Audited Financial Statements

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Obligation Trust Fund

*Year Ended September 30, 2017*
*with Report of Independent Auditors*

AHP
CPAs & ADVISORS
ANDREWS HOOPER PAVLIK PLC

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Obligation Trust Fund

Audited Financial Statements

Year Ended September 30, 2017

## Contents

ANDREWS HOOPER PAVLIK PLC
691 N. SQUIRREL ROAD | SUITE 280 | AUBURN HILLS, MI 48326
p: 248.340.6050 | f: 248.340.6104 | www.ahpplc.com

# Report of Independent Auditors

State of Michigan
Office of the Auditor General,
Office of Financial Management, and
Talent Investment Agency

## Report on the Financial Statements

We have audited the accompanying financial statements of the Obligation Trust Fund of the State of Michigan Talent Investment Agency, as of and for the year ended September 30, 2017, and the related notes to the financial statements, as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Obligation Trust Fund as of September 30, 2017, and the change in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### *Emphasis of Matter*

As discussed in Note 1, the financial statements present only the Obligation Trust Fund of the State of Michigan Talent Investment Agency and do not purport to, and do not, present fairly the financial position of the State of Michigan or the State of Michigan Talent Investment Agency in its entirety as of September 30, 2017, or the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### *Other Matter*

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that management's discussion and analysis be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated December 8, 2017, on our consideration of the Obligation Trust Fund of the State of Michigan Talent Investment Agency's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Obligation Trust Fund of the State of Michigan Talent Investment Agency's internal control over financial reporting and compliance.

Andrews Hooper Pavlik PLC

Auburn Hills, Michigan
December 8, 2017

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Obligation Trust Fund

Management's Discussion and Analysis

September 30, 2017

The Obligation Trust Fund was established, in section 421.10a of the Michigan Employment Security Act of 1936, in order to repay advances received from the Federal Government that were provided to temporarily assist the State of Michigan (State) with unemployment payments that exceeded current revenue collections. The Fund was established as a Special Revenue Fund of the State which accounts for the receipt of the Obligation Assessment Tax, a special unemployment tax surcharge imposed on certain employers. These payments from employers are then transferred to the Michigan Finance Authority who currently holds the bonds and makes regular payments to the bond holders.

This annual report includes management's discussion and analysis report, the independent auditors' report, and the financial statements of the Fund for the year ended September 30, 2017. The accompanying financial statements present the results of operations for the Fund only. Accordingly, these financial statements do not present fairly the financial position or results of operations of the State of Michigan or the State of Michigan Talent Investment Agency. The financial statements also include notes that explain in more detail some of the information in the financial statements. The notes are essential to a full understanding of the data provided in the financial statements.

*Financial Highlights*

- The Obligation Assessment (OA) bonds are structured to be repaid over a ten year period; however the fund has the ability to perform early calls if excess funds are available. OA tax rates are reset annually to ensure the fund has adequate revenues to meet its debt repayment requirements.

- The Fund experienced a $3.1 million increase in revenues in 2017. There was a reduction in the average obligation assessment rates assessed on employers, dropping from 1.35% in 2016, to 1.31% in the current year. Offsetting this reduction during the year was an increase of approximately 80,000 covered employees and 6,000 subject employers.

- The decrease in assets is largely attributable to the decrease in the Receivable from Contributing Employers. Tax payments from contributing employers are required to be applied against OA debt first, then to regular unemployment insurance tax. This priority in the allocation methodology results in a 99% collection rate for OA. In 2017 the reserve methodology for receivables was modified to more accurately represent the collection history of these receivables.

*Financial Analysis of the Fund*

Our analysis provides an overview of the financial performance of the State of Michigan, Talent Investment Agency's Obligation Trust Fund. The Fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting.

Exhibit A provides the comparative summary of the Fund's fund balance as of September 30, 2017 and 2016:

*Exhibit A*

| | 2017 (In Thousands) | 2016 (In Thousands) |
|---|---|---|
| **Assets** | | |
| Total assets (all current) | **$ 62,518** | $ 65,563 |
| **Liabilities** | | |
| Total liabilities (all current) | **56,697** | 58,652 |
| **Deferred inflows of resources** | | |
| Total deferred inflows of resources | **5,821** | 6,911 |
| **Fund Balance** | | |
| Total fund balance (all restricted) | **$ -** | $ - |

The statement of revenues, expenditures, and changes in fund balance presents information on the revenue and expenditure activity for the Fund. The results of this year's operations for the Fund are summarized in Exhibit B below.

