

An Audit

Unemployment Reserve Fund

Department of Workforce Development

2009-2010 Joint Legislative Audit Committee Members

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Janice Mueller
State Auditor

January 27, 2009

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Vinehout and Representative Barca:

At the request of the Department of Workforce Development and to meet our audit responsibilities under s. 13.94, Wis. Stats., we have audited the financial statements of the State of Wisconsin Unemployment Reserve Fund, which funds unemployment benefits paid to eligible workers, primarily through taxes paid by employers. The Unemployment Reserve Fund operates on a fiscal year that ends June 30. This audit report contains our unqualified opinion on financial statements and related notes for the years ended June 30, 2008 and 2007. During our audit period, the seasonally adjusted unemployment rate ranged between 4.3 percent and 5.1 percent, and unemployment benefit payments exceeded employer payments to the Unemployment Reserve Fund.

As a result, the Fund's balance has continued to decline from its high of \$1.9 billion as of June 30, 2000. As of June 30, 2008, the Unemployment Reserve Fund balance was \$608.8 million. It has continued to decline after that date, and as of November 30, 2008, \$312.0 million was available to pay benefits. The Department expects that the Fund's cash balances will be depleted in February 2009, at which time borrowed federal funds will be needed in order to continue unemployment benefit payments.

2007 Wis. Act 59 included several provisions to strengthen the Unemployment Reserve Fund, including increasing the amount of wages subject to unemployment taxes starting in calendar year 2009, with additional increases in 2011 and 2013. However, given current economic conditions, it is unclear whether anticipated increases in revenues from the taxes paid by employers will be sufficient to restore the Fund's balances, and further changes may be needed to increase employer taxes or reduce unemployment benefit payments.

Accompanying the financial statements is the Schedule of Cash Balance Related to Taxable Employers, which is used to determine the tax rate paid by employers. Section 108.18(3m), Wis. Stats., 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. Consequently, the second-highest of four tax rate schedules will continue to be applied in calendar year 2009.

We appreciate the courtesy and cooperation extended to us by Department of Workforce Development 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, 2008 and 2007, as listed in the table of contents. 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, 2008 and 2007, 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 11 is presented for purposes of additional analysis and is not a required part of the financial statement. 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, 2008 and 2007. 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.

The Unemployment Reserve Fund's balance declined from \$895.0 million as of June 30, 2006, to \$608.8 million as of June 30, 2008, or by \$286.2 million. Subsequent to June 30, 2008, the Unemployment Reserve Fund's balance continued to decline because unemployment benefit payments continued to exceed revenues. If the Fund's resources are depleted, the Fund will need to borrow from the federal government in order to continue paying benefits.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 12, 2009, on our consideration of the Unemployment Reserve Fund's internal control over financial reporting; 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 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 12, 2009

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Deputy State Auditor for Financial Audit

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, 2008 and 2007. The financial statements, notes, and this discussion are the responsibility of management of the Fund.

Financial Summary (Highlights)

The assets of the Unemployment Reserve Fund exceeded liabilities at the close of fiscal year (FY) 2007-08 by approximately \$608.8 million. With the exception of \$145.7 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 \$286.2 million during the two-year period from July 1, 2006, through June 30, 2008. Benefits paid to unemployed workers significantly exceeded unemployment taxes paid by employers during both fiscal years. In addition, benefit payments increased each fiscal year compared to the previous fiscal year.

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 130,000 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 earnings on the Trust Fund may be used only to pay benefits. With the exception of federal Reed Act allocations, the Fund's reserves may 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, may be used either to pay benefits or to pay costs associated with administering the Unemployment Insurance program and/or employment service programs. If the Fund exhausts all of its reserves, it may 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 may not be funded from employer taxes.

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 2007-08 and FY 2006-07. The Balance Sheet reports the Fund's assets and liabilities. 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 provides 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 \$115.4 million between June 30, 2006, and June 30, 2007, and by \$169.2 million between June 30, 2007, and June 30, 2008.

