

An Audit

Unemployment Reserve Fund

Department of Workforce Development

2011-2012 Joint Legislative Audit Committee Members

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Janice Mueller
State Auditor

June 16, 2011

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

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. It funds regular unemployment benefits paid to eligible individuals and is funded primarily through taxes paid by employers. During the period we reviewed, certain other benefits funded by the federal government, including extended and emergency unemployment benefits, were also paid. This audit report contains our unqualified opinion on the Unemployment Reserve Fund's financial statements and related notes for the years ended June 30, 2010 and 2009.

In the past ten years, the Fund's balance has declined from a high of \$1.9 billion as of June 30, 2000, to a deficit in the amount of (\$920.4 million) as of June 30, 2010. As its reserves have been depleted, the Fund has borrowed from the federal government to pay unemployment benefits to eligible individuals. The balance owed to the federal government as of May 31, 2011, was \$1.3 billion plus an additional \$25.4 million in interest accrued on the loan as of that date.

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 highest tax rate schedule to be applied when the Fund's cash balance as of June 30 is less than \$300 million. Consequently, the highest of four tax rate schedules is being applied in calendar year 2011.

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

Respectfully submitted,

Janice Mueller
State Auditor

JM/BN/ss

Introduction ■

The Unemployment Insurance program provides benefits to those who become unemployed through no fault of their own.

Wisconsin's Unemployment Insurance program was enacted in 1932 and was the first such program in the United States. Unemployment Insurance program benefits temporarily replace a portion of wages lost when individuals become unemployed through no fault of their own. Regular unemployment benefits are funded primarily by employer-paid taxes that are deposited to the Unemployment Reserve Fund, which is managed by the Department of Workforce Development (DWD). Certain other types of unemployment benefits that were paid during the period we reviewed—including emergency unemployment compensation, extended benefits, and Federal Additional Compensation (FAC)—are funded by the federal government. The costs of administering Wisconsin's Unemployment Insurance program are funded primarily by federal grants that are accounted for in state appropriations.

Each employer has an account within the Unemployment Reserve Fund. Employers are subject to a basic tax and a solvency tax, which together constitute their total state unemployment insurance tax. Taxes are assessed on the taxable wages of their employees. The basic tax is credited to each employer's account based on that employer's unemployment experience rating, so employers with more employee layoffs pay more than those with fewer layoffs. The solvency tax is credited to a solvency account and is based on each employer's unemployment experience rating and payroll size. The solvency account is used to pay benefits that by statute cannot be charged to an employer's account, such as unemployment benefits for unemployed workers of a bankrupt employer.

The highest unemployment insurance tax rate schedule is currently in effect.

Wisconsin Statutes include four unemployment insurance tax rate schedules. The highest tax rate schedule, which is currently in effect, is used when the Fund's cash balance as of June 30 of the preceding year is less than \$300 million. The lowest schedule, and the one most favorable to employers, applies when the Fund's cash balance as of June 30 of the preceding year exceeds \$1.2 billion. Unemployment insurance tax rates are applied to each employee's wages up to the taxable wage base established in statutes. The taxable wage base was \$12,000 in 2009 and 2010, increased to \$13,000 in 2011, and will increase again to \$14,000 in 2013.

Not all unemployed individuals, such as those with a minimal prior work history, are eligible to receive unemployment benefits. Therefore, the total unemployment rate is always higher than the insured unemployment rate. For example, Wisconsin's average unemployment rate for fiscal year (FY) 2009-10 was 8.6 percent, but the average insured unemployment rate was 5.4 percent.

ARRA funds have been used to fund emergency and extended unemployment benefits.

Regular unemployment benefits are paid for up to 26 weeks. In addition, under the 2009 American Recovery and Reinvestment Act (ARRA), the federal government has funded emergency and extended benefits. Those who meet eligibility requirements first receive regular unemployment benefits, followed by emergency and extended benefits. The number of weeks unemployed individuals may receive the federally funded benefits varies and depends, in part, on a state's unemployment rate.

Benefits for eligible individuals were available for up to 99 weeks when Wisconsin's unemployment rate was at its highest.

During the period that Wisconsin had its highest unemployment rate, which began June 2009 and ended October 2010, it was possible for eligible individuals to receive unemployment benefits for up to 99 weeks, including 26 weeks of regular unemployment benefits, 53 weeks of federally funded emergency benefits, and 20 weeks of federally funded extended benefits. In addition, from February 2009 through December 2010, most unemployed individuals were eligible for an additional \$25 weekly supplement, referred to as FAC, which was funded entirely by ARRA. Some of the federally funded benefits, including extended benefits, are no longer available now because of the decline in Wisconsin's unemployment rate. However, it is noted that eligible unemployed individuals could receive 13 weeks of federally funded extended benefits through January 4, 2012, if certain statutory changes are enacted.

Currently, the maximum weekly unemployment benefit payment is \$363.