*Exhibit B*

| | 2017 (In Thousands) | 2016 (In Thousands) |
|---|---|---|
| **Revenues** | | |
| Obligation assessment collections | **$ 483,024** | $ 479,970 |
| Interest earned | **140** | 60 |
| Total revenues | **483,164** | 480,030 |
| **Expenditures** | | |
| Other fees | **483,160** | 480,025 |
| Treasury Fees | **4** | 5 |
| Total expenditures | **483,164** | 480,030 |
| Change in fund balance | **$ -** | $ - |

*Factors Expected to Have an Effect on Future Operations*

- Based on the November 2017 University of Michigan Research Seminar in Quantitative Economics (RSQE) Forecast, the unemployment rate in Michigan is expected to decline in 2018, with a projected increase in job growth of .9%. As a result, the Fund would expect further reduction in tax rates, since the target collection amount would be spread over a larger population. The Obligation Assessment Rate for rate year 2018 was determined in November 2017 and is set at a level that is expected to generate $453 million in revenue that is required. The average OA Tax rate is projected to be 1.2%.

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Obligation Trust Fund

Balance Sheet

September 30, 2017

| | | |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Equity in State of Michigan Treasurer's common cash | $ | 1,532,077 |
| Receivable from contributing employers – net of allowance of $17,199,362 | | 59,820,939 |
| Due from State of Michigan funds | | 1,164,994 |
| Total assets | $ | 62,518,010 |
| | | |
| **Liabilities, Deferred Inflows of Resources, and Fund Balance** | | |
| | | |
| **Liabilities** | | |
| Current liabilities: | | |
| Due to State of Michigan component units | $ | 56,697,071 |
| Total liabilities | | 56,697,071 |
| | | |
| **Deferred inflows of resources** | | |
| Obligation assessment collections | | 5,820,939 |
| | | |
| **Fund Balance** | | |
| Fund balance – restricted | | - |
| Total liabilities, deferred inflows of resources, and fund balance | $ | 62,518,010 |

*See accompanying notes.*

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Obligation Trust Fund

Statement of Revenues, Expenditures, and Changes in Fund Balance

Year Ended September 30, 2017

| | |
|---|---|
| Revenues: | |
| Obligation assessment collections | $ 483,024,469 |
| Interest earned | 140,394 |
| Total revenues | 483,164,863 |
| Expenditures: | |
| Other fees | 483,160,308 |
| Treasury fees | 4,555 |
| Total expenditures | 483,164,863 |
| Change in fund balance | - |
| Fund balance at beginning of year | - |
| Fund balance at end of year | $ - |

*See accompanying notes.*

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2017

## 1. General Activities and Significant Accounting Policies

The Obligation Trust Fund (Fund) was created by Michigan Compiled Laws (MCL) section 421.10a to facilitate the repayment of debt incurred through a bond issuance authorized under MCL 421.26a and the Employment Security Financing Act, MCL 12.271 *et seq*. This debt was issued in order to repay advances received from the Federal Government that were provided to temporarily assist the State of Michigan (State) with unemployment payments that exceeded current revenue collections. Revenues within the Fund are generated from annual assessments on employers. Payments are transferred to the Michigan Finance Authority who currently holds the bonds and makes regular payments to the bond holders. The financial statements of the Fund have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting.

The Fund is a special revenue fund which accounts for the receipt of a special unemployment tax surcharge imposed on certain employers known as Obligation Assessment Tax.

The Fund is not subject to an annual appropriation from the State. Therefore, the Fund does not have an annual budget and no budget to actual schedule is included in the report.

The Fund's financial statement amounts are included in the combined financial statements contained in the State of Michigan Comprehensive Annual Financial Report.

### Basis of Accounting

The Fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Fund considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

### Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

**1. General Activities and Significant Accounting Policies (continued)**

**Deferred Outflows and Inflows of Resources**

In addition to assets, the balance sheet will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of fund balance that applies to a future period(s) and thus, will not be recognized as an outflow of resources (expense/expenditure) until then. The Fund has no items that qualify for reporting in this category.

In addition to liabilities, the balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of fund balance that applies to a future period(s) and thus, will not be recognized as an inflow of resources (revenue) until that time. The Fund had one item that qualified for reporting in this category. The Fund reports unavailable revenue, which arise only under the modified accrual basis of accounting, from receivables related to contributing employers. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

**2. Equity in State of Michigan Treasurer's Common Cash**

Equity in State of Michigan Treasurer's common cash pool represents the Fund's interest, at fair market value, in an investment pool managed by the Treasurer of the State of Michigan. The Fund is credited quarterly with investment earnings and interest based upon average daily balances.

