

An Audit

Unemployment Reserve Fund

Department of Workforce Development

2005-2006 Joint Legislative Audit Committee Members

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State Auditor - Janice Mueller

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Janice Mueller
State Auditor

February 2, 2005

Senator Carol A. Roessler and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

We have completed a financial audit of the State of Wisconsin Unemployment Reserve Fund for the years ended June 30, 2004 and 2003. We performed the audit at the request of the Department of Workforce Development and to meet our audit responsibilities under s. 13.94, Wis. Stats.

Our audit report contains our unqualified opinion on the financial statements and related notes. Wisconsin continued to experience higher unemployment rates, reaching a seasonally adjusted rate of 5.8 percent in January 2003. As a result, unemployment benefit payments exceeded employer contributions and other revenues, causing the Unemployment Reserve Fund balance to decline. The June 30, 2004 fund balance of \$971.0 million is the lowest fund balance during the past 16 years. In contrast, the fund balance reached a high of \$1.9 billion as of June 30, 2000. As required by s. 16.48, Wis. Stats., the Secretary of the Department of Workforce Development recently reported to the Legislature on the overall financial condition and outlook of the Unemployment Reserve Fund, including suggestions for increasing the fund balance to ensure sufficient reserves are maintained.

Accompanying the financial statements is the Schedule of Cash Balance Related to Taxable Employers. This cash balance is used to determine the tax rate schedule that applies to taxable employers. Section 108.18(3m), Wis. Stats., currently requires the second-highest tax rate schedule to be applied when the cash balance as of June 30 is between \$300 million and \$900 million. Because the June 30, 2004 cash balance related to taxable employers was \$812.3 million, the second-highest of the four tax rate schedules will be applied to taxable employers in calendar year 2005. It is estimated that the higher tax rates will require employers to pay an additional \$30.0 million into the Unemployment Reserve Fund during 2005.

We appreciate the courtesy and cooperation extended to us by Department of Workforce Development staff during the audit.

Respectfully submitted,

Handwritten signature of Janice Mueller.

Janice Mueller
State Auditor

JM/BN/ss

Audit Opinion ■

Independent Auditor's Report on the Financial Statements of the State of Wisconsin Unemployment Reserve Fund

We have audited the accompanying financial statements of the State of Wisconsin Unemployment Reserve Fund as of and for the years ended June 30, 2004 and 2003. These financial statements are the responsibility of the Unemployment Reserve Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only the Unemployment Reserve Fund and do not purport to, and do not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

4 AUDIT OPINION

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Unemployment Reserve Fund as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Unemployment Reserve Fund. The supplementary information included as Management's Discussion and Analysis on pages 5 through 10 is presented for purposes of additional analysis and is not a required part of the Unemployment Reserve Fund's financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying Schedule of Cash Balance Related to Taxable Employers on page 25, which is also supplementary information, is presented for the purpose of disclosing the calculation of the portion of the Unemployment Reserve Fund's cash balance related to taxable employers as of June 30, 2004 and 2003. This cash balance is used to determine the unemployment tax rate schedule to be used during the following calendar year. This supplementary information is not a required part of the Unemployment Reserve Fund's financial statements. The Schedule of Cash Balance Related to Taxable Employers has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 7, 2005 on our consideration of the Unemployment Reserve Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which is presented on pages 29 and 30, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

January 7, 2005

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Audit Director

Management's Discussion and Analysis ■

Prepared by Management of the Unemployment Reserve Fund

This management discussion and analysis provides users of the State of Wisconsin Unemployment Reserve Fund financial statements with an overview of the statements and an analysis of the Fund's financial performance during the fiscal years ended June 30, 2003 and 2004. The financial statements, notes, and this discussion are the responsibility of the management of the Fund.

Financial Summary (Highlights)

The assets of the Unemployment Reserve Fund exceeded liabilities at the close of fiscal year (FY) 2003-04 by approximately \$971.0 million. With the exception of \$156.7 million in federal Reed Act allocations, the net assets can only be used to pay unemployment benefits to eligible unemployed persons.