Unemployed individuals may file their initial benefit claim applications either by telephone or using the Internet. They then are typically required to contact a call center operated by DWD's Unemployment Insurance Division, where certain information is verified and their eligibility and weekly benefit payments are established. Subsequently, eligible individuals file weekly benefit claims either by telephone or the Internet for as long as they continue to be unemployed. Eligible individuals must generally be available to

work and must be searching for work. However, they typically are not required to submit work-search documentation except when claiming federally funded extended benefits. Currently, the minimum weekly benefit payment is \$54 and the maximum payment is \$363. Individuals may receive a reduced benefit payment in weeks they work part-time hours.

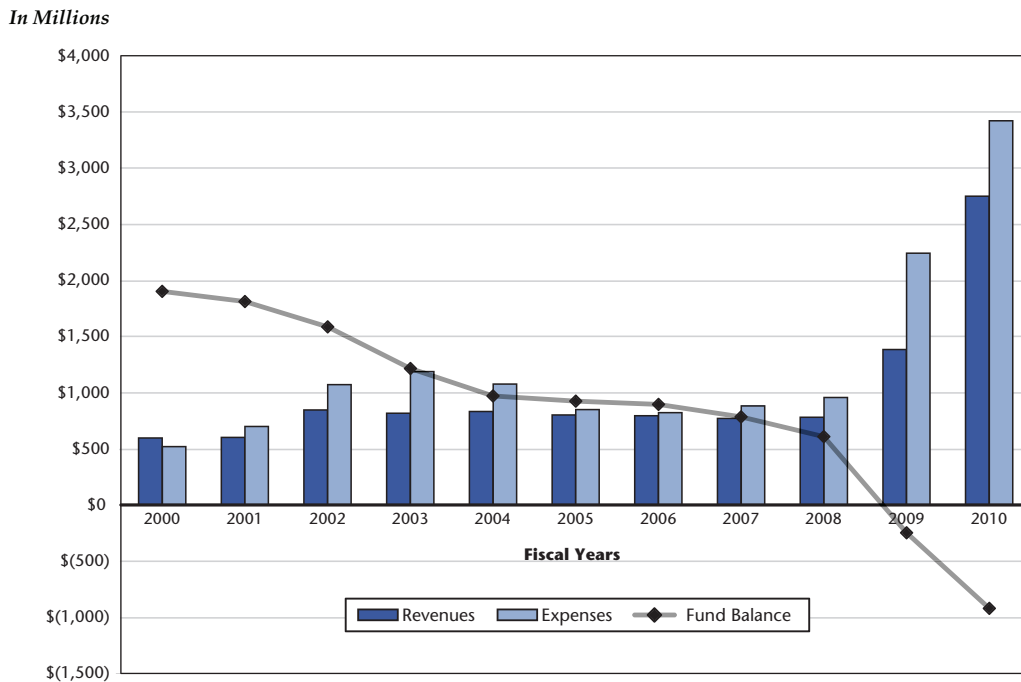
Fund Balance

The Fund balance has been declining since 2000.

Ideally, the Unemployment Reserve Fund accumulates resources during periods of low unemployment to ensure the fund balance plus current-year employer taxes and interest earnings are sufficient to pay benefits during periods of high unemployment. However, as shown in Figure 1, the Unemployment Reserve Fund balance has been declining since 2000 because benefit payments have exceeded employer taxes and other revenues. While a decline would be expected during years of high unemployment, such as FY 2000-01 and FY 2001-02, the balance continued to decline from FY 2004-05 through FY 2006-07, even though the economy in general was improving at that time.

Figure 1

Unemployment Reserve Fund Revenues, Expenses, and Fund Balance¹



¹ Revenues include employer taxes, interest earnings, and federal funds received for certain benefits.

As of June 30, 2010, the Unemployment Reserve Fund had a deficit balance in the amount of (\$920.4 million). As shown in Table 1, while the total of all employers' accounts was positive at \$388.8 million, the solvency account had a negative balance in the amount of (\$1.3 billion).

Table 1

Unemployment Reserve Fund Balance
As of June 30, 2010
(in millions)

Account	Amount
Employer Accounts	\$ 388.8
Restricted Accounts	22.5
Solvency Account	(1,331.7)
Total Fund Balance	\$ (920.4)

Certain unemployment benefit payments are charged to a solvency account rather than to employer accounts.

We focused our analysis on the reasons for the large negative balance in the Fund's solvency account, which includes the employer solvency tax, interest earnings, and other statutorily required payments and is used to fund unemployment benefit payments that, by statute, are not chargeable to employers' accounts, which are primarily:

- unemployment benefit payments related to bankrupt employers;
- unemployment benefit payments related to an employee who lost his or her occupational license and is unable to perform job duties; and
- unemployment benefit payments related to an employee who quit for certain specified reasons.

In addition, Wisconsin Statutes are apparently unique in providing that certain unemployment benefit payments initially charged to employers' accounts will subsequently be transferred to the solvency account if an employer's account balance is negative by more than 10 percent of the employer's taxable payroll. As shown in Table 2, the amounts transferred from employer accounts to the solvency account can be significant and have grown as the economy worsened. For example, the transfer was \$150.7 million for FY 2006-07, but \$407.0 million for FY 2009-10.

Table 2

Transfers to the Solvency Account
(in millions)

Fiscal Year	Amount
2005-06	\$151.7
2006-07	150.7
2007-08	167.9
2008-09	194.7
2009-10	407.0

The solvency account had a negative balance in the amount of (\$1.3 billion) as of June 30, 2010.

