

AN AUDIT

Unemployment Reserve Fund

Department of Workforce Development

02-22

December 2002

2001-2002 Joint Legislative Audit Committee Members

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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December 20, 2002

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Leibham:

We have completed a financial audit of the State of Wisconsin Unemployment Reserve Fund for the years ended June 30, 2002 and 2001. 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. During fiscal year 2001-02, unemployment benefit payments exceeded employer contributions and other operating revenues, resulting in an operating loss of \$392 million. This loss was partially offset by a one-time distribution from the federal government of \$166 million in previously paid federal unemployment taxes. These funds, which may be used to pay certain unemployment benefits as well as administrative costs of the unemployment insurance program and employment services offices, currently remain in the Unemployment Reserve Fund.

Accompanying the financial statements is the Schedule of Cash Balance Related to Taxable Employers. As shown in the schedule, the cash balance declined \$236 million from \$1.71 billion as of June 30, 2001, to \$1.47 billion as of June 30, 2002. This cash balance, which includes the \$166 million distribution from the federal government, is used to determine the tax rate schedule that applies to taxable employers. Section 108.18(3m), Wis. Stats., currently allows the lowest tax rate to be applied when the cash balance as of June 30 is at least \$1.2 billion. Because the June 30, 2002, cash balance is in excess of \$1.2 billion, the lowest tax rate schedule will continue to be applied for taxable employers during calendar year 2003.

The Unemployment Reserve Fund implemented new financial reporting requirements of Governmental Accounting Standards Board Statement Number 34. As a result, included in this report on pages 5-8 are Management's Discussion and Analysis, which were prepared by the management of the Unemployment Reserve Fund and provide its analysis of the financial statements.

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

Respectfully submitted,

A handwritten signature in cursive script that reads 'Janice Mueller'.

Janice Mueller
State Auditor

JM/BN/ss

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

We have audited the accompanying balance sheet of the State of Wisconsin Unemployment Reserve Fund as of June 30, 2002 and 2001, and the related statement of revenues, expenses, and changes in fund equity and statement of cash flows for the years then ended. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States 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 audit 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 audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Unemployment Reserve Fund and are not intended to present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Wisconsin Unemployment Reserve Fund as of June 30, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

For fiscal years 2001-02 and 2000-01, the Unemployment Reserve Fund implemented Governmental Accounting Standards Board Statement Number 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as discussed in Note 5 to the financial statements.

Our audit was made for the purpose of forming an opinion on the Unemployment Reserve Funds' basic financial statements taken as a whole. Management's Discussion and Analysis on pages 5 through 8 is not a required part of the basic financial statements but is supplementary information. 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 19, 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, 2002 and 2001. This cash balance is used to determine the unemployment tax rate schedule for the following calendar year. This supplementary information is not a required part of the basic financial statements. The Schedule of Cash Balance Related to Taxable Employers has been subjected to the procedures applied in the audit of the basic financial statements and, in our opinion, is presented fairly in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 16, 2002, on our consideration of the Unemployment Reserve Fund's internal control over financial reporting and our tests of its compliance with laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

December 16, 2002

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 is intended to provide users of the State of Wisconsin Unemployment Reserve Fund's financial statements with a narrative overview of the statements, as well as an analysis of some key data presented in the statements.

Financial Highlights

The assets of the Unemployment Reserve Fund exceeded liabilities at the close of fiscal year (FY) 2001-02 by approximately \$1.6 billion. With the exception of \$166 million in federal Reed Act allocations, these assets can only be used to pay unemployment benefits to eligible unemployed persons.

During FY 2001-02, the Fund's equity decreased by \$226 million. This is largely attributable to increased benefits payments due to an increase in Wisconsin's unemployment rate.

Overview of the Financial Statements

These annual financial statements for the Unemployment Reserve Fund are intended to show the Fund's financial position, results of operations, and cash flows for FYs 2000-01 and 2001-02. The Fund was established under ch. 108, Wis. Stats., to account for contributions received from employers and benefits paid to unemployed workers. The principal source of revenue for the Fund is quarterly unemployment taxes (contributions) paid by the 122,000 employers subject to the taxing provisions of the unemployment insurance law. The Fund also earns interest on its reserves, which are required to be held in the Federal Unemployment Trust Fund. With the exception of Reed Act allocations, the Unemployment Reserve Fund's reserves can only be used to pay unemployment benefits or to refund tax overpayments to employers. 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 loan situations, any federal borrowing carries interest charges. The interest payments cannot be funded from contributions collected from employers.