The Fund's equity decreased by \$615.2 million during the two-year period between July 1, 2002 and June 30, 2004. This is mostly attributable to sustained higher unemployment levels and resulting higher benefit payments during the two-year period compared to previous years.

Overview of the Fund

The Wisconsin Unemployment Reserve Fund was established under ch. 108, Wis. Stats., to account for unemployment taxes received from employers and benefits paid to unemployed workers. The principal source of revenue for the Fund

is quarterly unemployment taxes paid by the 120,000 employers subject to the taxing provisions of ch. 108, Wis. Stats. Federal law requires the Fund to hold all reserves in the Federal Unemployment Trust Fund. These reserves are invested in obligations guaranteed by the United States, and the earnings can be used only to pay benefits. With the exception of federal Reed Act allocations, the Fund's reserves can be used only to pay unemployment benefits or to refund overpayments to employers. Reed Act allocations, which are excess federal unemployment taxes collected by the federal government and paid to each state, can be used either to pay benefits or to pay costs associated with administering the unemployment insurance and/or employment service programs. If the Fund exhausts all of its reserves, it can borrow from the Federal Unemployment Trust Fund to continue paying benefits. With the exception of some short-term cash flow situations, any federal borrowing carries interest charges. The interest cannot be funded from employer taxes.

The administrative costs of the unemployment insurance program are accounted for in the State of Wisconsin's General Fund and are not reported within the Unemployment Reserve Fund's financial statements.

Financial Statements

These financial statements are intended to show the Fund's financial position, results of operations, and cash flows for fiscal years 2002-03 and 2003-04. The balance sheet reports all financial and capital resources. The statement of revenues, expenses, and changes in fund equity reports all Unemployment Reserve Fund revenues, expenses, and transfers regardless of when cash is received or paid. This statement also shows the Fund's equity and how it has changed. The statement of cash flows provides information about the Fund's cash receipts and cash payments during the fiscal years and profiles a reconciliation of net operating income to net cash flow from operating activities.

Assets

The Fund's assets consist primarily of cash and cash equivalents and receivables. Table A shows that total assets decreased by \$361.8 million between June 30, 2002 and June 30, 2003, and by \$250.6 million between June 30, 2003 and June 30, 2004.

Table A

Assets
(In Millions)

	June 30, 2002	June 30, 2003	Change	June 30, 2004	Change
Cash and Cash Equivalents	\$1,485.7	\$1,108.3	\$(377.4)	\$ 833.7	\$(274.6)
Receivables	144.3	159.9	15.6	183.9	24.0
Total Assets	\$1,630.0	\$1,268.2	\$(361.8)	\$1,017.6	\$(250.6)

The \$377.4 million decrease in cash and cash equivalents during FY 2002-03, and the \$274.6 million decrease during FY 2003-04, were mostly due to a continuing historically high level of unemployment and the resulting benefit payments over the last few years. The cash and cash equivalent balance maintained in the Federal Unemployment Trust Fund decreased significantly during both fiscal years because benefit payments exceeded tax collections.

Liabilities

As shown in Table B, the Fund's liabilities on June 30, 2003 and 2004, totaled \$52.4 million and \$46.6 million, respectively.

Table B

Liabilities
(In Millions)

	June 30, 2002	June 30, 2003	Change	June 30, 2004	Change
Overdrafts	\$21.7	\$24.2	\$2.5	\$14.6	\$(9.6)
Other Liabilities	22.0	28.2	6.2	32.0	3.8
Total Liabilities	\$43.7	\$52.4	\$8.7	\$46.6	\$(5.8)

The \$24.2 million and \$14.6 million bank account overdrafts on June 30 of each year are the result of the Fund's cash management policy. The Fund attempts to maintain a zero dollar balance in the bank account from which all unemployment

benefit disbursements are made. However, a negative book balance (carrying amount) results because disbursements are recorded for checks that have been issued but not yet presented to the bank. This negative balance is shown as a liability on the balance sheet. The \$9.6 million difference in the overdraft amount between June 30, 2004 and June 30, 2003 resulted from a decrease in the number of benefit checks issued near the end of FY 2003-04. The \$6.2 million increase in other liabilities between June 30, 2002 and June 30, 2003 is due to an increase in benefits payable to claimants and benefit overpayments due other states and the federal government.

