

AN AUDIT

# *Unemployment Reserve Fund*

*Department of Workforce Development*

99-4

*March 1999*

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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March 30, 1999

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

Dear Senator George and Representative Kelso:

We have completed a financial audit of the State of Wisconsin Unemployment Reserve Fund for the years ended June 30, 1998 and 1997. 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.

The Reserve Fund's cash balance related to taxable employers increased over \$83 million during the past fiscal year, to over \$1.6 billion as of June 30, 1998. This cash balance is used to determine the tax rate schedule that applies to taxable employers, and s.108.18(3m), Wis. Stats., currently allows the lowest rate to be applied when the cash balance as of June 30 is at least \$1.2 billion. For each of the past nine years, the June 30 cash balance has exceeded the amount that allows the Fund to apply the lowest tax rate schedule for taxable employers.

A new accounting standard requires the Unemployment Reserve Fund to include a note disclosure on its year 2000 readiness. However, because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. As a result, we qualify our independent auditor's report because, in our judgment, it is not possible to obtain sufficient evidence to support the Unemployment Reserve Fund's disclosures with respect to the year 2000 issue.

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

Respectfully submitted,

Janice Mueller  
State Auditor

JM/BN/bh

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# INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF THE STATE OF WISCONSIN UNEMPLOYMENT RESERVE FUND

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We have audited the accompanying balance sheet of the State of Wisconsin Unemployment Reserve Fund as of June 30, 1998 and 1997, and the related statement of revenues, expenditures, and changes in fund balance for the years then ended. These financial statements are the responsibility of the management of the Unemployment Reserve Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards 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.

Governmental Auditing Standards Board Technical Bulletin 98-1, *Disclosures About Year 2000 Issues*, requires disclosure of certain matters regarding the year 2000 issue. The Unemployment Reserve Fund has included such disclosures in Note 6 to the financial statements. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, in our judgment, it is not possible to obtain sufficient evidence to support the Unemployment Reserve Fund's disclosures with respect to the year 2000 issue made in Note 6. Further, we do not provide assurance that the Unemployment Reserve Fund is or will be year 2000 ready, that the Unemployment Reserve Fund's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Unemployment Reserve Fund does business will be year 2000 ready.

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 results of its operations and changes in financial position in conformity with generally accepted accounting principles.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had it been possible to obtain sufficient evidence regarding year 2000 disclosures, 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, 1998 and 1997, and the results of its operations for the years then ended, in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying 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, 1998 and 1997, which is used to determine the unemployment tax rate schedule for the following calendar year. The supplementary information is not a required part of the basic financial statements. The supplementary information 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 March 24, 1999 on our consideration of the Unemployment Reserve Fund's internal control over financial reporting and our tests of its compliance with laws and regulations.

LEGISLATIVE AUDIT BUREAU

March 24, 1999

by

Bryan Naab  
Audit Director



**State of Wisconsin Unemployment Reserve Fund  
Balance Sheet  
June 30, 1998 and 1997**

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
<b>Assets</b>		
Cash and Cash Equivalents (Note 3):		
United States Treasury Unemployment Trust Fund	\$ 1,645,302,035	\$ 1,558,972,832
Cash in bank	153,447	76,164
Total Cash and Cash Equivalents	1,645,455,482	1,559,048,996
Employer Accounts Receivable:		
Taxable (less allowances for doubtful collections of \$2,776,304 for 1998 and \$2,817,160 for 1997)	116,396,717	118,795,227
Governmental units and nonprofit organizations	1,436,049	1,654,509
Other states	1,508,641	1,506,906
Federal government	128,750	271,824
Net Employer Accounts Receivable	119,470,157	122,228,466
Other Receivables:		
Overpayments to claimants (less allowance of \$14,397,338 for 1998 and \$14,130,555 for 1997)	4,669,849	4,241,772
State of Wisconsin	33,315	28,390
Net Other Receivables	4,703,164	4,270,162
Other Assets (Note 4)	206,008	233,351
Total Assets	\$ 1,769,834,811	\$ 1,685,780,975
<b>Liabilities and Fund Balance</b>		
Liabilities:		
Overdrafts (Note 3)	\$ 9,899,377	\$ 8,740,471
Benefits payable	5,313,732	4,478,010
Employer overpayments	2,703,922	2,021,772
Benefit overpayments due employers, other states, and federal government	690,534	634,963
Combined Wage Claim Plan liabilities	1,224,137	1,323,964
Advances under federal programs	217,420	88,881
Due to State of Wisconsin	743,791	333,761
Deferred revenue	1,601,264	1,788,243
Other	211,384	303,146
Total Liabilities	22,605,561	19,713,211
Fund Balance (Notes 1 and 4)	1,747,229,250	1,666,067,764
Total Liabilities and Fund Balance	\$ 1,769,834,811	\$ 1,685,780,975