Even though all accounting for the Fund is done outside of the State of Wisconsin's central accounting system, the Fund is reported as an enterprise fund in the State's basic financial statements included in Wisconsin's Comprehensive Annual Financial Report. The administrative costs of the unemployment insurance program and the associated federal unemployment tax revenue used to fund administrative costs are not reported within the Unemployment Reserve Fund's financial statements. As an enterprise fund, the Fund's financial statements are prepared using the economic resources measurement focus and the full accrual basis of accounting. Under the economic resources

measurement focus, all assets and liabilities associated with an activity are included in the balance sheet. Under the full accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred. The financial statements include a balance sheet, a statement of revenues, expenses, and changes in fund equity, and a statement of cash flows. The balance sheet reports all financial and capital resources. The statement of revenues, expenses, and changes in fund equity reports all of the Unemployment Reserve Fund's revenues and expenses 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 year. This statement also profiles a reconciliation of the changes in operating income to the net cash flow from operating activities.

Financial Analysis

As shown in Table 1, the Fund's equity was \$1,812 million as of June 30, 2001, and \$1,586 million as of June 30, 2002.

Table 1

Wisconsin Unemployment Reserve Fund Equity
(in millions)

	<u>June 30, 2002</u>	<u>June 30, 2001</u>
Cash and Investments	\$1,486	\$1,715
Receivables and Other	<u>144</u>	<u>131</u>
Total Assets	1,630	1,846
Less: Total Liabilities	<u>44</u>	<u>34</u>
Fund Equity	\$1,586	\$1,812

As shown in Table 2, the Fund's equity decreased by \$226 million or 12 percent between June 30, 2001, and June 30, 2002. Although total revenue increased by \$246 million (41 percent) during FY 2001-02, employer contributions decreased by \$4 million.

Table 2

Wisconsin Unemployment Reserve Fund
Changes in Fund Equity
(in millions)

<u>Revenues</u>	<u>FY 2001-02</u>	<u>FY 2000-01</u>	<u>Change</u>	<u>% Change</u>
Employer Contributions	\$ 432	\$ 436	\$ (4)	(1)%
Benefit Reimbursements	144	44	100	227
Interest Earnings	99	116	(17)	(15)
Reed Act Allocations	166	0	166	n/a
Other Revenues	<u>5</u>	<u>4</u>	<u>1</u>	25
Total Revenues	846	600	246	41
 <u>Expenses</u>				
Benefit Payments	1,073	696	377	54
Bad Debt Expense	<u>(1)</u>	<u>2</u>	<u>(3)</u>	(150)
Total Expenses	<u>1,072</u>	<u>698</u>	<u>374</u>	54
Net Change in Fund Equity	(226)	(98)	(128)	131
 Fund Equity, Beginning of Year	 <u>1,812</u>	 <u>1,910</u>	 <u>(98)</u>	 (5)
Fund Equity, End of Year	\$1,586	\$1,812	\$(226)	(12)

During FY 2001-02, the Fund received a one-time federal Reed Act allocation of \$166 million. The Reed Act money represents Wisconsin's share of an \$8 billion federal allocation of excess federal unemployment tax payments made over time to the Federal Unemployment Trust Fund. This allocation was made in accordance with federal law, and the funds may be used to either pay state unemployment benefits or to pay for the cost of administering the unemployment insurance and/or employment service programs at the state level. In accordance with federal law, any of these funds used for administration must be appropriated by the State Legislature and enacted into law.

Benefit reimbursements increased during FY 2001-02, largely due to an \$85 million reimbursement from the federal government for benefits paid under the Federal Temporary Extended Unemployment Compensation Program. The Federal Temporary Extended Unemployment Compensation Program provides up to 13 additional weeks of 100 percent federally funded benefits in states that are experiencing high unemployment rates. The \$17 million decrease in interest earnings during FY 2001-02 resulted from a slight decrease in the earnings rate from 6.52 percent to 6.36 percent and the reduced level of reserves held in the Federal Unemployment Trust Fund.