Fund Equity

As shown in Table C, the Fund's equity decreased by \$370.4 million between June 30, 2002 and June 30, 2003, and by \$244.8 million between June 30, 2003 and June 30, 2004. These decreases were primarily due to increased levels of benefit payments caused by higher unemployment rates.

Table C

Fund Equity
(In Millions)

	June 30, 2002	June 30, 2003	Change	June 30, 2004	Change
Fund Equity	\$1,586.2	\$1,215.8	\$(370.4)	\$971.0	\$ (244.8)

Operating Revenues

The three major sources of operating revenues for the Fund are employer-paid unemployment taxes; earnings on reserves held in the Federal Unemployment Trust Fund; and reimbursements for benefits paid on behalf of the federal government, other governmental units, and nonprofit organizations. Table D shows changes in the Fund's operating revenues during fiscal years 2002-03 and 2003-04.

Table D

Operating Revenues
(In Millions)

	FY 2001-02	FY 2002-03	Change	FY 2003-04	Change
Employer Contributions	\$432.0	\$484.5	\$ 52.5	\$578.4	\$93.9
Interest Earnings	99.0	76.0	(23.0)	55.3	(20.7)
Benefit Reimbursements	144.1	251.8	107.7	193.2	(58.6)
Forfeitures and Other Revenues	4.9	5.1	0.2	5.3	0.2
Total Operating Revenues	\$680.0	\$817.4	\$137.4	\$832.2	\$14.8

The increase in employer contributions was due primarily to an increase in individual employer tax rates for calendar years 2003 and 2004 and moving to a higher statutory rate schedule for 2004. Individual employer tax rates can fluctuate from year to year depending on each employer's unemployment experience and level of payroll. Depending on which tax rate schedule is in effect for a particular year, individual employer rates can range from a minimum of zero to a maximum of 9.8 percent of taxable payroll. Only the employees' first \$10,500 in wages is taxed annually. Because of the higher unemployment rates experienced in 2002 and 2003, rates for a significant number of employers increased for 2004. In addition, a higher statutory rate schedule went into effect for calendar year 2004 because the Fund's cash balance on June 30, 2003, dropped under the statutory threshold of \$1.2 billion. Since the June 30, 2004 balance dropped under the next threshold of \$900.0 million, the second-highest of the four schedules will be in effect for calendar year 2005. The highest rate schedule would go into effect if the June 30 cash balance dropped under \$300.0 million.

Although the Federal Unemployment Trust Fund earnings rates averaged about 6 percent during both fiscal years, interest earnings decreased because of the decrease in reserves.

The increase in benefit reimbursements between fiscal years 2001-02 and 2002-03 resulted largely from an increase in reimbursements under the 100 percent federally funded Temporary Extended Unemployment Compensation program. This program provided up to 13 additional weeks of unemployment benefits for claimants who had exhausted their regular unemployment benefits. Since the program expired on December 27, 2003, benefit reimbursements decreased significantly during fiscal year 2003-04.

Expenses and Transfers

Although benefits paid on behalf of taxable employers decreased \$60.5 million between fiscal year 2002-03 and 2003-04, as shown in Table E, the levels for both years remained higher than normal. The unemployment rates for both years were higher compared to previous years.