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

**State of Wisconsin Unemployment Reserve Fund**  
**Statement of Revenues, Expenditures, and**  
**Changes in Fund Balance**  
**for the Years Ended June 30, 1998 and 1997**

	For the Year Ended June 30, 1998	For the Year Ended June 30, 1997
<b>Revenues</b>		
Employer contributions	\$ 413,202,848	\$ 420,582,862
Benefit reimbursements (Note 5)	39,506,294	47,893,851
Interest earnings	107,909,286	102,896,369
Forfeitures and other revenues	2,597,031	2,433,947
Total Revenues	<u>563,215,459</u>	<u>573,807,029</u>
<b>Expenditures</b>		
Benefits paid or provided on behalf of:		
Taxable employers	441,426,336	452,217,416
Governmental units, nonprofit organizations, and other organizations (Note 5)	39,506,294	47,893,851
Adjustment for allowance - claimants (Note 2D)	1,121,343	1,539,636
Total Expenditures	<u>482,053,973</u>	<u>501,650,903</u>
Excess of revenues over expenditures	81,161,486	72,156,126
Fund Balance at Beginning of Year	1,666,067,764	1,593,911,638
Fund Balance at End of Year (Notes 1 and 4)	<u>\$ 1,747,229,250</u>	<u>\$ 1,666,067,764</u>

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

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# NOTES TO THE FINANCIAL STATEMENTS

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## 1. Description of the Unemployment Reserve Fund

The unemployment insurance (UI) program was authorized in ch. 108, Wis. Stats., which included 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 a partial offset against the FUTA tax. The FUTA taxes paid by employers to the federal government are used 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 General Fund and are not reported within the State of Wisconsin Unemployment Reserve Fund's financial statements.

The Fund, which is part of the State of Wisconsin financial reporting entity and is reported as an expendable trust fund in the State's general purpose financial statements, accounts for the operations and unexpended resources of the UI program. The Fund's balance 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. Balances 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 closed employers or relating to statutory provisions regarding certain employees who have quit their employment.

## **2. Summary of Significant Accounting Policies**

Except for other assets discussed in notes 2E and 4, the Fund is accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet. The operating statement presents revenues and expenditures. Other financing sources and uses are not currently applicable to the Fund.

The Fund is reported on the modified accrual basis of accounting. This basis of accounting recognizes revenues and overpayment recoveries when they become measurable and available to pay current reporting-period liabilities. Expenditures and related liabilities are recognized when obligations are incurred.

### **A. Amounts Receivable from Employers**

Employer contributions are recognized as revenue under the modified accrual basis of accounting. Under the modified accrual basis, employer contributions are recognized in the accounting period in which they became susceptible to accrual; that is, when they become both measurable and available to pay liabilities of the current period. 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 has been used to estimate, and establish an allowance for, the amount for which collectibility is not reasonably assured. In addition, a deferred revenue liability has been established for the amount of receivables outstanding that are not expected to be collected within the next twelve-month period and, as such, are not available to finance current operations.

### **B. Amounts Receivable from Governmental Units and Nonprofit Organizations**

Governmental units and nonprofit organizations that are covered by the Unemployment Insurance 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. Management has established an allowance for the amount estimated as not collectible within the next 12 months.