Table A

Assets
(in millions)

	June 30, 2006	June 30, 2007	Change	June 30, 2008	Change
Cash and Cash Equivalents	\$766.6	\$659.9	\$(106.7)	\$462.9	\$(197.0)
Receivables	172.7	164.0	(8.7)	191.8	27.8
Total Assets	\$939.3	\$823.9	\$(115.4)	\$654.7	\$(169.2)

Cash and cash equivalents decreased by \$106.7 million during FY 2006-07, and by \$197.0 million during FY 2007-08. These decreases reflect the recent trend of increasing levels of unemployment benefits without a corresponding increase in unemployment taxes collected from employers.

The \$27.8 million increase in the receivable balance between FY 2006-07 and FY 2007-08 is mainly attributed to an increase in delinquent employer tax receivables.

Liabilities

As shown in Table B, the Fund's liabilities totaled \$40.1 million on June 30, 2007, and \$45.9 million on June 30, 2008.

Table B

Liabilities
(in millions)

	June 30, 2006	June 30, 2007	Change	June 30, 2008	Change
Overdrafts	\$ 8.4	\$ 8.7	\$ 0.3	\$16.1	\$ 7.4
Benefits Payable	14.9	14.9	0.0	10.4	(4.5)
Other Liabilities	21.0	16.5	(4.5)	19.4	2.9
Total Liabilities	\$44.3	\$40.1	\$(4.2)	\$45.9	\$5.8

Bank account overdrafts of \$8.7 million as of June 30, 2007, and \$16.1 million as of June 30, 2008, 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 \$7.4 million increase in the overdraft amount from June 30, 2007, to June 30, 2008, resulted from an increase in the number of benefit checks issued near the end of FY 2007-08.

Fund Equity

As shown in Table C, the Fund's equity decreased by \$111.1 million between June 30, 2006, and June 30, 2007, and by \$175.1 million between June 30, 2007, and June 30, 2008.

Table C

Fund Equity
(in millions)

	June 30, 2006	June 30, 2007	Change	June 30, 2008	Change
Employer Accounts	\$1,246.0	\$ 1,269.7	\$ 23.7	\$1,260.7	\$ (9.0)
Omnibus Account	(502.0)	(637.1)	(135.1)	(797.6)	(160.5)
Reed Act Allocations	151.0	151.3	0.3	145.7	(5.6)
Total Fund Equity	\$ 895.0	\$ 783.9	\$ (111.1)	\$ 608.8	\$(175.1)

Charges to the omnibus account during each fiscal year significantly exceeded revenues credited to the account. Most revenues are generated through employer "solvency" tax payments and interest earnings from balances maintained in the Federal Unemployment Trust Fund. A number of statutory provisions require certain benefit payments to be charged to the omnibus account rather than directly to an employer's account. For example, benefits paid to former employees of closed employers are charged to the omnibus account. As a result, \$134.3 million in benefit payments were charged directly to the account during FY 2007-08, and \$128.6 million in FY 2006-07. 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 \$167.9 million during FY 2007-08 and \$150.7 million during FY 2006-07. In addition, positive and negative balances in the accounts of out-of-business employers or employers no longer covered under unemployment insurance law are transferred to the omnibus account.

2007 Wisconsin Act 59 was enacted in response to the Unemployment Insurance Advisory Council's recommendations. This legislation included increases in the taxable wage base in calendar years 2009, 2011, and 2013. The taxable wage base will increase in increments from the present \$10,500 to \$14,000 in 2013. 2007 Wisconsin Act 59 also included a provision to increase the employer's solvency tax payment, which is credited to the omnibus account. For employers with a positive account balance, the solvency tax rate will increase by 0.2 percent. For employers with a negative account balance, the increase will be 0.4 percent. These increases are offset by an equal decrease in the employer's basic tax rate (that portion of the total tax payment credited to the employer's account balance).

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 since FY 2005-06.