Table E

Expenses and Transfers (In Millions)

	FY 2001-02	FY 2002-03	Change	FY 2003-04	Change
Benefits Paid on Behalf of:					
Taxable Employers	\$ 928.7	\$ 933.1	\$ 4.4	\$ 872.6	\$ (60.5)
Other Entities	143.0	253.3	110.3	196.0	(57.3)
Total Operating Expenses	\$1,071.7	\$1,186.4	\$114.7	\$1,068.6	\$(117.8)
Transfer to Pay Administrative Expenses in General Fund and Other Nonoperating Expenses					
	\$ 0	\$ 1.4	\$ 1.4	\$ 8.4	\$ 7.0

Transfers of \$1.4 million and \$8.4 million to the State of Wisconsin General Fund occurred in fiscal years 2002-03 and 2003-04, respectively. These represent the amount of Reed Act funds appropriated and obligated for administrative expenses during each fiscal year. The \$7.0 million increase between fiscal years 2002-03 and 2003-04 resulted from an increase in the amounts appropriated for administrative expenses. The Fund received a one-time federal Reed Act allocation of \$166.2 million during fiscal year 2001-02. This allocation can be used either for payment of unemployment and employment service administrative costs or to pay unemployment benefits. The unspent and unobligated portion of the \$166.2 million on June 30, 2004, totaled \$156.7 million. This amount is available for the payment of unemployment benefits.

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Financial Statements ■

Balance Sheet
June 30, 2004 and 2003

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3):		
Federal Unemployment Trust Fund	\$ 832,719,955	\$ 1,056,307,983
Cash in bank	1,011,356	52,030,597
Total Cash and Cash Equivalents	<u>833,731,311</u>	<u>1,108,338,580</u>
Employer Accounts Receivable:		
Taxable employers (less allowance for doubtful collections of \$11,086,875 for 2004 and \$10,612,205 for 2003)	150,444,745	124,384,967
Governmental units and nonprofit organizations (less allowance for doubtful collections of \$474,307 for 2004 and \$499,141 for 2003)	3,404,402	3,877,230
Combined Wage Claim Plan receivables	2,279,645	2,666,273
Net Employer Accounts Receivable	<u>156,128,792</u>	<u>130,928,470</u>
Other Receivables:		
Overpayments to claimants (less allowance for doubtful collections of \$14,043,240 for 2004 and \$14,995,267 for 2003)	27,312,781	24,190,111
Federally funded unemployment benefit programs	456,173	4,716,639
Due from State of Wisconsin (Note 5)	11,577	30,140
Net Other Receivables	<u>27,780,531</u>	<u>28,936,890</u>
TOTAL ASSETS	<u>\$ 1,017,640,634</u>	<u>\$ 1,268,203,940</u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Overdrafts (Note 3)	\$ 14,569,396	\$ 24,167,194
Benefits payable	11,087,335	14,258,466
Employer overpayments	4,232,007	3,831,700
Benefit overpayments due employers, other states, and federal government	5,172,385	4,276,133
Combined Wage Claim Plan liabilities	2,024,509	2,202,510
Advances under federal programs	243,956	2,515
Due to State of Wisconsin (Note 5)	9,126,796	3,197,222
Other	162,189	463,059
Total Current Liabilities	<u>46,618,573</u>	<u>52,398,799</u>
Fund Equity (Note 1):		
Employer accounts	1,001,092,209	1,032,810,630
Omnibus account	(186,772,940)	17,940,321
Reed Act allocations	156,702,792	165,054,190
Total Fund Equity	<u>971,022,061</u>	<u>1,215,805,141</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 1,017,640,634</u>	<u>\$ 1,268,203,940</u>

The accompanying notes are an integral part of this statement.

**Statement of Revenues, Expenses, and Changes in Fund Equity
for the Years Ended June 30, 2004 and 2003**

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
OPERATING REVENUES		
Employer Contributions	\$ 578,438,628	\$ 484,503,234
Benefit Reimbursements (Note 4)	193,152,080	251,760,723
Interest Earnings	55,316,371	75,988,647
Forfeitures and Other Revenues	5,308,340	5,145,743
Total Operating Revenues	832,215,419	817,398,348
OPERATING EXPENSES		
Benefits Paid or Provided on Behalf of:		
Taxable employers	872,603,857	933,082,491
Governmental units, nonprofit organizations, and other organizations (Note 4)	193,516,999	251,760,723
Adjustment for allowance—claimants (Note 2E)	2,526,245	1,557,547
Total Operating Expenses	1,068,647,101	1,186,400,761
OPERATING INCOME (LOSS)	(236,431,682)	(369,002,413)
NONOPERATING REVENUES (EXPENSES)		
Loss on Sale of Other Assets	0	(54,012)
INCOME (LOSS) BEFORE TRANSFERS	(236,431,682)	(369,056,426)
TRANSFERS		
Transfer to State of Wisconsin General Fund (Note 2D)	(8,351,398)	(1,356,211)
NET CHANGE IN FUND EQUITY	(244,783,080)	(370,412,636)
Fund Equity at Beginning of Year	1,215,805,141	1,586,217,777
Fund Equity at End of Year (Note 1)	\$ 971,022,061	\$ 1,215,805,141