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 amount 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 migrated 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 those benefits. Amounts are recorded as due from claimants for specific benefit overpayments at the time the claimants are determined to be ineligible. A related liability is established for the portion of the overpayments that, when collected, will be credited to reimbursable employers or the federal government. Management has established an allowance for the amount estimated as not collectible within the next 12 months.

E. Reed Act Funding

The federal Reed Act provides funds to states to purchase land and to build and improve employment security offices, to pay benefits, and to pay costs of administering the Unemployment Insurance Program. In Wisconsin, certain Reed Act funds have been 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 sale of fully amortized Reed Act-funded land or buildings, any proceed of the sale would revert to the federal government.

Reed Act funds used for benefit payments or certain program administration costs are not reimbursable from the federal government and are recorded as expenditures.

F. Benefits Payable to Claimants

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

**3. Cash and Cash Equivalents**

The amounts reported as cash and cash equivalents include the Unemployment Reserve Fund's deposit with a U.S. Treasury trust fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act, which includes deposits from the unemployment insurance funds of various states. The trust fund is required by federal statute 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 carrying amounts of the Fund's bank deposits are reported as cash in bank for accounts with positive balances, and as overdrafts for accounts with negative balances. The net carrying amounts were negative at the ends of both fiscal years: (\$8,664,307) and (\$9,745,930) on June 30, 1997, and June 30, 1998, respectively. The net bank balances on those respective dates were \$51,110, which was covered by federal deposit insurance and therefore is categorized as risk category 1 in accordance with GASB Statement Number 3 criteria, and (\$68,467).

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 were drawn down by depositing or retaining the excess amounts in the U.S. Treasury trust fund. This is done to minimize FDIC insurance surplus charges to the Fund, which are based on the Fund's total bank balance as of the end of each quarter.

#### 4. Other Assets

Of the original \$2,956,828 of Reed Act funds, \$714,233 remains in the fund balance as of June 30, 1998. These funds can be used for purposes other than the payment of benefits. On June 30, 1998 and 1997, \$206,008 and \$233,351, respectively, were invested in buildings and were not available for expenditure.

#### 5. Benefit Reimbursements

The amounts reported as benefits paid or provided on behalf of governmental units, electing nonprofit organizations, and other organizations, and the matching amount reported as benefit reimbursements, consist of several types of benefits:

<u>Type of Benefit</u>	<u>Fiscal Year 1997-98 (in millions)</u>	<u>Fiscal Year 1996-97 (in millions)</u>
Benefits reimbursed by the federal government for former federal employes and various supplemental benefits programs	\$ 9.7	\$ 11.5
Benefits reimbursed by governmental units and electing nonprofit organizations for benefits paid to their former employes	19.8	21.5
Amounts reimbursed by other states under the Combined Wage Claim Plan	6.4	6.6
Other types of benefits provided to claimants through various federal grant programs that are reimbursed by the federal government *	<u>3.6</u>	<u>8.3</u>
Totals	\$39.5	\$47.9

\* Benefits under these federal programs are not for unemployment insurance benefits; however, they are accounted for within the Fund for administrative convenience.

#### 6. Year 2000 Compliance

Technical issues associated with the arrival of the year 2000 have the potential of disrupting certain types of business and operational activities that rely heavily on computer systems. The use of two digits to represent the year in many older computer programs, data files, or chips may be recognized incorrectly when the year 2000 arrives. To eliminate the

problem, all software, data, and hardware that relies on a two-digit field to represent the year must be modified prior to December 31, 1999.

DWD's process to address year 2000 compliance includes:

- identifying a plan to deal with year 2000 issues (awareness stage);
- identifying systems and components for which year 2000 work is needed (assessment stage);
- modifying systems and equipment (remediation stage); and
- verifying that correct changes were made during remediation (validation/testing stage).

DWD has identified the UI benefits and tax systems as mission-critical and high-priority systems. As such, resources have been devoted to the assessment, renovation, and testing of these systems to make them year 2000 compliant.

Work on remediation of UI systems began in early 1996 and is now complete. Extensive tests were conducted from August through December 1998. Information technology consultants completed an independent verification and validation of the UI benefits system, and it is considered to be year 2000 compliant. All assessment and remediation is completed on the UI tax system. The information technology consultants are currently validating the UI tax system for year 2000 compliance.