Table D

Operating Revenues
(in millions)

	FY 2005-06	FY 2006-07	Change	FY 2007-08	Change
Employer Contributions	\$679.5	\$655.2	\$(24.3)	\$671.7	\$16.5
Benefit Reimbursements	74.7	77.8	3.1	77.3	(0.5)
Forfeitures and Other Revenues	4.7	4.8	0.1	5.3	0.5
Total Operating Revenues	\$758.9	\$737.8	\$(21.1)	\$754.3	\$16.5

There were no significant increases or decreases in the amounts of employer contributions during FY 2006-07 and FY 2007-08. This is primarily because the same tax rate schedules were in effect during the three-year period shown and because there were no significant increases or decreases in taxable payroll reported by employers.

An employer's annual tax rate can change from year to year depending on its unemployment experience. In addition, the rate schedule in use during any calendar year can change depending on the overall cash balance in the Unemployment Reserve Fund on June 30 of the previous year. Since the Fund's cash balance on June 30, 2006, and June 30, 2007, was between \$300 million and \$900 million, the second-highest of four statutory rate schedules was in effect during calendar years 2007 and 2008.

Nonoperating Revenues

As shown in Table E, the Fund's investment earnings decreased by \$1.7 million from June 30, 2006, to June 30, 2007, and by \$6.3 million from June 30, 2007, to June 30, 2008.

Table E

Nonoperating Revenues (in millions)

	FY 2005-06	FY 2006-07	Change	FY 2007-08	Change
Investment Earnings	\$35.1	\$33.4	\$(1.7)	\$27.1	\$(6.3)

The decrease in investment earnings was primarily because of a decline in the amount invested in the Federal Unemployment Trust Fund during FY 2006-07 and FY 2007-08. While the quarterly yield grew slightly from 4.65 percent in the third quarter of 2006 to 4.83 percent in the second quarter of 2008, the amount invested declined from \$764.6 million on June 30, 2006, to \$461.3 million on June 30, 2008.

Expenses and Transfers

As shown in Table F, the Fund's operating expenses totaled \$882.6 million on June 30, 2007, and \$950.8 million on June 30, 2008.

Table F

Expenses and Transfers (in millions)

	FY 2005-06	FY 2006-07	Change	FY 2007-08	Change
Benefits Paid on Behalf of:					
Taxable Employers	\$ 744.4	\$ 804.0	\$ 59.6	\$ 872.9	\$ 68.9
Other Entities	76.7	78.6	1.9	77.9	(0.7)
Total Operating Expenses	\$821.1	\$882.6	\$61.5	\$950.8	\$68.2
Transfer to Pay Administrative Expenses in General Fund and Other Nonoperating Expenses	\$1.7	\$(0.3)	\$(2.0)	\$5.6	\$5.9

The increase in benefits paid on behalf of taxable employers between FY 2005-06 and FY 2007-08 was primarily due to an increase in the unemployment rate. The seasonally adjusted unemployment rate in Wisconsin ranged from 4.3 percent to 5.1 percent during this period.

Currently Known Facts and Decisions

The Unemployment Reserve Fund cash balance has declined to \$334.6 million as of November 30, 2008. Of that amount, \$312.0 million is available to pay benefits.