Largely because of increased transfers, but also because the Unemployment Reserve Fund is currently not earning interest, the solvency account declined and, as noted, had a negative balance in the amount of (\$1.3 billion) as of June 30, 2010.

Federal Borrowing

Wisconsin has borrowed federal funds twice in the history of the Unemployment Insurance program.

When the Unemployment Reserve Fund was depleted in February 2009, the Fund began to borrow from the federal government. This is the second time in the history of the Unemployment Insurance program that Wisconsin has borrowed from the federal government to pay benefits. The first occurred in 1982. To address the deficit at that time, legislation was enacted to increase employer taxes and reduce the benefits paid to unemployed individuals. These changes generated sufficient funds to repay the loan by December 1986.

However, federal rules prohibit using funds available in the Unemployment Reserve Fund to pay the interest on federal loans. In the past, a special assessment charged to employers, as well as interest and penalties paid by delinquent employers, were used to pay the interest on the loan.

The federal loan balance was \$1.3 billion as of May 31, 2011.

As of June 30, 2010, the end of our audit period, the loan balance was \$1.4 billion. The loan balance fluctuates depending on the timing of employer tax payments and was \$1.3 billion as of May 31, 2011, which was the 11th highest loan balance among the 29 states with federal loan balances.

Under current federal rules, the Fund began to incur interest at 4.1 percent on the outstanding loan balance on January 1, 2011, with the first interest payment due on September 30, 2011. As of

May 31, 2011, Wisconsin has accrued \$25.4 million in interest on the outstanding loan balance.

We note that as provided for in the appropriation authorized under s. 20.445(1)(gd), Wis. Stats., the State may use funds from interest and penalties assessed on employers with delinquent accounts to pay a portion of the interest on federal loans. As of June 30, 2010, the balance in this appropriation was \$330,000. The balance would be higher, but the Department of Administration directed DWD to lapse a total of \$3.2 million during FY 2007-08, FY 2008-09, and FY 2009-10 to meet the lapse requirements under 2007 Wisconsin Acts 20 and 226 and 2009 Wisconsin Acts 2 and 28. Therefore, this money is no longer available for interest payments.

Fiscal Management

***Fiscal management issues
were noted during
the audit.***

Our Report on Internal Control and Compliance includes two fiscal management issues. These findings were previously included in our FY 2009-10 single audit report (report 11-04). First, we recommend that DWD's Unemployment Insurance Division improve financial reporting for unemployment benefits related to certain governmental and nonprofit employers that reimburse the Unemployment Reserve Fund on an after-the-fact basis for benefits paid to unemployed workers. We found a material omission of revenues and expenses that was not identified during the financial statement review process. Second, the Unemployment Insurance Division has not identified and established overpayments related to the FAC supplement. Any overpayments collected would be returned to the federal government.

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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, 2010 and 2009, 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, 2010 and 2009, 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.


The Unemployment Reserve Fund's balance declined from \$608.8 million as of June 30, 2008, to (\$920.4 million) as of June 30, 2010, or by \$1,529.2 million. Beginning in February 2009, the Unemployment Reserve Fund's resources were depleted and the Fund started borrowing from the federal government in order to continue paying benefits. The Fund had an outstanding loan balance of \$1,424.8 million as of June 30, 2010, and, under current federal rules, began accruing interest on the balance January 1, 2011.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 9, 2011, 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 grant agreements; 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.

The supplementary information included as the Schedule of Cash Balance Related to Taxable Employers on page 33, 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, 2010 and 2009. 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.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Unemployment Reserve Fund. The supplementary information included as Management's Discussion and Analysis on pages 11 through 18 is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

June 9, 2011

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, 2010 and 2009. The financial statements, notes, and this discussion are the responsibility of management of the Fund.

Financial Summary

The liabilities of the Unemployment Reserve Fund exceeded assets at the close of FY 2009-10 by approximately \$920.4 million. With the exception of \$22.5 million in federal allocations, the Fund's equity, if positive, could be used only to pay unemployment benefits to eligible unemployed persons.

The Fund's equity decreased by \$1,529.2 million during the two-year period from July 1, 2008, through June 30, 2010. 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 contributions received from employers and benefits paid to unemployed workers. The Fund is administered by the State of Wisconsin's

Department of Workforce Development. 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.

Generally, the principal source of revenue for the Fund is quarterly contributions paid by the approximately 126,000 employers subject to the taxing provisions of ch. 108, Wis. Stats. However, during FYs 2008-09 and 2009-10, the Fund also received a significant amount of federal funding to pay for extended unemployment benefits. 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 certain federal allocations, the Fund's reserves may be used only to pay unemployment benefits or to refund overpayments to employers or, in the event benefits were federally funded, to the federal government. Federal Reed Act allocations, which are excess federal unemployment taxes collected by the federal government and paid to each state, may be used to pay costs associated with administering the Unemployment Insurance program or employment service programs. Federal special administrative allocations, which are special distributions to each state, may be used to pay costs associated with implementing and administering the provisions of state law that qualify it for incentive payments made under the February 2009 Assistance for Unemployed Workers and Struggling Families Act, and certain other administrative costs.

