

An Audit

Unemployment Reserve Fund

Department of Workforce Development

2007-2008 Joint Legislative Audit Committee Members

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Janice Mueller
State Auditor

February 16, 2007

Senator Jim Sullivan and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Sullivan and Representative Jeskewitz:

We have completed a financial audit of the State of Wisconsin Unemployment Reserve Fund for the years ended June 30, 2006 and 2005. We performed the audit at the request of the Department of Workforce Development (DWD) 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. It does not discuss DWD's ongoing development of computer software to support the Unemployment Insurance program, which we will address in a future evaluation.

During the period of this audit, the seasonally adjusted unemployment rate was lower than in prior years and ranged between 4.5 percent and 5.0 percent. However, unemployment benefit payments and other expenses exceeded employer contributions and other revenues. Consequently, the Unemployment Reserve Fund's balance continued to decline from its high of \$1.9 billion as of June 30, 2000. The Fund's balance was \$971.0 million at the start of our audit period and \$895.0 million as of June 30, 2006. 2005 Wisconsin Act 86 directed DWD to study the long-term financial stability of the Fund and report to the Unemployment Insurance Advisory Council by July 1, 2007, on any measures required to maintain the Fund's stability.

As part of our audit, we matched data on unemployment benefit payments and individuals in the custody of the Department of Corrections. From this work, it was determined that two prisoners had inappropriately received \$2,697 in unemployment benefits. We have therefore recommended in a separate audit communication that DWD work with the Department of Corrections to periodically identify any similar instances of inappropriate benefit payments.

We appreciate the courtesy and cooperation extended to us by DWD staff during the audit.

Respectfully submitted,

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, 2006 and 2005. 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.

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, 2006 and 2005, 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 audits were 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 11 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 27, 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, 2006 and 2005. 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 audits 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 26, 2007, on our consideration of the Unemployment Reserve Fund's internal control over financial reporting and on 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 31 and 32, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

January 26, 2007

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's financial statements with an overview of the statements and an analysis of the Fund's financial performance during the fiscal years ended June 30, 2006 and 2005. 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) 2005-06 by approximately \$895.0 million. With the exception of \$151.0 million in federal Reed Act allocations, the net assets can be used only to pay unemployment benefits to eligible unemployed persons.

The Fund's equity decreased by \$76.1 million during the two-year period between July 1, 2004, and June 30, 2006. Despite a relatively stable economy and reduced levels of unemployment during the two-year period, the balance declined because unemployment taxes paid by employers were less than benefits paid to unemployed workers.

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 Fund is administered by the State of Wisconsin's Department of Workforce Development (DWD). The Unemployment

Insurance Advisory Council, consisting of labor and management representatives, advises DWD on the administration of unemployment insurance law and submits its recommended changes in the law to the Legislature during every biennial legislative session. The principal source of revenue for the Fund is quarterly unemployment taxes paid by the approximately 124,000 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, which invests in obligations guaranteed by the United States, and the earnings on the Trust Fund may 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 charges 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 FY 2005-06 and FY 2004-05. 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 loss to net cash flow used by operating activities.

Assets

The Fund's assets consist primarily of cash and cash equivalents and receivables. Table A shows that total assets decreased by \$47.6 million between June 30, 2004, and June 30, 2005, and by \$30.7 million between June 30, 2005, and June 30, 2006.

Table A

Assets
(In Millions)

	June 30, 2004	June 30, 2005	Change	June 30, 2006	Change
Cash and Cash Equivalents	\$ 833.7	\$774.7	\$(59.0)	\$766.6	\$ (8.1)
Receivables	183.9	195.3	11.4	172.7	(22.6)
Total Assets	\$1,017.6	\$970.0	\$(47.6)	\$939.3	\$(30.7)

Cash and cash equivalents decreased by \$59.0 million during FY 2004-05, and by \$8.1 million during FY 2005-06. These decreases are significantly less than the decreases of \$377.4 million during FY 2002-03 and \$274.6 million during 2003-04, which resulted from high levels of unemployment and benefit payments. Despite a relatively stable economy during FY 2004-05 and FY 2005-06, benefit payments continued to exceed revenue for both years, causing continued declines in the cash and cash equivalents balances.

Liabilities

As shown in Table B, the Fund's liabilities totaled \$46.3 million on June 30, 2005, and \$44.3 million on June 30, 2006.