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Financial Statements ■

Balance Sheet
June 30, 2008 and 2007

	June 30, 2008	June 30, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3):		
Federal Unemployment Trust Fund	\$ 461,291,522	\$ 658,307,048
Cash in bank	1,651,760	1,590,858
Total Cash and Cash Equivalents	<u>462,943,282</u>	<u>659,897,906</u>
Employer Accounts Receivable:		
Taxable employers (net of allowance for doubtful collections of \$17,022,926 for 2008 and \$14,203,701 for 2007)	144,480,517	134,415,514
Governmental units and nonprofit organizations (net of allowance for doubtful collections of \$100,000 for 2008 and \$200,000 for 2007)	3,022,104	2,339,536
Combined Wage Claim Plan receivables	<u>2,801,289</u>	<u>2,733,613</u>
Net Current Employer Accounts Receivable	<u>150,303,910</u>	<u>139,488,663</u>
Other Receivables:		
Overpayments to claimants (net of allowance for doubtful collections of \$20,896,935 for 2008 and \$20,911,367 for 2007)	7,467,996	7,890,279
Federally funded unemployment benefit programs	356,525	279,984
Due from State of Wisconsin (Note 5)	<u>12,516</u>	<u>27,735</u>
Net Current Other Receivables	<u>7,837,037</u>	<u>8,197,998</u>
Total Current Assets	<u>621,084,229</u>	<u>807,584,567</u>
Noncurrent Assets:		
Taxable employer accounts receivable	22,191,548	4,717,283
Overpayments to claimants	<u>11,447,887</u>	<u>11,621,174</u>
Total Noncurrent Assets	<u>33,639,435</u>	<u>16,338,457</u>
TOTAL ASSETS	<u>\$ 654,723,664</u>	<u>\$ 823,923,024</u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Overdrafts (Note 3)	\$ 16,113,413	\$ 8,706,450
Benefits payable	10,407,534	14,927,425
Employer overpayments	6,407,463	6,972,637
Benefit overpayments due employers, other states, and federal government	2,185,560	2,533,629
Combined Wage Claim Plan liabilities	3,786,629	2,271,607
Advances under federal programs	28,710	318,161
Due to State of Wisconsin (Note 5)	6,626,924	4,165,251
Other	<u>297,979</u>	<u>176,348</u>
Total Current Liabilities	<u>45,854,212</u>	<u>40,071,508</u>
Fund Equity (Note 1):		
Employer accounts	1,260,732,236	1,269,726,405
Omnibus account	(797,570,243)	(637,143,824)
Reed Act allocations	<u>145,707,459</u>	<u>151,268,935</u>
Total Fund Equity	<u>608,869,452</u>	<u>783,851,516</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 654,723,664</u>	<u>\$ 823,923,024</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, 2008 and 2007**

	For the Year Ended June 30, 2008	For the Year Ended June 30, 2007
OPERATING REVENUES		
Employer Contributions	\$ 671,744,064	\$ 655,188,243
Benefit Reimbursements (Note 4)	77,283,442	77,828,677
Forfeitures and Other Revenues	5,252,512	4,783,648
Total Operating Revenues	754,280,018	737,800,568
OPERATING EXPENSES		
Benefits Paid or Provided on Behalf of:		
Taxable employers	872,940,089	804,001,174
Governmental units, nonprofit organizations, and other organizations (Note 4)	77,188,715	77,921,279
Adjustment for allowance—claimants (Note 2E)	704,141	699,105
Total Operating Expenses	950,832,945	882,621,558
OPERATING LOSS	(196,552,927)	(144,820,990)
NONOPERATING REVENUES (EXPENSES)		
Investment Earnings	27,132,339	33,400,868
INCOME (LOSS) BEFORE TRANSFERS	(169,420,588)	(111,420,122)
TRANSFERS		
Transfer to State of Wisconsin General Fund	(5,561,476)	304,824
NET CHANGE IN FUND EQUITY	(174,982,064)	(111,115,298)
Fund Equity at the Beginning of the Year	783,851,516	894,966,814
Fund Equity at the End of the Year (Note 1)	\$ 608,869,452	\$ 783,851,516

The accompanying notes are an integral part of this statement.