The investment authority for the State Treasurer's common cash pool is found in Public Act 105 of 1855, as amended. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States Government and its agencies and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is located in the State.

The Fund's pro-rata share of the State Treasurer's common cash pool was $1,532,077 as of September 30, 2017. For the total amount of deposits and investments in the State Treasurer's common cash pool and their specific risks, please refer to the State of Michigan Comprehensive Annual Financial Report.

**2. Equity in State of Michigan Treasurer's Common Cash (continued)**

**<u>Common Cash Deposits</u>**

**Custodial Credit Risk**

The custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

a. Uncollateralized,
b. Collateralized with securities held by the pledging financial institution or,
c. Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

The State Treasurer's common cash pool policy requires the following criteria to lessen the custodial credit risk: all financial institutions holding the State's deposits must pledge collateral equal to the amount of the account balance for all demand and time deposits to secure the State's funds. A bank, savings and loan association, or credit union holding the State's deposits must be organized under the laws or federal law and maintain a principal office or branch office in the State. No deposit in any financial organization may be in excess of 50% of the net worth of the organization.

**Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Public Act 35 of 1997 requires State deposits be held in a financial institution which maintains a principal office or branch office located in the State. The State had no common cash pool deposits subject to foreign currency risk as of September 30, 2017.

**<u>Common Cash Investments</u>**

**Types of Investments**

State Treasurer's common cash pool investments include prime commercial paper, corporate notes, and emergency municipal notes.

**2. Equity in State of Michigan Treasurer's Common Cash (continued)**

**<u>Common Cash Investments (continued)</u>**

**Risk**

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them. The custodial credit risk, credit risk, interest rate risk, concentration of credit risk, and foreign currency risk are discussed in the following paragraphs.

**Custodial Credit Risk**

Custodial credit risk for investments is the risk that, in the event of a failure by a counterparty, the Fund will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:

The counterparty or,

The counterparty's trust department or agent but not in the government's name.

The State Treasurer's common cash pool does not have an investment policy for managing custodial credit risk. As of September 30, 2017, the State Treasurer's common cash pooled investments were not exposed to custodial credit risk.

**Credit Risk**

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

The State Treasurer's common cash pool requires prime commercial paper investments be rated A-1 or P-1 at the time of purchase as rated by the two major rating services: Standard and Poor's (A-1) and Moody's (P-1). Borrowers must also have at least $400 million in commercial paper outstanding and the State Treasurer may not invest in more than 10% of a borrower's outstanding debt. The State Treasurer's common cash pool investments are further limited to $200 million in any borrower, unless the borrower has an A-1+ rating, in which case the investment is not to exceed $300 million.

The State Treasurer's investment in emergency municipal loans is evidenced by unrated notes held by the State in the State's name. In addition, as of September 30, 2017, prime commercial paper investments were rated at A-1, P-1, or above.

**2. Equity in State of Michigan Treasurer's Common Cash (continued)**

**Common Cash Investments (continued)**

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The State Treasurer's common cash pool policy states that cash equivalents are to be invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

The State Treasurer does not have a policy for controlling interest rate risk regarding the State Treasurer's common cash pool investments in special loan programs (Emergency Financial Assistance Loan Program, Michigan Marina Dredging Loan Program, and Agriculture Disaster Relief Program). These loan programs are investments created through legislation. Although some interest rate risk exposure exists, interest rate risk is not a consideration when entering into the special loan programs.

### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of a government's investments with a single issuer.

The Fund is invested in pooled investments in the State Treasurer's common cash pool, which are excluded from the concentration of credit risk disclosure requirements.

### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments.

The State Treasurer's common cash pool investment policy does not allow for investment in foreign investments or currency; therefore, the Fund is not exposed to foreign currency risk.

**3. Risk Management**

The State of Michigan has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State of Michigan is self-insured for most general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment compensation claims. Areas of risk where some level of insurance coverage is purchased include: aircraft liability, property and loss rental insurance that may be required by bond or lease agreements, portions of the State employee insurance benefits program, certain State artifacts, builder's risk coverage, boiler and machinery coverage, and employee bonding. Settled claims have not exceeded commercial coverage in any of the past 10 fiscal years.

The State of Michigan has established two internal service funds to account for certain aspects of the risk management program. Fund expenditures (expenses) are recognized in the paying funds in a manner similar to purchased commercial insurance. For other uninsured losses not covered by an internal service fund program, such as general liability and property losses, the Fund recognizes liabilities and records expenditure when a loss is due and payable.