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2004 and 2003

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from:		
Employer contributions	\$ 552,836,938	\$ 476,271,375
Benefit reimbursements	198,903,194	251,362,836
Other operating revenues	5,076,616	4,824,755
Cash Payments for:		
Benefits	(1,075,186,069)	(1,187,780,082)
Net Cash Provided (Used) by Operating Activities	(318,369,321)	(455,321,116)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers to State of Wisconsin General Fund	(1,956,521)	(557,985)
Cash Overdraft Implicitly Financed (Repaid)	(9,597,798)	2,417,914
Other Cash Inflows from Noncapital Financing Activities	0	76,282
Net Cash Provided (Used) by Noncapital Financing Activities	(11,554,319)	1,936,211
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest	55,316,371	75,988,647
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(274,607,269)	(377,396,258)
Cash and Cash Equivalents at the Beginning of the Year	1,108,338,580	1,485,734,838
Cash and Cash Equivalents at the End of the Year	\$ 833,731,311	\$ 1,108,338,580
RECONCILIATION OF NET OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net Operating Income (Loss)	\$ (236,431,682)	\$ (369,002,413)
Adjustments to Reconcile Net Operating Loss to Net Cash Provided by Operating Activities:		
Operating income (interest earnings) classified as an investing activity	(55,316,371)	(75,988,647)
Provision for uncollectible accounts	(502,191)	2,081,421
Changes to Assets and Liabilities:		
Decrease (Increase) in employer accounts receivables	(25,650,159)	(10,002,123)
Decrease (Increase) in other receivables	2,108,387	(7,818,705)
Increase (Decrease) in liabilities	(2,577,305)	5,409,351
Total Adjustments	(81,937,639)	(86,318,703)
Net Cash and Cash Equivalents Provided (Used) by Operating Activities	\$ (318,369,321)	\$ (455,321,116)

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements ■

1. DESCRIPTION OF THE UNEMPLOYMENT RESERVE FUND

The unemployment insurance (UI) program is authorized in ch. 108, Wis. Stats., which includes the creation of the Unemployment Reserve Fund to account for contributions received from employers and subsequent benefits paid to unemployed workers. The Unemployment Reserve Fund is administered by the State of Wisconsin Department of Workforce Development (DWD).

The UI program follows the requirements of the Federal Unemployment Tax Act (FUTA), as amended. Therefore, covered employers in Wisconsin are permitted to offset their FUTA tax by a portion of the amount contributed to the Wisconsin Unemployment Reserve Fund. The net FUTA taxes paid by employers to the federal government are used, in part, to reimburse DWD for its costs to administer the Fund. These administrative costs, along with federal reimbursements, are accounted for in the State of Wisconsin's General Fund and are not reported within the State of Wisconsin Unemployment Reserve Fund's financial statements.

The Unemployment Reserve Fund, which is part of the State of Wisconsin financial reporting entity and is reported as an enterprise fund in the State's basic financial statements, accounts for employer contributions and benefits paid to unemployed workers, as well as reimbursements of benefits paid on behalf of the federal government, other governmental units, and nonprofit organizations. The Fund's equity, which is restricted for unemployment benefit payments or other purposes allowed by federal law, includes:

A. Balance Attributable to Individual Employer Accounts

A separate account is maintained for each employer for the purpose of determining employer contribution rates. Each account is credited for a portion of the employer's contribution paid into the Fund and charged with certain benefits paid from the Fund to the employer's former employees, based on their past employment.