**Statement of Cash Flows
for the Years Ended June 30, 2008 and 2007**

	For the Year Ended June 30, 2008	For the Year Ended June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from:		
Employer contributions	\$ 643,381,211	\$ 663,179,435
Benefit reimbursements	76,119,778	77,750,334
Other operating revenues	5,239,732	4,711,290
Cash Payments for:		
Benefits	(953,163,157)	(881,726,830)
Net Cash Used by Operating Activities	(228,422,436)	(136,085,771)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers to State of Wisconsin General Fund	(3,071,490)	(4,232,447)
Cash Overdraft Implicitly Financed (Repaid)	7,406,963	291,977
Net Cash Used by Noncapital Financing Activities	4,335,473	(3,940,470)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Earnings	27,132,339	33,400,868
NET DECREASE IN CASH AND CASH EQUIVALENTS	(196,954,624)	(106,625,373)
Cash and Cash Equivalents at the Beginning of the Year	659,897,906	766,523,279
Cash and Cash Equivalents at the End of the Year	<u>\$ 462,943,282</u>	<u>\$ 659,897,906</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	\$ (196,552,927)	\$ (144,820,990)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Provision for uncollectible accounts	2,704,793	1,183,982
Changes to assets and liabilities:		
Decrease (Increase) in employer accounts receivables	(31,008,738)	7,007,029
Decrease (Increase) in other receivables	548,680	525,009
Increase (Decrease) in liabilities	(4,114,244)	19,199
Total Adjustments	(31,869,509)	8,735,219
Net Cash and Cash Equivalents Used by Operating Activities	\$ (228,422,436)	\$ (136,085,771)

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 omnibus account primarily accounts for solvency contributions from employers and earnings from deposits with the Federal Unemployment Trust Fund. Charges to this account primarily include benefit payments that statutorily cannot be charged to a specific employer's account, such as benefits paid relating to out-of-business employers or benefits paid to certain employees who voluntarily terminate employment. In addition, the omnibus account is charged for a portion of benefits previously charged to the accounts of certain employers who are at the maximum tax rate.

C. Reed Act Allocations

Reed Act funds are 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 (GASB) 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 of accounting, 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 \$22.2 million on June 30, 2008, and \$4.7 million on June 30, 2007.

D. Amounts Receivable from Governmental Units and Nonprofit Organizations

The federal government, the State of Wisconsin, electing local governmental units, and electing nonprofit organizations are referred to as "reimbursable employers" because they reimburse the Fund for benefits charged to their accounts, rather than contribute in advance of benefit payments. 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 2007-08, the Fund wrote off as uncollectible \$5,274 in amounts receivable from nonprofit organizations. FY 2006-07 write-offs totaled \$90,738. All receivables, net of the allowance, are expected to be collected within 12 months. Amounts receivable from nonprofit organizations written off as uncollectible are 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 \$11.4 million on June 30, 2008, and \$11.6 million on June 30, 2007.

F. Reed Act Funding

The Fund's total cash and cash equivalents balances on June 30, 2008, and June 30, 2007, include Reed Act funds of \$150,934,316 and \$154,005,806, respectively. Of these balances, \$5,226,857 on June 30, 2008, and \$2,736,871 on June 30, 2007, were not available for the payment of benefits, since those amounts had 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 all 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, if any, 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 consists of 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 \$1,651,760 at June 30, 2008, and \$1,590,858 at June 30, 2007, which is reported as cash and cash equivalents. The carrying amounts of the Fund’s other two bank accounts at June 30, 2008 and 2007, totaled (\$16,113,413) and (\$8,706,450), respectively. Since those amounts are negative, they are reported as overdrafts 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 \$2,365,340 as of June 30, 2008, and \$1,472,833 as of June 30, 2007, were exposed to custodial credit risk:

	<u>FY 2007-08</u>	<u>FY 2006-07</u>
Uninsured and uncollateralized	\$1,865,340	\$972,833

4. BENEFIT REIMBURSEMENTS

The amounts reported as benefits paid or provided on behalf of governmental units, nonprofit organizations, and other organizations, as well as 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 adjustments for uncollectible reimbursements, are summarized in the following table.

<u>Type of Benefit</u>	<u>FY 2007-08 (in millions)</u>	<u>FY 2006-07 (in millions)</u>
Benefits reimbursed by the federal government under various unemployment benefit programs	\$18.8	\$18.3
Benefits reimbursed by the federal government for former federal employees	11.4	13.0
Benefits reimbursed by the State of Wisconsin, electing local governmental units, and electing nonprofit organizations for former employees	35.7	36.3
Benefits reimbursed by other states under the Combined Wage Claim Plan	11.3	10.3
Bad debt expense for reimbursable employers	<u>.1</u>	<u>(.1)</u>
Total	<u>\$77.3</u>	<u>\$77.8</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 a program revenue appropriation 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.