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 and the period between February 2009 and December 2010, any federal borrowing carries interest charges. The interest charges may not be funded from regular employer contributions.

Administrative costs of the Unemployment Insurance program are accounted for in the State of Wisconsin's General Fund, as reported in the State's Comprehensive Annual Financial Report, 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 2009-10 and FY 2008-09. 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 of cash and cash equivalents and receivables. Table A shows that total assets decreased by \$342.3 million between June 30, 2008, and June 30, 2009, and then increased by \$324.7 million between June 30, 2009, and June 30, 2010.

Table A

Assets
(in millions)

	June 30, 2008	June 30, 2009	Change	June 30, 2010	Change
Cash and Cash Equivalents	\$462.9	\$ 28.5	\$(434.4)	\$234.3	\$205.8
Receivables	191.8	283.9	92.1	402.8	118.9
Total Assets	\$654.7	\$312.4	\$(342.3)	\$637.1	\$324.7

Cash and cash equivalents decreased by \$434.4 million during FY 2008-09, reflecting the recent trend of increasing levels of unemployment benefits without a corresponding increase in employer contributions. Cash and cash equivalents increased by \$205.8 million during FY 2009-10, primarily due to different cash management practices. During FY 2008-09, the Fund repaid \$236.7 million in advances from the federal government; however, the Fund did not repay any advances during FY 2009-10.

The \$211.0 million increase in the receivable balance between FY 2007-08 and FY 2009-10 is attributable, in part, to an increase in delinquent employer contributions. In addition, the receivable from the federal government related to federally funded benefits increased from \$0.4 million as of June 30, 2008, to \$93.3 million as of June 30, 2010.

Liabilities

As shown in Table B, the Fund's liabilities increased by \$514.5 million between June 30, 2008, and June 30, 2009, and by \$997.1 million between June 30, 2009, and June 30, 2010.

Table B

Liabilities
(in millions)

	June 30, 2008	June 30, 2009	Change	June 30, 2010	Change
Advance from Federal Government	\$ 0.0	\$435.5	\$435.5	\$1,424.8	\$989.3
Overdrafts	16.1	40.2	24.1	28.4	(11.8)
Benefits Payable	10.4	61.5	51.1	71.0	9.5
Other Liabilities	19.4	23.2	3.8	33.3	10.1
Total Liabilities	\$45.9	\$560.4	\$514.5	\$1,557.5	\$997.1

During FY 2008-09, the Fund depleted its reserves and began to borrow from the federal government. Starting in 2011, the Fund will incur 4.1 percent annual interest on the amount borrowed. Because the Fund had a loan balance outstanding on both January 1, 2010, and January 1, 2011, the federal government can begin recovering the loan from employers by incrementally reducing their federal unemployment tax credits beginning with the tax due for 2011. The Fund can avoid these credit reductions for employers by voluntarily repaying certain portions of the loan and meeting other federal requirements.

Bank account overdrafts of \$40.2 million as of June 30, 2009, and \$28.4 million as of June 30, 2010, are the result of the Fund's cash management policy. The Fund attempts to maintain a balance of \$0 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 \$11.8 million decrease in the overdraft amount from June 30, 2009, to June 30, 2010, resulted from a decrease in the number of benefit checks issued near the end of FY 2009-10.

Fund Equity

As shown in Table C, the Fund's equity decreased by \$856.7 million between June 30, 2008, and June 30, 2009, and by \$672.5 million between June 30, 2009, and June 30, 2010.

Table C

Fund Equity
(in millions)

	June 30, 2008	June 30, 2009	Change	June 30, 2010	Change
Employer Accounts	\$1,260.7	\$ 741.8	\$(518.9)	\$ 388.8	\$ (353.0)
Solvency Account	(797.6)	(1,016.8)	(219.2)	(1,331.7)	(314.9)
Reed Act Allocations	145.7	0.0	(145.7)	0.0	0.0
Restricted for Administration	0.0	27.1	27.1	22.5	(4.6)
Total Fund Equity	\$ 608.8	\$ (247.9)	\$(856.7)	\$ (920.4)	\$(672.5)

Charges to the solvency account during each fiscal year significantly exceeded revenues credited to the account. Most revenues are generated through employer "solvency" contributions 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 solvency account rather than directly to an employer's account. For example, benefits paid to former employees of closed employers are charged to the solvency account. As a result, \$191.8 million in benefit payments were charged directly to the account during FY 2009-10, and \$213.1 million in FY 2008-09. Another statutory provision requires transferring to the solvency account a portion of benefits previously charged to the accounts of certain employers who are at the maximum tax rate. These transfers amounted to \$407.0 million during FY 2009-10 and \$194.7 million during FY 2008-09. 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 solvency 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 increased from \$10,500 to \$12,000 in 2009 and to \$13,000 in 2011, and it will increase to \$14,000 in 2013. 2007 Wisconsin Act 59 also included a provision to increase employers' solvency tax payments, which are credited to the solvency account, beginning in calendar year 2009. For employers with positive account balances, the solvency tax rate increased by 0.2 percent; for those with negative account balances, the increase was 0.4 percent. These increases were offset by equal decreases in the basic tax rate (portion of the total tax payment credited to the employers' account balances).