The \$377 million (54 percent) increase in benefit payments during FY 2001-02 was caused by a number of factors. As mentioned above, the Federal Temporary Extended Unemployment Compensation Program was enacted in March 2002. This resulted in paying extended benefits totaling \$85 million during FY 2001-02. This did not result in a decrease in the Unemployment Reserve Fund's equity because the federal government reimbursed the Fund for 100 percent of these benefit payments. Benefit payments made with Fund assets totaled \$929 million during FY 2001-02, compared with \$652 million during FY 2000-01. This 42 percent increase in benefit payments is largely attributable to an increase in the State's unemployment rate.

Although the Fund's equity totaled \$1.6 billion on June 30, 2002, a continued high rate of unemployment would continue to reduce this balance. Wisconsin's unemployment insurance law contains a number of provisions that help to limit the negative impact of continued high benefit payments. The rate at which an employer pays contributions can increase from year to year depending on the level of layoffs experienced by that individual employer. Tax rates for employers currently range from a low of zero percent to a high of 9.75 percent of taxable payroll. Only the first \$10,500 of payroll is taxed annually.

The law currently contains four progressively higher tax rate schedules. The schedule in effect for a particular calendar year is based on the Fund's cash balance attributable to taxable employers on June 30 of the previous year. The highest rates are in effect when the cash balance on June 30 of the previous year is under \$300 million. The lowest rates are in effect when the balance is in excess of \$1.2 billion. According to the Schedule of Cash Balance Related to Taxable Employers on page 19, the applicable cash balance at June 30, 2002 is \$1.47 billion, which is in excess of \$1.2 billion. Therefore, calendar year 2003 will be the 11th consecutive year that the lowest tax rate schedule will be in effect.

State of Wisconsin Unemployment Reserve Fund
Balance Sheet
June 30, 2002 and 2001

Assets	<u>June 30, 2002</u>	<u>June 30, 2001</u>
Current Assets:		
Cash and Cash Equivalents (Note 3):		
United States Treasury Unemployment Trust Fund	\$ 1,485,734,730	\$ 1,715,185,704
Cash in bank	108	0
Total Cash and Cash Equivalents	<u>1,485,734,838</u>	<u>1,715,185,704</u>
Employer Accounts Receivable:		
Taxable (less allowance for doubtful collections of \$9,919,534 for 2002 and \$10,124,080 for 2001)	115,701,254	115,115,355
Governmental units and nonprofit organizations (less allowance for doubtful collections of \$500,000 for 2002 and \$85,674 for 2001)	2,716,099	1,966,532
Other states	3,026,122	2,508,335
Federal government	5,379,388	254,895
Net Employer Accounts Receivable	<u>126,822,863</u>	<u>119,845,117</u>
Other Receivables:		
Overpayments to claimants (less allowances of \$13,605,658 for 2002 and \$10,789,908 for 2001)	17,269,365	10,310,030
State of Wisconsin	33,725	8,255
Net Other Receivables	<u>17,303,090</u>	<u>10,318,285</u>
Total Current Assets	1,629,860,791	1,845,349,106
Noncurrent Assets:		
Other Assets	130,295	148,226
Total Assets	<u>\$ 1,629,991,086</u>	<u>\$ 1,845,497,332</u>
Liabilities and Fund Equity		
Current Liabilities:		
Overdrafts (Note 3)	\$ 21,749,280	\$ 9,558,560
Benefits payable	11,400,664	16,523,986
Employer overpayments	3,192,678	3,950,520
Benefit overpayments due employers, other states, and federal government	1,696,504	612,729
Combined Wage Claim Plan liabilities	2,285,484	1,824,798
Advances under federal programs	262,729	9,747
Due to State of Wisconsin	2,496,462	1,160,214
Other	689,508	100,501
Total Current Liabilities	<u>43,773,309</u>	<u>33,741,055</u>
Fund Equity (Note 1) Restricted for:		
Employer accounts	1,229,256,525	1,526,704,117
Omnibus account	190,496,839	284,238,952
Reed Act allocations	166,464,413	813,208
Total Fund Equity	<u>1,586,217,777</u>	<u>1,811,756,277</u>
Total Liabilities and Fund Equity	<u>\$ 1,629,991,086</u>	<u>\$ 1,845,497,332</u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Wisconsin Unemployment Reserve Fund
Statement of Revenues, Expenses, and
Changes in Fund Equity
for the Years Ended June 30, 2002 and 2001