Table B

Liabilities
(In Millions)

	June 30, 2004	June 30, 2005	Change	June 30, 2006	Change
Overdrafts	\$14.6	\$11.9	\$(2.7)	\$ 8.4	\$(3.5)
Other Liabilities	32.0	34.4	2.4	35.9	1.5
Total Liabilities	\$46.6	\$46.3	\$(0.3)	\$44.3	\$(2.0)

Bank account overdrafts of \$11.9 million as of June 30, 2005, and \$8.4 million as of June 30, 2006, 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 \$3.5 million decrease in the overdraft amount from June 30, 2005, to June 30, 2006, resulted from a decrease in the number of benefit checks issued near the end of FY 2005-06.

Fund Equity

As shown in Table C, the Fund's equity decreased by \$47.3 million between June 30, 2004, and June 30, 2005, and by \$28.7 million between June 30, 2005, and June 30, 2006. Unemployment benefit payments continued to exceed employer tax receipts and investment earnings during both fiscal years. In 2005 Wisconsin Act 86, the Legislature directed DWD to study the long-term stability of the Fund and determine what measures, if any, are required to maintain the Fund's stability. The findings and recommendations are due to be reported to the Unemployment Insurance Advisory Council no later than July 1, 2007.

Table C

Fund Equity (In Millions)

	June 30, 2004	June 30, 2005	Change	June 30, 2006	Change
Employer Accounts	\$1,001.1	\$1,133.2	\$132.1	\$1,246.0	\$112.8
Omnibus Account	(186.8)	(362.1)	(175.3)	(502.0)	(139.9)
Reed Act Allocations	156.7	152.6	(4.1)	151.0	(1.6)
Total Fund Equity	\$971.0	\$923.7	\$(47.3)	\$ 895.0	\$(28.7)

Charges to the Omnibus Account during each fiscal year significantly exceeded revenues credited to the account. A number of statutory provisions prohibit charging certain benefit payments directly to an employer's account. This resulted in \$119.8 million in benefit payments charged directly to the account during FY 2005-06, and \$117.4 million in FY 2004-05. Another statutory provision requires transferring to the Omnibus Account a portion of benefits previously charged to the accounts of certain employers who are at the maximum tax rate. These transfers amounted to \$151.7 million during FY 2005-06 and \$197.9 million during FY 2004-05.

Operating Revenues

The two major sources of operating revenue for the Fund are employer-paid unemployment taxes, and reimbursements for benefits paid on behalf of the federal government, other governmental units, and nonprofit organizations. A smaller amount of revenue is received from forfeitures and other sources. Table D shows changes in the Fund's operating revenues during FY 2004-05 and FY 2005-06.

Table D

Operating Revenues (In Millions)

	FY 2003-04	FY 2004-05	Change	FY 2005-06	Change
Employer Contributions	\$578.4	\$671.9	\$ 93.5	\$679.5	\$ 7.6
Benefit Reimbursements	193.2	82.6	(110.6)	74.7	(7.9)
Forfeitures and Other Revenues	5.3	4.5	(0.8)	4.7	0.2
Total Operating Revenues	\$776.9	\$759.0	\$(17.9)	\$758.9	\$(0.1)

The increase in employer contributions between FY 2003-04 and FY 2004-05 had two primary causes. First, because of higher unemployment rates and benefit payments during calendar years 2002 and 2003, a significant number of employers were subject to increased tax rates during calendar years 2004 and 2005. Each employer's tax rates can fluctuate from year to year depending on unemployment experience and level of payroll. Depending on which tax rate schedule is in effect, an employer's rate 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.

Second, a higher statutory tax rate schedule went into effect for calendar year 2004 because the Fund's cash balance on June 30, 2003, had dropped below the statutory threshold of \$1.2 billion. The June 30, 2004, 2005, and 2006 balances dropped below the next threshold of \$900.0 million, so the second-highest of the four schedules is in effect for calendar years 2005, 2006, and 2007. The highest rate schedule would go into effect if the June 30 cash balance were to drop below \$300.0 million. The tax rate schedule in effect for calendar years 2006 and 2005 is based on the Schedule of Cash Balance Related to Taxable Employers presented on page 27, and not on the fund equity balance presented in the financial statements on an accrual basis.

Benefit reimbursements declined by \$110.6 million between FY 2003-04 and FY 2004-05, primarily because the 100 percent federally funded Temporary Extended Unemployment Compensation program expired at the end of calendar year 2003. This program provided up to 13 additional weeks of unemployment benefits for claimants who had exhausted their regular unemployment benefits.

Nonoperating Revenues

As shown in Table E, the Fund's investment earnings decreased by \$12.7 million from June 30, 2004, to June 30, 2005, and by \$7.5 million from June 30, 2005, to June 30, 2006.