In addition to assessing, remediating, and validating its mission-critical systems, DWD is on track to complete assessment, remediation, and testing of all applications, infrastructure, equipment, and facilities by June 30, 1999. This includes testing all personal computers and key networks and is not limited to UI systems. DWD is also working with its business partners that help carry out key programs. For example, the bank that provides deposit and checking services for the UI program was asked to provide an explanation of what action it is taking to ensure its computers, networks, and facilities will be ready for the year 2000.

DWD is developing detailed contingency plans to deal with possible internal or external year 2000 problems. Implementation of these plans would allow DWD to continue essential services such as processing UI benefit claims.



DWD cannot provide absolute assurance that all year 2000 problems will be corrected by January 1, 2000, nor that all systems will continue to work efficiently on January 1, 2000. There remains a possibility that some year 2000 problems will not be corrected by January 1, 2000. However, DWD believes that the actions it is taking should minimize such potential problems, especially for critical business applications.

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**State of Wisconsin Unemployment Reserve Fund**  
**Schedule of Cash Balance**  
**Related to Taxable Employers**  
**June 30, 1998 and 1997**

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Cash and Cash Equivalents	\$ 1,645,455,482	\$ 1,559,048,996
Overdrafts	<u>(9,899,377)</u>	<u>(8,740,471)</u>
Net Cash Balance	1,635,556,105	1,550,308,525
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)	3,135,079	3,495,244
Cash Balance Related to:		
Certain allowance programs (Note 1B)	(153,447)	4,896
Benefits funded by the federal government (Note 1C)	(41,628)	(76,601)
Employer tax overpayments not refunded (Note 1D)	(2,703,922)	(2,021,772)
Other non-taxable employer activities (Note 1E)	<u>(906,432)</u>	<u>(572,477)</u>
Cash Balance Related to Taxable Employers	<u>\$ 1,634,885,755</u>	<u>\$ 1,551,137,815</u>

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

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## **NOTE TO THE SCHEDULE OF CASH BALANCE RELATED TO TAXABLE EMPLOYERS**

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### **1. Summary of Significant Accounting Policies for Determining the Cash Balance**

The Schedule of Cash Balance Related to Taxable Employers as of June 30, 1998 and 1997, 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 1998 and 1999 because the June 30, 1998, and the June 30, 1997 taxable employer cash balances of \$1,634,885,755 and \$1,551,137,815, respectively, are greater than the \$1.2 billion level specified in Wisconsin Statutes. In arriving at the cash balance specified in the Statutes, the cash and cash equivalent balance reported in the Unemployment Reserve Fund financial statements is reduced by overdrafts to arrive at a net cash balance. The following adjustments to the net cash balance are appropriate.

- A. The net cash balance is adjusted 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 reduced or increased by the net amount of unexpended cash advances under certain allowance programs that are funded totally by the federal government, other state agencies, local governmental units, and/or other organizations.
- C. The net cash balance is reduced or increased by the net amount of unexpended cash advances or unreimbursed cash payments under federally funded unemployment benefit programs.
- D. 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.

- E. 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 penalty, and special assessments and other amounts not yet paid to the State; withheld child support payments not yet distributed to the county courts; and benefit overpayments recovered for other states.

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# INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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We have audited the financial statements of the State of Wisconsin Unemployment Reserve Fund as of and for the years ended June 30, 1998 and 1997, and have issued our report thereon dated March 24, 1999, which was qualified because it was not possible to obtain sufficient evidence to support the Unemployment Reserve Fund's disclosures with respect to the year 2000 issue. Except as discussed in the preceding sentence, we conducted our audit in accordance with generally accepted auditing standards 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. However, we noted other matters involving internal control over financial reporting, which we will report to the management of the Unemployment Reserve Fund in a separate letter.

This report is intended for the information of the State of Wisconsin's Unemployment Reserve Fund management and the Wisconsin Legislature's Joint Legislative Audit Committee. This restriction is not intended to limit the distribution of this report, which, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited.

LEGISLATIVE AUDIT BUREAU

March 24, 1999

by

Bryan Naab  
Audit Director