During FY 2008-09, the Fund exhausted its cash reserves in the Federal Unemployment Trust Fund and was required by federal law to expend all other moneys available for the payment of unemployment benefits before borrowing from the federal government. Therefore, \$126.7 million in Reed Act allocations

were used to pay unemployment benefits, while \$22.6 million was set aside as unavailable for the payment of benefits. In addition, the Fund received a \$9.6 million special administrative transfer from the Federal Unemployment Trust Fund in FY 2008-09 to be used only for implementing and administering the provisions of state law that qualify Wisconsin for incentive payments made under the February 2009 Assistance for Unemployed Workers and Struggling Families Act and certain other administrative costs. These funds remain unspent.

Operating Revenues

The two major sources of operating revenue for the Fund are employer contributions 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 that the Fund's operating revenues increased by \$565.9 million during FY 2008-09, and by \$1,315.0 million during FY 2009-10.

Table D

Operating Revenues (in millions)

	FY 2007-08	FY 2008-09	Change	FY 2009-10	Change
Employer Contributions	\$671.7	\$ 635.2	\$ (36.5)	\$ 828.6	\$ 193.4
Benefit Reimbursements	77.3	676.9	599.6	1,796.5	1,119.6
Forfeitures and Other Revenues	5.3	8.1	2.8	10.1	2.0
Total Operating Revenues	\$754.3	\$1,320.2	\$565.9	\$2,635.2	\$1,315.0

Benefit reimbursements increased by \$599.6 million during FY 2008-09 and by \$1,119.6 million during FY 2009-10, due to temporary federal funding that extended benefit payments from a possible 26 weeks to a possible 99 weeks.

Employer contributions increased by \$193.4 million during FY 2009-10 primarily, due to the higher tax rates imposed under the rate schedule that took effect in calendar year 2010, in addition to the taxable wage base increase. 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. The highest of four statutory rate schedules was in effect during calendar year 2010 because the Fund's cash balance on June 30, 2009, was below the statutory index of \$300 million. The second-highest rate schedule was in effect during 2009 because the cash balance on June 30, 2008, was between \$300 million and \$900 million.

Nonoperating Revenues

As shown in Table E, the Fund's nonoperating revenues increased by \$37.5 million during FY 2008-09, and by \$24.7 million during FY 2009-10.

Table E

Nonoperating Revenues (in millions)

	FY 2007-08	FY 2008-09	Change	FY 2009-10	Change
Investment Earnings	\$27.1	\$10.4	\$(16.7)	\$ 0.0	\$(10.4)
Special Federal Aids	0.0	54.2	54.2	89.3	35.1
Total Nonoperating Revenues	\$27.1	\$64.6	\$37.5	\$89.3	\$24.7

The Fund is credited quarterly with investment earnings only to the extent its deposit with the Federal Unemployment Trust Fund exceeds any outstanding advances as computed on a daily basis. Since the Fund began to borrow from the Trust Fund during FY 2008-09, its deposits have not exceeded its advances, and the Fund has not since been credited with investment earnings.

During FY 2008-09 and FY 2009-10, the Federal Unemployment Trust Fund made two special distributions to states pursuant to the February 2009 Assistance for Unemployed Workers and Struggling Families Act. A state could receive the first distribution if its law contained specific provisions related to eligibility for unemployment benefits. Wisconsin met those provisions and the Fund received \$44.6 million in FY 2008-09 and \$89.3 million in FY 2009-10. The second distribution was made without conditions but may be used only to pay costs associated with implementing and administering the statutory provisions that qualify a state for incentive payments made under the Assistance for Unemployed Workers and Struggling Families Act, as well as certain other administrative costs. As noted, the Fund received \$9.6 million from this distribution in FY 2008-09.

Expenses and Transfers

As shown in Table F, the Fund's operating expenses increased by \$1,289.2 million during FY 2008-09, and by \$1,152.3 million during FY 2009-10.

Table F

Expenses and Transfers
(in millions)

	FY 2007-08	FY 2008-09	Change	FY 2009-10	Change
Benefits Paid on Behalf of:					
Taxable Employers	\$872.9	\$1,563.2	\$ 690.3	\$1,591.1	\$ 27.9
Other Entities	77.9	676.8	598.9	1,801.2	1,124.4
Total Operating Expenses	\$950.8	\$2,240.0	\$1,289.2	\$3,392.3	\$1,152.3
Transfer to Pay Administrative Expenses in General Fund and Other Nonoperating Expenses					
	\$5.6	\$(1.5)	\$(7.1)	\$(4.6)	\$(3.1)

The increase in benefits paid on behalf of taxable employers is the result of the average insured unemployment rate increasing from 4.5 percent in FY 2007-08 to 6.8 percent in FY 2008-09 and to 8.6 percent in FY 2009-10. The increase in benefits paid on behalf of governmental units, nonprofit organizations, and others is due to temporary federally funded unemployment benefits that extended the benefit payments from a possible 26 weeks to a possible 99 weeks.

