118,368,226	$	118,368,226
Average	**$**	**130,107,964**	**$**	**130,107,964**
Investment Expense as % of Average Net Position		0.60%		-1.45%
Note: Attach Exhibit detailing investment expenses of $1,886, 405 including investment manager names etc.				

Note: I added the disclosed Investment Expense of $778.5 million to the $1.1 billion in External Investment Management Fees in the Management Discussion and Analysis to calculate $1.9 billion in Total Investment Expense.

In its February 09, 2023 report to the Joint Legislative Audit Committee, the Joint Finance Committee, and the Department of Administration, the SWIB reported $713,112,210 in Total External Investment Management Fees.

This does not agree with the $1,107,884,000 reported in the 2022 Management Discussion and also by the LAB. The difference is $394 million.

One of the key metrics reported by SWIB is that it is a low-cost investment manager. In last week's WRS Board Meeting, the SWIB reported a total of 64.1 basis points in Total Costs including performance fees in 2023.

This does not agree with the above reformatted 2022 Change in Net Position Report which would put the total cost of investment management at 145 basis points. (double the amount reported by SWIB). This is a difference of over $1 billion.

Recommendations

As the 9th or 10th largest state pension fund, the ETF should follow best practices and fully disclose investment management fees and who are the outside investment managers, including how much is being paid to each manager and what assets are being managed.

The ETF should prepare its ACFR and does not need to follow the practice or advice of the investment manager.

An independent qualified CPA firm should be engaged to review the financial statements including the LAB audit to ensure that the opinions issued by LAB meet current GAAP requirements. Specifically, the treatment of investment expenses, and the failure to give an explanation as to reason for the accounting change in 2021 and why it is preferable to not fully disclose investment expenses in the Statement of Changes in Fiduciary Net Position.

The ETF was responsible for issuing an explanation for the 2021 accounting change and why netting out the largest expenses of the investment fund is preferrable to disclosing them. I can't think of a good reason for this change but I can think of a lot of reasons it is bad policy.

It was the LAB's responsibility for noting the lack of a reason for the accounting change and should have issued a disclaimer in the audit opinion that this change is not in compliance with GAAP. I think the LAB also should have noted that the accounting change itself would not conform to GAAP.

If needed, the 2021 and 2022 Statement of Changes in Fiduciary Net Position be restated disclosing the total investment management and performance fees and a reason for the restatement.

Ideally, to avoid the appearance of a conflict of interest and to ensure independence, the ETF should engage a qualified CPA firm as their external auditor. The LAB can continue to do internal audit functions as directed by the legislature and to review the SWIB investment statement.

The 2023 ACFR should fully disclose the total investment management fees by the WRS in the Statement of Changes in Fiduciary Net Position and include an Exhibit detailing the fees paid and expenses incurred. To enhance confidence in the financial statements, the Total of the Investment Fees and Expenses should agree with the Total Investment Expense that is reported on the Changes in Fiduciary net Position.