Operating Revenues	For the Year Ended <u>June 30, 2002</u>	For the Year Ended <u>June 30, 2001</u>
Employer Contributions	\$ 432,002,605	\$ 436,164,448
Benefit Reimbursements (Note 4)	144,144,962	44,389,892
Interest Earnings	98,998,873	115,958,317
Forfeitures and Other Revenues	<u>4,856,343</u>	<u>4,271,191</u>
Total Operating Revenues	<u>680,002,783</u>	<u>600,783,848</u>
Operating Expenses		
Benefits Paid or Provided on Behalf of:		
Taxable employers	928,744,168	652,045,883
Governmental units, nonprofit organizations, and other organizations (Note 4)	144,144,962	44,389,892
Adjustment for allowance—claimants (Note 2D)	<u>(1,133,428)</u>	<u>2,295,100</u>
Total Operating Expenses	<u>1,071,755,702</u>	<u>698,730,875</u>
Operating Income (Loss)	<u>(391,752,919)</u>	<u>(97,947,027)</u>
Nonoperating Revenues (Expenses)		
Reed Act Allocations (Note 1C)	<u>166,214,419</u>	<u>0</u>
Total Nonoperating Revenues (Expenses)	<u>166,214,419</u>	<u>0</u>
Net Change in Fund Equity	(225,538,500)	(97,947,027)
Fund Equity at Beginning of Year (Note 5)	<u>1,811,756,277</u>	<u>1,909,703,304</u>
Fund Equity at End of Year (Note 1)	<u><u>\$ 1,586,217,777</u></u>	<u><u>\$ 1,811,756,277</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Wisconsin Unemployment Reserve Fund
Statement of Cash Flows
for the Years Ended June 30, 2002 and 2001

	<u>For Year Ended June 30, 2002</u>	<u>For Year Ended June 30, 2001</u>
Cash Flows from Operating Activities		
Cash Received from:		
Employer contributions	\$ 431,482,118	\$ 438,924,663
Reed Act allocation (Note 1C)	166,214,419	0
Other operating activity	42,823,239	29,763,469
Federal aids	101,326,168	14,627,784
Cash Payments for:		
Benefits	(1,082,385,467)	(687,907,787)
Other	(100,936)	(198,814)
Net Cash Provided by Operating Activities	<u>(340,640,459)</u>	<u>(204,790,685)</u>
Cash Flows from Investing Activities		
Interest	<u>98,998,873</u>	<u>115,958,317</u>
Net Cash Used for Investment Activities	<u>98,998,873</u>	<u>115,958,317</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(241,641,586)	(88,832,368)
Cash and Cash Equivalents at the Beginning of the Year (net of overdrafts)	<u>1,705,627,144</u>	<u>1,794,459,512</u>
Cash and Cash Equivalents at the End of the Year (net of overdrafts)	<u>\$ 1,463,985,558</u>	<u>\$ 1,705,627,144</u>
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities		
Net Operating Income (Loss)	\$ (391,752,919)	\$ (97,947,027)
Adjustments to Reconcile Net Operating Loss to Net Cash Provided by Operating Activities:		
Operating income (interest earnings) classified as an investing activity	(98,998,873)	(115,958,317)
Provision for uncollectible accounts	3,025,530	(589,569)
Reed Act allocations classified as nonoperating revenues	166,214,419	0
Changes to Assets and Liabilities:		
Decrease (increase) in accounts receivables	(7,187,525)	2,817,221
Decrease (increase) in other receivables	(9,800,555)	(1,334,573)
Decrease (increase) in other assets	17,931	10,758
Increase (decrease) in other liabilities	(2,158,467)	8,210,822
Total Adjustments	<u>51,112,460</u>	<u>(106,843,658)</u>
Net Cash and Cash Equivalents Provided (Used) by Operating Activities	<u>\$ (340,640,459)</u>	<u>\$ (204,790,685)</u>

The accompanying notes are an integral part of this statement.

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 the employer contributions and benefits paid to unemployed workers. The Fund's equity, which is restricted for unemployment benefit payments or other purposes allowed by federal law, includes:

- A. Balances 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. Amounts Not Attributable to Individual Employer Accounts - An omnibus account includes credits for solvency contributions, interest from deposits with the United States Treasury, 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.
- C. Balance Attributable to Reed Act Allocations - Reed Act funds constitute \$166,464,413 of the June 30, 2002 fund equity. This includes a \$166,214,419 payment received in March 2002 that was Wisconsin's share

of an \$8 billion allocation made from the Federal Unemployment Trust Fund. These funds can be used for the payment of benefits and the administration of unemployment insurance law. The funds may also be used in the same manner that federal Wagner-Peyser Act funds are used for the administration of public employment services offices.