Table E

Nonoperating Revenues (In Millions)

	June 30, 2004	June 30, 2005	Change	June 30, 2006	Change
Investment Earnings	\$55.3	\$42.6	\$(12.7)	\$35.1	\$(7.5)

The decrease in investment earnings was due primarily to a decline in the Federal Unemployment Trust Fund earnings rate during FY 2004-05 and FY 2005-06. The rate declined from a high of 5.6 percent during the first quarter of calendar year 2005 to a low of 4.6 percent during the second quarter of calendar year 2006.

Expenses and Transfers

As shown in Table F, the Fund's operating expenses totaled \$844.9 million on June 30, 2005, and \$821.1 million on June 30, 2006.

Table F

Expenses and Transfers (In Millions)

	FY 2003-04	FY 2004-05	Change	FY 2005-06	Change
Benefits Paid on Behalf of:					
Taxable Employers	\$ 872.6	\$ 757.1	\$ (115.5)	\$ 744.4	\$ (12.7)
Other Entities	196.0	87.8	(108.2)	76.7	(11.1)
Total Operating Expenses	\$1,068.6	\$844.9	\$(223.7)	\$821.1	\$(23.8)
Transfer to Pay Administrative Expenses in General Fund and Other Nonoperating Expenses					
	\$ 7.0	\$4.1	\$(2.9)	\$1.7	\$(2.4)

The decrease in benefits paid on behalf of both taxable employers and other entities between FY 2003-04 and FY 2004-05 was primarily due to a decrease in the unemployment rate. The more stable economy during FY 2004-05 and FY 2005-06 resulted in approximately the same benefit payment levels during those years.

The \$4.1 million transfer during FY 2004-05 and the \$1.7 million transfer during FY 2005-06 represent Reed Act funds transferred to the State's General Fund for administrative expenses. The Unemployment Reserve Fund received a one-time federal Reed Act allocation of \$166.2 million during FY 2001-02, which can be used either to pay unemployment benefits or to pay administrative costs of the unemployment and employment service programs. As of June 30, 2006, the unspent and unobligated portion of the Reed Act allocation was \$151.0 million, which is available for the payment of unemployment benefits.

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Financial Statements ■

Balance Sheet
June 30, 2006 and 2005

	June 30, 2006	June 30, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3):		
Federal Unemployment Trust Fund	\$ 764,621,829	\$ 773,723,724
Cash in bank	1,901,450	1,017,045
Total Cash and Cash Equivalents	<u>766,523,279</u>	<u>774,740,769</u>
Employer Accounts Receivable:		
Taxable employers (net of allowance for doubtful collections of \$13,256,851 for 2006 and \$9,516,195 for 2005)	144,119,672	159,023,577
Governmental units and nonprofit organizations (net of allowance for doubtful collections of \$198,136 for 2006 and \$441,720 for 2005)	2,430,093	2,883,722
Combined Wage Claim Plan receivables	2,224,568	2,011,873
Net Current Employer Accounts Receivable	<u>148,774,333</u>	<u>163,919,172</u>
Other Receivables:		
Overpayments to claimants (net of allowance for doubtful collections of \$20,676,098 for 2006 and \$19,341,589 for 2005)	8,679,471	9,466,235
Federally funded unemployment benefit programs	152,552	332,937
Due from State of Wisconsin (Note 5)	22,545	14,823
Net Current Other Receivables	<u>8,854,568</u>	<u>9,813,995</u>
Total Current Assets	<u>924,152,180</u>	<u>948,473,936</u>
Noncurrent Assets:		
Taxable employer accounts receivable	3,387,355	8,670,020
Overpayments to claimants	11,724,882	12,917,681
Total Noncurrent Assets	<u>15,112,237</u>	<u>21,587,701</u>
TOTAL ASSETS	<u>\$ 939,264,417</u>	<u>\$ 970,061,637</u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Overdrafts (Note 3)	\$ 8,414,474	\$ 11,915,472
Benefits payable	14,915,168	13,378,664
Employer overpayments	7,169,030	5,280,702
Benefit overpayments due employers, other states, and federal government	2,833,394	3,739,875
Combined Wage Claim Plan liabilities	2,029,333	2,244,639
Advances under federal programs	2,420	263,144
Due to State of Wisconsin (Note 5)	8,535,327	9,423,288
Other	398,457	88,638
Total Current Liabilities	<u>44,297,603</u>	<u>46,334,422</u>
Fund Equity (Note 1):		
Employer accounts	1,245,967,739	1,133,229,854
Omnibus account	(501,965,035)	(362,126,447)
Reed Act allocations	150,964,110	152,623,808
Total Fund Equity	<u>894,966,814</u>	<u>923,727,215</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 939,264,417</u>	<u>\$ 970,061,637</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, 2006 and 2005**