Currently Known Facts, Decisions, and Conditions

The Fund owes \$25.4 million in interest to the U.S. Treasury as of May 31, 2011. Interest accrued on the outstanding federal advance for the period January 1, 2011, to September 30, 2011, must be paid on September 30, 2011. Interest may not be paid from regular unemployment funds or from federal funds.

Contacting the Unemployment Reserve Fund's Management

This financial report is designed to provide an overview of the financial results of the Fund's activities and to show the Fund's financial position. If you have questions on this report or need additional information, contact:

Wisconsin Unemployment Reserve Fund
Department of Workforce Development
Unemployment Insurance Division
201 East Washington Avenue
Madison, Wisconsin 53702

General information relating to the Fund can be found on the Fund's Web site, <http://dwd.wisconsin.gov/ui/>.

Financial Statements ■

Balance Sheet
June 30, 2010 and 2009

	June 30, 2010	June 30, 2009
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3):		
Federal Unemployment Trust Fund	\$ 209,554,144	\$ 244,000
Cash in bank	1,902,604	1,684,923
Total Cash and Cash Equivalents	<u>211,456,748</u>	<u>1,928,923</u>
Employer Accounts Receivable:		
Taxable employers (net of allowance)	214,761,393	125,559,765
Governmental units and nonprofit organizations (net of allowance)	7,053,009	7,292,736
Combined Wage Claim Plan receivables	3,304,100	6,164,156
Net Current Employer Accounts Receivable	<u>225,118,502</u>	<u>139,016,657</u>
Other Receivables:		
Overpayments to claimants (net of allowance)	19,797,748	12,970,037
Federally funded unemployment benefit programs	93,251,319	56,026,756
Due from State of Wisconsin (Note 5)	75,864	636,410
Net Current Other Receivables	<u>113,124,931</u>	<u>69,633,203</u>
Total Current Assets	<u>549,700,181</u>	<u>210,578,783</u>
Noncurrent Assets:		
Restricted cash for administration	22,886,513	26,610,163
Taxable employer accounts receivable	42,738,782	62,824,277
Overpayments to claimants	21,840,425	12,458,908
Total Noncurrent Assets	<u>87,465,720</u>	<u>101,893,348</u>
TOTAL ASSETS	<u>\$ 637,165,901</u>	<u>\$ 312,472,131</u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Overdrafts (Note 3)	\$ 28,385,180	\$ 40,227,145
Benefits payable	71,041,381	61,461,997
Employer overpayments	4,350,615	6,516,744
Benefit overpayments due employers, other states, and federal government	17,501,534	5,463,007
Combined Wage Claim Plan liabilities	903,212	6,091,536
Due to federal government	2,431,776	106,336
Due to State of Wisconsin (Note 5)	7,943,621	4,551,008
Other	191,861	427,261
Total Current Liabilities	<u>132,749,180</u>	<u>124,845,034</u>
Noncurrent Liabilities:		
Advance from federal government	1,424,768,541	435,547,245
Total Liabilities	<u>1,557,517,721</u>	<u>560,392,279</u>
Fund Equity (Note 1):		
Employer accounts	388,828,490	741,824,058
Solvency account	(1,331,666,822)	(1,016,788,824)
Restricted for administration	22,486,512	27,044,618
Total Fund Equity	<u>(920,351,820)</u>	<u>(247,920,148)</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 637,165,901</u>	<u>\$ 312,472,131</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, 2010 and 2009**

	For the Year Ended June 30, 2010	For the Year Ended June 30, 2009
OPERATING REVENUES		
Employer Contributions	\$ 828,643,068	\$ 635,188,312
Benefit Reimbursements (Note 4)	1,796,449,481	676,900,531
Forfeitures and Other Revenues	10,063,909	8,074,019
Total Operating Revenues	2,635,156,458	1,320,162,862
OPERATING EXPENSES		
Benefits Paid or Provided on Behalf of:		
Taxable employers	1,591,078,347	1,563,161,145
Governmental units, nonprofit organizations, and other organizations (Note 4)	1,796,468,420	676,939,308
Adjustment for allowance—claimants (Note 2E)	4,772,643	(107,145)
Total Operating Expenses	3,392,319,410	2,239,993,308
OPERATING LOSS	(757,162,952)	(919,830,446)
NONOPERATING REVENUES		
Investment Earnings	0	10,371,914
Special Federal Aids	89,289,386	54,211,412
Total Nonoperating Revenues	89,289,386	64,583,326
INCOME (LOSS) BEFORE TRANSFERS	(667,873,566)	(855,247,120)
TRANSFERS		
Transfer to State of Wisconsin General Fund	(4,558,106)	(1,542,480)
NET CHANGE IN FUND EQUITY	(672,431,672)	(856,789,600)
Fund Equity at the Beginning of the Year	(247,920,148)	608,869,452
Fund Equity at the End of the Year (Note 1)	<u>\$ (920,351,820)</u>	<u>\$ (247,920,148)</u>

The accompanying notes are an integral part of this statement.

