

Audited Financial Statements

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

*Year Ended September 30, 2018
with Report of Independent Auditors*

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

Audited Financial Statements

Year Ended September 30, 2018

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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, 2018, 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, 2018, 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, 2018, 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 April 19, 2019, 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 the effectiveness of 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 Paulik PLC

Auburn Hills, Michigan
April 19, 2019

State of Michigan
Department of Talent and Economic Development
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Management's Discussion and Analysis

September 30, 2018

The Obligation Trust Fund (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, 2018. 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 \$20.5 million decrease in revenues for fiscal year 2018. The decrease is attributable to a reduction in the Obligation Assessment rates assessed on employers for the year. Obligation Assessment rates are set to ensure enough revenue is collected to cover 1.5 times the scheduled debt services. The average obligation assessment rate assessed on employers was reduced from 1.31% in 2017 to 1.25% in 2018. Offsetting this reduction during the year was an increase of approximately 53,000 covered employees and 3,000 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.

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Management’s Discussion and Analysis

September 30, 2018

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, 2018 and 2017:

Exhibit A

	2018	2017
	(In Thousands)	(In Thousands)
Assets		
Total assets (all current)	\$ 58,279	\$ 62,518
 Liabilities		
Total liabilities (all current)	54,839	56,697
 Deferred inflows of resources		
Total deferred inflows of resources	3,440	5,821
 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

	2018	2017
	(In Thousands)	(In Thousands)
Revenues		
Obligation assessment collections	\$ 462,370	\$ 483,024
Interest earned	309	140
Total revenues	462,679	483,164
 Expenditures		
Other fees	462,675	483,160
Treasury Fees	4	4
Total expenditures	462,679	483,164
 Change in fund balance	\$ -	\$ -

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Management's Discussion and Analysis

September 30, 2018

Factors Expected to Have an Effect on Future Operations

Based on the November 2018 University of Michigan RSQE Forecast, the unemployment rate in Michigan is projected to average 3.9% in 2019, a slight decrease from the average of 4.5% in 2018. An increase in job growth is projected to be 0.8% in 2019, which is consistent with the projected 2018 job growth. As a result, the OA tax rates will experience a small reduction in 2019, since the target collection amount would be spread over a slightly larger population. The Obligation Assessment Rate for rate year 2019 was determined in November 2018 and is set at a level that is expected to generate \$448 million in revenue that is required. The average OA Tax rate is projected to be approximately 1.2%.

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Balance Sheet

September 30, 2018

Assets

Current assets:

Equity in State of Michigan Treasurer’s common cash	\$ 1,554,392
Receivable from contributing employers – net of allowance of \$23,356,750	55,839,717
Due from State of Michigan funds	885,162
Total assets	<u>\$ 58,279,271</u>

**Liabilities, Deferred Inflows of Resources, and
Fund Balance**

Liabilities

Current liabilities:

Due to State of Michigan component units	<u>\$ 54,839,554</u>
Total liabilities	54,839,554

Deferred inflows of resources

Obligation assessment collections	3,439,717
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Fund Balance

Fund balance – restricted	-
Total liabilities, deferred inflows of resources, and fund balance	<u>\$ 58,279,271</u>

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Statement of Revenues, Expenditures, and Changes in Fund Balance

Year Ended September 30, 2018

Revenues:	
Obligation assessment collections	\$ 462,370,168
Interest earned	<u>308,792</u>
Total revenues	<u>462,678,960</u>
Expenditures:	
Other fees	462,674,560
Treasury fees	<u>4,400</u>
Total expenditures	<u>462,678,960</u>
Change in fund balance	-
Fund balance at beginning of year	
Fund balance at end of year	<u><u>\$ -</u></u>

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Notes to Financial Statements

September 30, 2018

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.

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Notes to Financial Statements

September 30, 2018

1. General Activities and Significant Accounting Policies (continued)

Allowance for Uncollectible Accounts

An allowance for uncollectible accounts is provided for receivable balances where ultimate collection is doubtful as determined by management from their analysis of potential bad debts and prior years' experience.

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 \$1,554,392 as of September 30, 2018. 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.

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September 30, 2018

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

Common Cash Deposits

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, 2018.

Common Cash Investments

Types of Investments

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

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

Common Cash Investments (continued)

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, 2018, 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, 2018, prime commercial paper investments were rated at A-1, P-1, or above.

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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.

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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 expenditures when losses are due and payable.

4. Contingencies

The Fund is involved in various claims and legal actions. Although it is not possible to predict the outcome of these matters, in the opinion of management, their ultimate disposition will not have a material effect on the financial position of the Fund.