2. Summary of Significant Accounting Policies

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.

- A. Amounts Receivable from Employers - Under the full accrual basis, employer contributions are recognized as revenue in the accounting period in which they become due and measurable. Contributions are recorded based on employer self-declared payroll reports. However, some estimates are used to record contributions for employers who fail to file the required reports. Historical collection information is used to estimate and establish an allowance for uncollectible receivables.
- B. Amounts Receivable from Governmental Units and Nonprofit Organizations - Governmental units and nonprofit organizations that are covered by the UI program may, at their option, 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 uncollectible receivables.
- C. Amounts Receivable from Other States - Management bills other states for benefits paid from the Fund when all or a portion of such benefits are attributable to former employers in other states. Management records the amounts due from other states for unemployment benefits paid under the Combined Wage Claim Plan at the time the related benefits are paid. This plan provides a convenient way to pay the claims of employees who have moved to Wisconsin but have claims against employers in other states.
- D. 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. Amounts are reported as due from claimants at the time specific benefit overpayments are 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 uncollectible receivables.

- E. Reed Act Funding - In addition to the Reed Act allocations discussed in Note 1C, the Unemployment Reserve Fund receives additional Reed Act funds related to amortization of certain assets. The federal Reed Act provided funds to states to purchase land and to build and improve employment security offices, to pay benefits, and to pay costs of administering the UI program. In Wisconsin, certain Reed Act funds were used to construct and subsequently to upgrade local employment security offices and portions of certain state office buildings used to administer the program.

Under provisions of the Reed Act, the cost of these offices and buildings is amortized on a straight-line basis over a period of up to 20 years, and the program is entitled to receive reimbursement from the federal government for such amortization. The reimbursements are required to be used for any of the allowed purposes of the original Reed Act funds. In the event of the sale of fully amortized Reed Act-funded land or buildings, any sale proceeds would revert to the federal government.

During fiscal year (FY) 2001-02 and FY 2000-01, the Fund received \$17,931 and \$10,758, respectively, as reimbursements for amortization of offices and buildings.

- F. 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 United States Treasury Unemployment Trust Fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act. The 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 Unemployment Reserve Fund is credited quarterly with earnings only to the extent the Fund's deposit with the trust fund exceeds the balance of outstanding advances made to the program, as computed on a daily basis. The Fund's deposit with the Treasury trust fund is not subject to risk categorization under Governmental Accounting Standards Board (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, 2002, the benefit special account had a book balance (carrying amount) of \$108, which is reported as cash and cash equivalents. The carrying amount of the Fund's other two bank accounts at June 30, 2002 totaled (\$21,749,280). 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 \$1,642,327 on June 30, 2002, of which \$100,000 was covered by federal deposit insurance and \$400,000 was covered by a State of Wisconsin appropriation for losses on public deposits. Therefore, \$500,000 of the June 30, 2002 net bank balance was insured and is categorized as risk category 1 in accordance with GASB Statement Number 3 criteria, and \$1,142,327 was uncollateralized and uninsured and, therefore, categorized as risk category 3.

At June 30, 2001, the carrying amount for each of the three bank accounts was negative, totaling (\$9,558,560), which is reported as an overdraft. The net bank balance of the three accounts totaled \$64,145 on June 30, 2001, which was covered by federal deposit insurance and therefore is categorized as risk category 1 in accordance with GASB Statement Number 3 criteria.

The Fund's bank balances on June 30 were significantly lower than the average balances throughout each year. The Fund normally maintains compensating balances in its bank accounts sufficient to cover the costs of bank services received. However, at the end of each quarter (March 31, June 30, September 30, and December 31), the Fund's bank accounts are drawn down by depositing or retaining the excess amounts in the U.S. Treasury trust fund. This is done to minimize FDIC insurance charges that are based on the Fund's total bank balance as of the end of each quarter.

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. The benefits reimbursed by the federal government for former federal employees and various supplemental benefits programs increased during FY 2001-02 largely due to an \$85 million reimbursement from the federal government for benefits paid under the Federal Temporary Extended Unemployment Compensation Program. Benefit reimbursements are summarized on the following page.