Statement of Cash Flows for the Years Ended June 30, 2010 and 2009

	For the Year Ended June 30, 2010	For the Year Ended June 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from:		
Employer contributions	\$ 757,688,243	\$ 613,630,574
Benefit reimbursements	1,764,669,080	613,704,034
Other operating revenues	41,355,392	32,926,789
Cash Payments for:		
Benefits	(3,421,467,974)	(2,211,706,106)
Net Cash Used by Operating Activities	(857,755,259)	(951,444,709)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers to State of Wisconsin General Fund	(3,109,282)	(7,203,793)
Cash Overdraft Implicitly Financed (Repaid)	(11,841,965)	24,113,733
Cash Received for Special Federal Aids	89,289,386	54,211,413
Advance from Federal Government	989,221,296	672,291,443
Repayment of Advance from Federal Government	0	(236,744,198)
Net Cash Provided by Noncapital Financing Activities	1,063,559,435	506,668,598
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Earnings	0	10,371,914
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	205,804,176	(434,404,197)
Cash and Cash Equivalents at the Beginning of the Year	28,539,085	462,943,282
Cash and Cash Equivalents at the End of the Year	\$ 234,343,261	\$ 28,539,085
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	\$ (757,162,952)	\$ (919,830,446)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Provision for uncollectible accounts	16,018,885	4,793,031
Changes to assets and liabilities:		
Decrease (Increase) in employer accounts receivables	(73,242,860)	(35,006,144)
Decrease (Increase) in other receivables	(62,279,986)	(61,325,184)
Increase (Decrease) in liabilities	18,911,654	59,924,034
Total Adjustments	(100,592,307)	(31,614,263)
Net Cash and Cash Equivalents Used by Operating Activities	\$ (857,755,259)	\$ (951,444,709)

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.

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 or provided 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. Solvency Account

The solvency 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 solvency account is charged for a portion of benefits previously charged to the accounts of certain employers who are at the maximum tax rate.

C. Restricted for Administration

A portion of the Fund's equity has been restricted for 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, are reported as noncurrent assets on the Balance Sheet.

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 2009-10, the Fund wrote off as uncollectible \$18,940 in amounts receivable from nonprofit organizations. FY 2008-09 write-offs totaled \$38,777. 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, are reported as noncurrent assets on the Balance Sheet.

F. Amounts Receivable from Federally Funded Benefit Programs

The federal government provides funding for certain unemployment benefit programs that either supplement or extend regular state-funded benefits. Some programs, such as Disaster Unemployment Assistance and Trade Readjustment Assistance, are ongoing while other programs, such as Emergency Unemployment Compensation and Extended Benefits, are temporary. The Fund recognizes a receivable from the federal government when benefits are paid under these programs.

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 bank accounts. One account had a positive book balance, or carrying amount, at June 30, 2010 and 2009, which is reported as cash and cash equivalents. The carrying amounts of the Fund's other two bank accounts at June 30, 2010 and 2009, were negative and 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 \$250,000 by the Federal Deposit Insurance Corporation. In addition, from October 14, 2008, through December 31, 2009, 100 percent of the Fund's bank deposits were insured by the Federal Deposit Insurance Corporation through the Temporary Liquidity Guarantee Program. 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 \$2,036,583 as of June 30, 2010, and \$11,118,388 as of June 30, 2009, were exposed to custodial credit risk:

	<u>FY 2009-10</u>	<u>FY 2008-09</u>
Uninsured and Uncollateralized	\$1,386,583	\$0

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 2009-10</u> <u>(in millions)</u>	<u>FY 2008-09</u> <u>(in millions)</u>
Benefits reimbursed by the federal government under various unemployment benefit programs	\$1,689.55	\$598.85
Benefits reimbursed by the federal government for former federal employees	21.93	13.49
Benefits reimbursed by the State of Wisconsin, electing local governmental units, and electing nonprofit organizations for former employees	70.11	47.49
Benefits reimbursed by other states under the Combined Wage Claim Plan	14.88	17.11
Bad debt expense for reimbursable employers	<u>(.02)</u>	<u>(.04)</u>
Total	<u>\$1,796.45</u>	<u>\$676.90</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 amount reported as “Due from State of Wisconsin” results from the time lag between when benefits were paid out of the Unemployment Reserve Fund and when reimbursements were received.

The amount reported as “Due to State of Wisconsin” consists primarily of 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, 2010 and 2009**

	June 30, 2010	June 30, 2009
CASH BALANCE		
Cash and Cash Equivalents	\$ 211,456,748	\$ 1,928,923
Overdrafts	<u>(28,385,180)</u>	<u>(40,227,145)</u>
Net Cash Balance	183,071,568	(38,298,222)
INCREASES		
Employer Accounts Receivable:		
Government units and nonprofit organizations	5,014,565	5,136,659
Combined Wage Claim Plan receivables	<u>2,992,955</u>	<u>5,672,265</u>
Total Employer Accounts Receivable	8,007,520	10,808,924
Other Receivables:		
Federally funded unemployment benefit programs	45,504,621	34,114,597
Due from State of Wisconsin	<u>75,864</u>	<u>22,043</u>
Total Other Receivables	45,580,485	34,136,640
Total Increases	53,588,005	44,945,564
DECREASES		
Advance from Federal Government	1,424,768,541	435,547,245
Employer Overpayments	7,964,237	11,024,610
Due to State of Wisconsin	6,929,252	4,371,096
Due to Federal Government	2,431,776	106,336
Benefit Overpayments Due Other States	95,516	20,025
Other	186,618	425,065
Total Decreases	1,442,375,940	451,494,377
Cash Balance Related to Taxable Employers	<u>\$ (1,205,716,367)</u>	<u>\$ (444,847,035)</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, 2010 and 2009, 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 2009 because the taxable employer cash balance as of June 30, 2008, was \$439,634,465, which is greater than \$300 million but less than the \$900 million level specified in Wisconsin Statutes. Tax rate schedule A was in effect during 2010 because the balance as of June 30, 2009, was (\$444,847,035), which is less than the \$300 million level. Tax rate schedule A will again be in effect during 2011 because the balance as of June 30, 2010, was (\$1,205,716,367).