B. Balance Not Attributable to Individual Employer Accounts

The Fund has an omnibus account that includes credits for solvency contributions, interest from deposits with the Federal Unemployment Trust Fund, and certain reimbursements from the federal government. Charges to this account include disbursements on behalf of the federal government and all benefits not charged to a specific employer's account, such as benefits paid relating to out-of-business employers or relating to statutory provisions regarding certain employees who have terminated their employment. Because of the economic downturn and decline in interest earnings during the last few years, charges to this account exceeded credits, resulting in a deficit balance of \$186,772,940 as of June 30, 2004.

C. Balance Attributable to Reed Act Allocations

Reed Act funds constitute \$165,054,190 of the June 30, 2003 fund equity and \$156,702,792 of the June 30, 2004 fund equity. These include funds allocated from the Federal Unemployment Trust Fund and can be used for the payment of benefits and the administration of the unemployment insurance law and employment services.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**A. Fund Accounting and Basis of Presentation**

The financial statements of the Wisconsin Unemployment Reserve Fund have been prepared in conformance with generally accepted accounting principles (GAAP) for proprietary funds. The Fund applies all applicable Governmental Accounting Standards Board (GASB) statements. Financial Accounting Standards Board (FASB) statements effective after November 30, 1989, are not applied in accounting for operations of the Fund. The Fund is accounted for using the economic resources measurement focus. With this measurement focus, all assets and liabilities are included on the balance sheet. The Fund is reported on the full accrual basis of accounting. This basis of accounting recognizes revenues and overpayment recoveries when they are measurable and due, regardless of when cash is received. Expenses are recognized in the period incurred, regardless of when cash is paid. The statement of revenues, expenses, and changes in fund equity classifies revenues and expenses as either operating or nonoperating.

Transactions categorized as operating revenues and expenses are those relating to the Fund's principal operation of paying benefits to unemployed workers. Operating expenses include items such as benefits paid. Certain expenses that are not related to the Fund's principal operation, such as a loss on the sale of a building constructed with Reed Act funds, are reported as nonoperating expenses.

B. Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. For example, an allowance for doubtful collections is established for some receivables based on historical collection information. Actual results may differ from those estimates.

C. Amounts Receivable from Taxable Employers

Under the full accrual basis, employer contributions are recognized as revenues in the accounting period in which they become due and measurable. Contributions are reported based on employer self-declared payroll reports. However, some estimates are used to report contributions for employers who fail to file the required reports. Historical collection information is used to estimate and establish an allowance for doubtful collections. Amounts expected to be collected, but not within 12 months, were an estimated \$5.6 million on June 30, 2004, and \$3.6 million on June 30, 2003.

D. Amounts Receivable from Governmental Units and Nonprofit Organizations

The federal government, the State of Wisconsin, electing local governmental units, and electing nonprofit organizations reimburse the Fund for benefits charged to their accounts, rather than use contribution financing. The Fund recognizes a receivable from these organizations when benefits are paid to their former employees. Historical collection information is used to estimate and establish an allowance for doubtful collections. During FY 2003-04, the Fund wrote off as uncollectible \$389,754 in amounts receivable from nonprofit organizations. All receivables, net of the allowance, are expected to be collected within 12 months.

E. Amounts Receivable from Claimants

In some instances, benefits are paid to claimants who ultimately are proven to be ineligible to receive all or a portion of those benefits. The Fund recognizes a receivable from these claimants when the benefit overpayment is identified. A related liability is established for the portion of the overpayments that, when collected, will be credited to reimbursable employers or the federal government. Historical collection information is used to estimate and establish an allowance

for doubtful collections. Amounts expected to be collected, but not within 12 months, were an estimated \$16.7 million on June 30, 2004, and \$14.6 million on June 30, 2003.