Supplementary Information Schedule ■

**Schedule of Cash Balance Related to Taxable Employers
June 30, 2008 and 2007**

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Cash and Cash Equivalents	\$ 462,943,282	\$ 659,897,906
Overdrafts	(16,113,413)	(8,706,450)
Net Cash Balance	<u>446,829,869</u>	<u>651,191,456</u>
Adjustments:		
Accounts receivable balance related to reimbursable employers and other states (Note 1A)	6,192,434	5,380,868
Net benefits to be refunded to federal unemployment benefit programs (Note 1B)	(37,104)	(379,255)
Employer tax overpayments (Note 1C)	(6,407,464)	(6,972,637)
Reed Act funds obligated for administration (Note 1D)	(5,226,857)	(2,736,871)
Other activities (Note 1E)	(1,716,413)	(1,526,124)
Cash Balance Related to Taxable Employers	<u>\$ 439,634,465</u>	<u>\$ 644,957,437</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, 2008 and 2007, 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 2008 because the June 30, 2007 taxable employer cash balance was \$644,957,437, which is greater than \$300 million but less than the \$900 million level specified in Wisconsin Statutes. Tax rate schedule B will again be in effect during 2009 because the June 30, 2008 balance was \$439,634,465. 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 overpayments recovered but not yet 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 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, 2008 and 2007, and have issued our report thereon dated January 12, 2009. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Unemployment Reserve Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Unemployment Reserve Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant

deficiencies that are also considered material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We identified one deficiency which we consider to be a significant deficiency in internal control over financial reporting.

The Unemployment Reserve Fund did not properly report reserve account balances related to employers no longer subject to unemployment insurance (UI) tax. When an employer is considered subject to UI tax, a separate reserve account is maintained for that employer. If an employer is no longer subject to UI tax, the employer's reserve account balance is transferred to the omnibus account, which is used for, among other things, paying benefits that statutorily are not charged to an employer's account.

Both the employer accounts and the omnibus account are separately reported in the financial statements as part of the Unemployment Reserve Fund's equity. While staff periodically run a computer program to transfer to the omnibus account the account balances of employers no longer subject to UI tax, Unemployment Reserve Fund procedures do not require that this process be done as of June 30, the end of the fiscal year. Because this program was last run in September 2007, the most up-to-date information was not used when preparing the Unemployment Reserve Fund's financial statements. Based on information we requested, the omnibus account balance should have been reported as negative \$797.6 million (-\$797.6 million) at June 30, 2008, but was instead initially reported as negative \$791.0 million (-\$791.0 million). Similarly, the omnibus account should have been reported as approximately negative \$637.1 million (-\$637.1 million) at June 30, 2007, but instead was initially reported at negative \$629.0 million (-\$629.0 million).

Unemployment Reserve Fund management corrected these errors and noted that in the future, the program that identifies account balances to transfer between equity accounts will be run immediately prior to the end of the fiscal year.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We do not believe that the significant deficiency described above is a material weakness.

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 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 additional matters that we reported to management of the Unemployment Reserve Fund in a separate letter.

The Unemployment Reserve Fund's written response to the finding identified is described in our discussion of internal control over financial reporting. We did not audit the Unemployment Reserve Fund's response and, accordingly, express no opinion on it.

This independent auditor's report is intended for the information and use of the Unemployment Reserve Fund's management and the Wisconsin Legislature. This report is a matter of public record and its distribution is not limited. However, because we do not express an opinion on the effectiveness of the Unemployment Reserve Fund's internal control or on compliance, this report is not intended to be used by anyone other than these specified parties.

January 12, 2009

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Deputy State Auditor for Financial Audit