A. Net Cash Balance

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. Restricted cash is not included because it is not available for the payment of benefits on behalf of taxable employers. The net cash balance is then adjusted for balance sheet accounts that are unrelated to taxable employers to arrive at the cash balance related to taxable employers. Accruals that have no effect on the cash balance are removed from the balance sheet accounts.

B. Increases

The net cash balance is increased for the following items:

- Employer accounts receivable from governmental units and nonprofit organizations, gross of the allowance for uncollectible accounts, and from Combined Wage Claim plans.
- Receivables for federally funded unemployment benefit payments.
- Receivables for state-funded unemployment benefit payments.

C. Decreases

The net cash balance is reduced for the following items:

- Advance from the federal government.
- Employer overpayments of contributions.
- Cash receipts for interest and penalty assessments and state withholding taxes to be remitted to the State of Wisconsin.
- Cash receipts for federally funded unemployment benefit programs in excess of the benefits paid.
- Cash receipts for benefit overpayments to be remitted to other states.
- Other cash receipts to be remitted elsewhere, such as federal withholding taxes.

■ ■ ■ ■

Report on Internal 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, 2010 and 2009, and have issued our report thereon dated June 9, 2011. 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 (internal control) 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. Accordingly, we do not express an opinion on the effectiveness of the Unemployment Reserve Fund's internal control.

A *deficiency* in internal control 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 to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal

control, such that there is a reasonable possibility that a material misstatement of the Unemployment Reserve Fund's financial statements will not be prevented or will not be detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph. However, as discussed below, we identified deficiencies in internal control that we consider to be significant deficiencies. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Errors in Financial Reporting

The Unemployment Reserve Fund inappropriately omitted the accounts payable and expense and corresponding receivable and revenue for unemployment benefits related to reimbursable accounts for weeks through June 30, 2010, but paid after June 30. When a claimant of a reimbursable employer claims unemployment benefits, the employer must reimburse the Fund for the benefit payments, and the Fund should establish a payable for the claimant and a receivable from the employer for payments incurred during the fiscal year but paid after fiscal year-end. It is the Fund's policy to report a revenue at the same time as the expense.

While staff have procedures to prepare an accrual for unemployment benefits related to taxable accounts, staff did not, apparently due to oversight, prepare an accrual for unemployment benefits related to reimbursable accounts. Consequently, accounts payable and accounts receivable were understated by \$49.9 million and revenues and expenses were understated by \$25.2 million in the financial statements for FY 2009-10.

In response, Unemployment Reserve Fund management corrected this error and noted that in the future it would prepare an accrual at the end of the fiscal year for unemployment benefits related to reimbursable accounts. In addition, management also prepared an accrual to correct the FY 2008-09 financial statements.

Overpayments for Federal Additional Compensation

At the time of this audit, the Unemployment Reserve Fund had not identified and sought collection of any overpayments of the Federal Additional Compensation (FAC) supplement for certain claimants who had previously been identified as receiving overpayments for regular unemployment benefits. Collection of the FAC overpayments should be returned to the federal government.

Although staff are aware of the need to collect and return FAC overpayments to the federal government, they have not completed the necessary computer programming changes in the unemployment insurance benefits system to

automatically identify and establish overpayments related to the FAC supplement. Staff generated a computer report from the system and identified \$9,858,150 in FAC overpayments as of December 31, 2010, which we questioned in our FY 2009-10 single audit report for the State of Wisconsin.

In response to our recommendation, Unemployment Reserve Fund management indicated that certain programming changes were made in March 2011 and additional programming changes are anticipated for July 2011 to accurately track the overpayment collections to the appropriate claimant. Notice and recovery of FAC overpayments will proceed through normal recovery procedures. All recovered FAC overpayments will be returned to the federal government.


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, contracts, and grant agreements, 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 one instance of noncompliance that is required to be reported under *Government Auditing Standards*. This instance relates to overpayments for Federal Additional Compensation, as previously discussed in the Internal Control over Financial Reporting section and separately reported in our FY 2009-10 single audit report for the State of Wisconsin.

The Unemployment Reserve Fund's written responses to the findings identified in our audit are 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 solely for the information and use of the Unemployment Reserve Fund's management, the Wisconsin Legislature, and others within the organization. This report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on 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.

June 9, 2011

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