F. Reed Act Funding

The Fund's total cash and cash equivalents balance on June 30, 2004, and June 30, 2003, includes Reed Act funds of \$164,358,237 and \$166,314,758, respectively. Of this balance, \$7,655,445 on June 30, 2004, and \$1,260,569 on June 30, 2003, is not available for the payment of benefits since it has been obligated for the payment of administrative expenses. The obligated amounts are included in the Due to State of Wisconsin reported on the balance sheet and Transfer to State of Wisconsin General Fund reported on the statement of revenues, expenses, and changes in fund equity.

G. Benefits Payable to Claimants

Benefits payable to claimants reflect benefits payable through June 30. The liability is based upon known subsequent claim payments and other available information.

3. CASH AND CASH EQUIVALENTS

The majority of cash and cash equivalents consist of the Unemployment Reserve Fund's deposit with the Federal Unemployment Trust Fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act. The Trust Fund includes deposits from the unemployment insurance funds of various states. The Trust Fund is required by federal law to invest only in obligations guaranteed by the United States. The State of Wisconsin Unemployment Reserve Fund is credited quarterly with earnings only to the extent the Fund's deposit with the Trust Fund exceeds the Fund's outstanding advances from the Trust Fund, as computed on a daily basis. The Fund's deposit with the Trust Fund is not subject to risk categorization under GASB Statement Number 3 criteria.

The Unemployment Reserve Fund maintains three separate bank accounts: the contribution account, the benefit account, and the benefit special account. At June 30, 2004, the contribution account had a book balance (carrying amount) of \$1,011,356, which is reported as cash and cash equivalents. The carrying amount of the Fund's other two bank accounts at June 30, 2004, totaled (\$14,569,396). Since the carrying amount is negative, it is reported as an overdraft on the balance sheet. The net bank balance of all three accounts was \$2,945,492 on June 30, 2004, of which \$100,000 was covered by Federal Deposit Insurance Corporation (FDIC) insurance, and \$400,000 by a State of Wisconsin appropriation for losses on public deposits. Therefore, \$500,000 of the June 30, 2004 net bank balance was insured and is categorized as risk

category 1 in accordance with GASB Statement Number 3 criteria, and \$2,445,492 was uncollateralized and uninsured and, therefore, categorized as risk category 3.

At June 30, 2003, the contribution account had a carrying amount of \$52,030,597. The carrying amount of the other two bank accounts was (\$24,167,194). The net bank balance of the three accounts totaled \$53,203,600 on June 30, 2003, of which \$100,000 was covered by FDIC insurance and \$400,000 by the State of Wisconsin appropriation for losses on public deposits. Therefore, \$500,000 of the June 30, 2003 net bank balance was insured and is categorized as risk category 1 in accordance with GASB Statement Number 3 criteria, and \$52,703,600 was uncollateralized and uninsured and, therefore, categorized as risk category 3.

4. BENEFIT REIMBURSEMENTS

The amounts reported as benefits paid or provided on behalf of governmental units, electing nonprofit organizations, and other organizations, and the related revenues reported as benefit reimbursements, consist of several types of benefits, including benefits reimbursed by the federal government under various federally funded unemployment benefit programs and benefits reimbursed for former federal employees. Benefit reimbursements, net of charges for uncollectible reimbursements, are summarized in the following table.

<u>Type of Benefit</u>	<u>FY 2003-04</u> <u>(In Millions)</u>	<u>FY 2002-03</u> <u>(In Millions)</u>
Benefits reimbursed by the federal government under various unemployment benefit programs	\$127.6	\$194.9
Benefits reimbursed by the federal government for former federal employees	9.5	7.6
Benefits reimbursed by State of Wisconsin, electing local governmental units, and electing nonprofit organizations for former employees	45.3	37.8
Benefits reimbursed by other states under the Combined Wage Claim Plan	<u>10.7</u>	<u>11.5</u>
Total	<u>\$193.1</u>	<u>\$251.8</u>

5. AMOUNTS DUE TO/FROM STATE OF WISCONSIN

Under certain circumstances, benefits paid to former employees of governmental units and nonprofit organizations are reimbursed by interest and penalty funds accounted for in the State of Wisconsin General Fund. The amounts reported as Due from State of Wisconsin result from the time lag between when benefits were paid out of the Unemployment Reserve Fund and when reimbursements were received.