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
OPERATING REVENUES		
Employer Contributions	\$ 679,464,388	\$ 671,849,898
Benefit Reimbursements (Note 4)	74,747,830	82,629,892
Forfeitures and Other Revenues	4,663,084	4,531,999
Total Operating Revenues	758,875,302	759,011,789
OPERATING EXPENSES		
Benefits Paid or Provided on Behalf of:		
Taxable employers	744,402,241	757,082,288
Governmental units, nonprofit organizations, and other organizations (Note 4)	74,747,830	82,629,892
Adjustment for allowance—claimants (Note 2E)	1,971,823	5,157,187
Total Operating Expenses	821,121,894	844,869,367
OPERATING LOSS	(62,246,592)	(85,857,578)
NONOPERATING REVENUES (EXPENSES)		
Investment earnings	35,145,888	42,641,717
INCOME (LOSS) BEFORE TRANSFERS	(27,100,704)	(43,215,861)
TRANSFERS		
Transfer to State of Wisconsin General Fund	(1,659,697)	(4,078,985)
NET CHANGE IN FUND EQUITY	(28,760,401)	(47,294,846)
Fund Equity at the Beginning of the Year	923,727,215	971,022,061
Fund Equity at the End of the Year (Note 1)	\$ 894,966,814	\$ 923,727,215

The accompanying notes are an integral part of this statement.

**Statement of Cash Flows
for the Years Ended June 30, 2006 and 2005**

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from:		
Employer contributions	\$ 701,909,871	\$ 655,607,883
Benefit reimbursements	75,151,908	83,593,455
Other operating revenues	4,647,936	4,375,260
Cash Payments for:		
Benefits	(819,047,224)	(838,959,820)
Net Cash Used by Operating Activities	(37,337,509)	(95,383,222)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers to State of Wisconsin General Fund	(2,524,872)	(3,595,112)
Cash Overdraft Implicitly Financed (Repaid)	(3,500,997)	(2,653,925)
Net Cash Used by Noncapital Financing Activities	(6,025,869)	(6,249,037)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment earnings	35,145,888	42,641,717
NET DECREASE IN CASH AND CASH EQUIVALENTS	(8,217,490)	(58,990,542)
Cash and Cash Equivalents at the Beginning of the Year	774,740,769	833,731,311
Cash and Cash Equivalents at the End of the Year	<u>\$ 766,523,279</u>	<u>\$ 774,740,769</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	\$ (62,246,592)	\$ (85,857,578)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Provision for uncollectible accounts	4,831,581	2,600,531
Changes to assets and liabilities:		
Decrease (Increase) in employer accounts receivables	16,930,431	(20,716,829)
Decrease (Increase) in other receivables	817,718	6,704,752
Increase (Decrease) in liabilities	2,329,353	1,885,902
Total Adjustments	24,909,083	(9,525,644)
Net Cash and Cash Equivalents Used by Operating Activities	\$ (37,337,509)	\$ (95,383,222)

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 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 Fund is administered by the State of Wisconsin Department of Workforce Development (DWD).

The Unemployment Insurance 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. 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. Omnibus Account

The Fund has an omnibus account that includes credits for solvency contributions, earnings 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. During the last few years, charges to this account exceeded credits, resulting in a deficit balance of \$362,126,447 as of June 30, 2005, and \$501,965,035 as of June 30, 2006.

C. Reed Act Allocations

Reed Act funds constitute \$152,623,807 of the June 30, 2005 fund equity and \$150,964,110 of the June 30, 2006 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 for proprietary funds. The Fund applies all applicable Governmental Accounting Standards Board statements. Financial Accounting Standards Board 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 revenues that are not related to the Fund's principal operation, such as investment earnings, are reported as nonoperating revenue.

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, allowances for doubtful collections are 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. In addition, 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 \$3.4 million on June 30, 2006, and \$8.7 million on June 30, 2005.

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 2005-06, the Fund wrote off as uncollectible \$243,571 in amounts receivable from nonprofit organizations. FY 2004-05 write-offs totaled \$41,973. All receivables, net of the allowance, are expected to be collected within 12 months. Beginning in FY 2006-07, amounts receivable from nonprofit organizations written off as uncollectible will be recovered through a statutory assessment against active nonprofit employers who have elected reimbursement financing.