<u>Type of Benefit</u>	<u>FY 2001-02 (in millions)</u>	<u>FY 2000-01 (in millions)</u>
Benefits reimbursed by the federal government for former federal employees	\$ 16.1	\$ 14.6
Benefits reimbursed by the federal government for the Federal Temporary Extended Unemployment Compensation Program	85.2	0
Benefits reimbursed by governmental units and electing nonprofit organizations for benefits paid to their former employees	30.1	20.8
Amounts reimbursed by other states under the Combined Wage Claim Plan	<u>12.7</u>	<u>8.9</u>
Totals	\$144.1	\$44.3

5. Restatement of Beginning Fund Balance

For FY 2001-02 and FY 2000-01, the Unemployment Reserve Fund implemented GASB Statement Number 34, *Basic Financial Statement—and Management's Discussion and Analysis—for State and Local Governments*. GASB Statement Number 34 establishes new financial reporting requirements for state and local governments. As required by GASB Statement Number 34, the Unemployment Reserve Fund was reclassified from an expendable trust fund, which used the modified accrual basis of accounting, to an enterprise fund, which uses the full accrual basis of accounting. As a result, a prior-period adjustment to the FY 2000-01 beginning fund balance was required to reflect additional recoveries of overpayments and other revenues not expected to be received within one year. The ending fund balance for the year ended June 30, 2000, as previously reported, was \$1,902,183,715. With a prior-period adjustment of \$7,519,589, the adjusted beginning fund balance for FY 2000-01 is \$1,909,703,304.

State of Wisconsin Unemployment Reserve Fund
Schedule of Cash Balance
Related to Taxable Employers
June 30, 2002 and 2001

	<u>June 30, 2002</u>	<u>June 30, 2001</u>
Cash and Cash Equivalents	\$ 1,485,734,838	\$ 1,715,185,704
Overdrafts	<u>(21,749,280)</u>	<u>(9,558,560)</u>
Net Cash Balance	1,463,985,558	1,705,627,144
Adjustments Related to Nontaxable Employer Activities:		
Accounts receivable balance related to reimbursable employers, other states, and benefit payments funded by interest and penalty money (Note 1A)	6,275,946	4,568,796
Net benefits to be funded by the federal government (Note 1B)	5,363,745	245,148
Cash Balance Related to:		
Employer tax overpayments not refunded (Note 1C)	(3,192,678)	(3,950,520)
Other non-taxable employer activities (Note 1D)	<u>(3,001,222)</u>	<u>(1,214,114)</u>
Cash Balance Related to Taxable Employers	<u>\$ 1,469,431,349</u>	<u>\$ 1,705,276,454</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, 2002 and 2001, 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 D was and will be in effect during 2002 and 2003 because the June 30, 2001 and the June 30, 2002 taxable employer cash balances of \$1,705,276,454 and \$1,469,431,349, respectively, are greater than the \$1.2 billion level specified in Wisconsin Statutes. In arriving at the cash balance related to taxable employers, 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 following adjustments to the net cash balance are then made:

- A. The net cash balance is increased by the net amount of unreimbursed benefit payment receivables outstanding on June 30 from nonprofit and governmental reimbursable employers, from other states, and for benefits partially funded with interest and penalty money.
- B. The net cash balance is increased by the net amount of unreimbursed cash payments under federally funded unemployment benefit programs.
- C. The net cash balance is reduced by the net amount of tax overpayments that will either be refunded to employers or applied to the employers' future tax liability.
- D. The net cash balance is reduced by the net amount of other non-taxable employer-related cash balances, including collections for court costs, interest and penalties, and special assessments and other amounts not yet paid to the State; withheld child support payments not yet distributed; and benefit overpayments recovered for other states.

Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting 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, 2002 and 2001, and have issued our report thereon dated December 16, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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 laws and regulations, 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 that are required to be reported under *Government Auditing Standards*.

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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a 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 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.

This report is intended for the information of the State of Wisconsin's Unemployment Reserve Fund management and the Wisconsin Legislature. This restriction is not intended to limit the distribution of this report, which, upon submission to the Joint Legislative Audit Committee, is a public document. However, because we do not express an opinion on compliance or provide assurance on internal control over financial reporting, this report is not intended to be used by anyone other than those specified parties.

LEGISLATIVE AUDIT BUREAU

December 16, 2002

by



Bryan Naab
Audit Director