The amounts reported as Due to State of Wisconsin consist primarily of Reed Act funds obligated for administrative costs and state income taxes withheld from claimant benefit checks but not yet paid to the General Fund.

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Supplementary Information Schedule ■

**Schedule of Cash Balance Related to Taxable Employers
June 30, 2004 and 2003**

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Cash and Cash Equivalents	\$ 833,731,311	\$ 1,108,338,580
Overdrafts	<u>(14,569,396)</u>	<u>(24,167,194)</u>
Net Cash Balance	819,161,915	1,084,171,386
Adjustments:		
Accounts receivable balance related to reimbursable employers and other states (Note 1A)	6,152,613	7,042,643
Net benefits to be funded by federal unemployment benefit programs and by interest and penalty money (Note 1B)	465,769	4,744,263
Employer tax overpayments (Note 1C)	(4,232,007)	(3,831,700)
Reed Act funds obligated for administration (Note 1D)	(7,655,445)	(1,260,569)
Other activities (Note 1E)	<u>(1,562,175)</u>	<u>(2,404,347)</u>
Cash Balance Related to Taxable Employers	<u>\$ 812,330,670</u>	<u>\$ 1,088,461,676</u>

The accompanying Note to the Schedule of Cash Balance Related to Taxable Employers is an integral part of this schedule.

Note to the Schedule of Cash Balance Related to Taxable Employers ■

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES FOR DETERMINING THE CASH BALANCE

The Schedule of Cash Balance Related to Taxable Employers as of June 30, 2004 and 2003, is presented for informational purposes. Section 108.18(3m), Wis. Stats., provides for one of four tax rate schedules to be in effect during a particular calendar year, depending on the preceding June 30 cash balance in the Unemployment Reserve Fund. Tax rate schedule C was in effect during 2004 because the June 30, 2003 taxable employer cash balance was \$1,088,461,676, which is greater than the \$900 million but less than the \$1.2 billion level specified in Wisconsin Statutes. Tax rate schedule B will be in effect during 2005 because the June 30, 2004 balance was \$812,330,670, which is greater than the \$300 million but less than the \$900 million specified in the Statutes. The cash and cash equivalent balance reported in the Unemployment Reserve Fund financial statements is reduced by overdrafts to arrive at a net cash balance. The net cash balance is adjusted as follows to arrive at the cash balance related to taxable employers:

- A. The net cash balance is increased by the net amount of unreimbursed benefit payment receivables outstanding on June 30 due from the federal government, the State of Wisconsin, local governmental units, nonprofit organizations, and other states under the Combined Wage Claim Plan.
- B. The net cash balance is increased by the net amount of unreimbursed benefit payments to be funded by federal unemployment benefit programs and by interest and penalty money.

- C. The net cash balance is reduced by the net amount of tax overpayments to be refunded to employers or applied to the employers' future tax liabilities.
- D. The net cash balance is reduced by the amount of Reed Act funds obligated for the payment of administrative costs.
- E. The net cash balance is reduced by the net amount of other cash activities, including collections for court costs, interest and penalties, special assessments, and other amounts not yet paid to the State of Wisconsin; withheld child support payments not yet distributed; and benefit overpayment recoveries not yet paid to other states.

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Report on Control and Compliance ■

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the State of Wisconsin Unemployment Reserve Fund as of and for the years ended June 30, 2004 and 2003, and have issued our report thereon dated January 7, 2005. 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*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the Unemployment Reserve Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Unemployment Reserve Fund’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement 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 noted certain matters that will be reported to the management of the Unemployment Reserve Fund in a separate letter.

This independent auditor’s report is intended for the information of the State of Wisconsin Unemployment Reserve Fund management and the Wisconsin Legislature. This independent auditor’s report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on internal control over financial reporting or on compliance, this report is not intended to be and should not be used by anyone other than those specified parties.

January 7, 2005

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Audit Director