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 \$11.7 million on June 30, 2006, and \$12.9 million on June 30, 2005.

F. Reed Act Funding

The Fund's total cash and cash equivalents balance on June 30, 2006, and June 30, 2005, includes Reed Act funds of \$158,164,364 and \$160,763,125, respectively. Of this balance, \$7,274,142 on June 30, 2006, and \$8,139,317 on June 30, 2005, 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 "Due to State of Wisconsin" on the Balance Sheet.

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. DEPOSITS

Deposits include cash and cash equivalents on deposit in banks or other financial institutions, and nonnegotiable certificates of deposit. The majority of the Fund's cash and cash equivalents consist of deposits with the Federal Unemployment Trust Fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act. The Federal Unemployment 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 Federal Unemployment Trust Fund exceeds the Fund's outstanding advances from the Trust Fund, as computed on a daily basis. The deposit with the Federal Unemployment Trust Fund is not categorized in accordance with the criteria under GASB Statement No. 40, *Deposit and Investment Risk Disclosures—an Amendment of GASB Statement No. 3*, because the Trust Fund is neither a deposit with a financial institution nor an investment.

The remainder of the Fund's cash and cash equivalents are deposits in three separate bank accounts: the contribution account, the benefit account, and the benefit special account. The contribution account had a book balance (carrying amount) of \$1,091,450 at June 30, 2006, and \$1,017,045 at

June 30, 2005, which is reported as cash and cash equivalents. The carrying amount of the Fund's other two bank accounts at June 30, 2006 and 2005, totaled (\$8,414,474) and (\$11,915,472), respectively. Since the carrying amount is negative, it is reported as an overdraft on the Balance Sheet.

For deposits held in financial institutions, custodial credit risk is the risk that in the event of a failure of a depository financial institution, deposits may not be returned. The Fund does not have a policy over custodial credit risk. All of the deposits that are held in financial institutions are insured up to \$100,000 by the Federal Deposit Insurance Corporation. The State of Wisconsin Public Deposit Guarantee fund insures up to \$400,000 above the amount of federal insurance. The following amounts of the Fund's bank balances of \$2,093,224 as of June 30, 2006, and \$2,549,513 as of June 30, 2005, were exposed to custodial credit risk:

	<u>FY 2005-06</u>	<u>FY 2004-05</u>
Uninsured and uncollateralized	\$1,593,224	\$2,049,513

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 2005-06</u> <u>(In Millions)</u>	<u>FY 2004-05</u> <u>(In Millions)</u>
Benefits reimbursed by the federal government under various unemployment benefit programs	\$18.5	\$24.4
Benefits reimbursed by the federal government for former federal employees	11.3	10.3
Benefits reimbursed by the State of Wisconsin, electing local governmental units, and electing nonprofit organizations for former employees	36.6	39.0
Benefits reimbursed by other states under the Combined Wage Claim Plan	<u>8.3</u>	<u>8.9</u>
Total	<u>\$74.7</u>	<u>\$82.6</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, 2006 and 2005**

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Cash and Cash Equivalents	\$ 766,523,279	\$ 774,740,769
Overdrafts	(8,414,474)	(11,915,471)
Net Cash Balance	<u>758,108,805</u>	<u>762,825,298</u>
Adjustments:		
Accounts receivable balance related to reimbursable employers and other states (Note 1A)	4,902,687	5,243,235
Net benefits to be refunded to federal unemployment benefit programs (Note 1B)	(76,031)	(263,144)
Employer tax overpayments (Note 1C)	(7,169,030)	(5,280,702)
Reed Act funds obligated for administration (Note 1D)	(7,274,143)	(8,139,318)
Other activities (Note 1E)	(1,328,171)	(1,357,671)
Cash Balance Related to Taxable Employers	<u><u>\$ 747,164,117</u></u>	<u><u>\$ 753,027,698</u></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, 2006 and 2005, 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 B was in effect during 2006 because the June 30, 2005 taxable employer cash balance was \$753,027,698, which is greater than the \$300 million but less than the \$900 million level specified in Wisconsin Statutes. Tax rate schedule B will again be in effect during 2007 because the June 30, 2006 balance was \$747,164,117. 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 reduced by the net amount of benefit payments to be refunded to federal unemployment benefit programs.

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- 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, 2006 and 2005, and have issued our report thereon dated January 26, 2007. 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.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, 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 discussed certain other matters, including matching data on unemployment benefits and prisoners in the custody of the State, in a separate audit communication to the management of the Unemployment Reserve Fund.

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 26, 2007

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Audit Director