

Audited Financial Statements

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Unemployment Compensation Fund

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

State of Michigan
Department of Talent and Economic Development
Talent Investment Agency –
Unemployment Compensation 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 Unemployment Compensation 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 Unemployment Compensation Fund as of September 30, 2018, and the changes in financial position and cash flows 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 Unemployment Compensation 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, the changes in its financial position, or, where applicable, cash flows 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 April 19, 2019, on our consideration of the Unemployment Compensation 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 Unemployment Compensation Fund of the State of Michigan Talent Investment Agency's internal control over financial reporting and compliance.

Andrews Hooper Pavlik PLC

Auburn Hills, Michigan
April 19, 2019

State of Michigan
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Management's Discussion and Analysis

September 30, 2018

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Unemployment Compensation Fund (Fund) was established under the provisions of the Michigan Employment Security Act of 1936 to account for unemployment contributions from Michigan employers and the payment of benefits to eligible unemployed workers. The Fund also accounts for the payment of benefits reimbursed under programs sponsored by certain federal government agencies. The Fund, like other state and local governmental funds, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

This annual report includes management's discussion and analysis report, the independent auditors' report, and the financial statements of the Fund. 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 Fund is steadily improving its net position, with an increase this year of approximately \$533 million. The total net position balance is approximately \$4.3 billion, the third largest in the country. The percentage of fund balance to total insured wages has increased from 2.05 in 2017 to 2.27 in 2018. A higher percentage is generally considered a sign of health and Michigan is above the national average of 0.88 percent.
- Operating Income increased \$38 million during the year. This represents a \$22 million decrease in revenue and a decrease in expenses of \$60 million over the previous fiscal year. The change in Operating Income is primarily attributable to a reduction in benefit expenditures.
- During 2nd quarter 2018, the program continues with the record low for initial claims and first payments as seen in 2nd quarter 2017. The incremental decrease in the average number of weeks an individual collected unemployment benefits (from 12.2 weeks in 2017 to 11.9 weeks in 2018), coupled with the increase in individuals returning to work within the first calendar quarter of receiving unemployment benefits (from 74.1 percent to 74.5 percent) continues to show positive results in individuals returning to work.

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- The average tax rate on taxable wages dropped from 3.58 percent in 2017 to 3.35 percent in 2018. This 0.23 percent decrease equates to an average tax reduction of \$21 per employee to the Fund. Countering this reduction during the year was an increased coverage of approximately 53,000 employees and 3,000 subject employers.*
- The Fund earned approximately \$87 million in interest income. The 2.3036 percent average yield on the Unemployment Trust Fund is consistent with 2017, although the comparatively higher fund balance generated approximately \$12 million more in interest income.*

*Source: USDOL ETA UI dashboard for Michigan 2Q 2018 (<https://ows.doleta.gov/unemploy/DataDashboard.asp>)

Financial Analysis of the Fund

Our analysis provides an overview of the financial performance of the State of Michigan, Talent Investment Agency's Unemployment Compensation Fund.

The statement of net position presents information on all of the Fund's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Fund is improving or deteriorating. However, one will need to consider other nonfinancial factors such as changes in economic conditions, population growth, and new or changed government legislation.

The net position of the Fund is restricted for the payment of unemployment benefits, with the exception of funds that were received under the Reed Act, and the American Recovery and Reinvestment Act Modernization Incentive and Special Administrative distributions. The net position for these distributions is restricted for certain costs of administration of unemployment compensation programs and employment services.

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Management’s Discussion and Analysis

September 30, 2018

Exhibit A provides the comparative summary of the Fund’s net position as of September 30, 2018 and 2017:

Exhibit A

| | 2018 | 2017 |
|-----------------------------------|---------------------|----------------|
| | (In Thousands) | (In Thousands) |
| Assets | | |
| Current assets | \$ 4,374,849 | \$ 3,840,042 |
| Noncurrent assets | 23,500 | 27,400 |
| Total assets | 4,398,349 | 3,867,442 |
| Liabilities | | |
| Current liabilities | 29,235 | 31,979 |
| Noncurrent liabilities | 47,447 | 46,549 |
| Total liabilities | 76,682 | 78,528 |
| Net position | | |
| Restricted for benefit payments | 4,299,379 | 3,766,295 |
| Restricted for Reed Act | 21,627 | 21,627 |
| Restricted for STC Administrative | 661 | 992 |
| Total net position | \$ 4,321,667 | \$ 3,788,914 |

The statement of revenues, expenses, and changes in net position present information showing how the Fund’s net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

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Management’s Discussion and Analysis

September 30, 2018

Exhibit B provides a comparative summary of the changes in net position for the years ended September 30, 2018 and 2017, as reported in the statement of revenues, expenses, and changes in net position:

Exhibit B

| | 2018 (In Thousands) | 2017 (In Thousands) |
|-----------------------------|-------------------------------|-------------------------------|
| Revenues | | |
| Operating | \$ 1,239,335 | \$ 1,261,085 |
| Nonoperating | 87,118 | 74,694 |
| Total revenues | 1,326,453 | 1,335,779 |
| Expenses | | |
| Operating | 793,369 | 853,540 |
| Income before transfers | 533,084 | 482,239 |
| Transfers out | (332) | (375) |
| Change in net position | \$ 532,752 | \$ 481,864 |

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 percent in 2019, a slight decrease from the average of 4.5 percent in 2018. An increase in job growth is projected to be 0.8 percent, which is consistent with the projected percentage in 2018. As a result, unemployment benefit payments should continue to decline along with a reduction in employer tax rates.

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Statement of Net Position

September 30, 2018

| | |
|--|------------------|
| Assets | |
| Current assets: | |
| Cash | \$ 5,490,424 |
| Deposits with federal government | 4,196,465,145 |
| Receivable from contributing employers, net of allowance of approximately \$90,200,000 | 152,500,000 |
| Receivable from states under combined wage programs | 679,094 |
| Due from State of Michigan funds | 502,975 |
| Due from State of Michigan component units | 295,618 |
| Due from federal agencies | 643,236 |
| Receivable from local governments and nonprofit entities, net of allowance of approximately \$6,400,000 | 18,273,010 |
| Total current assets | 4,374,849,502 |
| Noncurrent assets: | |
| Benefit overpayments, net of allowance of \$181,000,000 | 23,500,000 |
| Total assets | 4,398,349,502 |
| Liabilities | |
| Current liabilities: | |
| Accounts payable and accrued liabilities | 4,730,893 |
| Employer overpayments | 15,751,476 |
| Due to State of Michigan agencies | 29,270 |
| Due to State of Michigan funds | 2,520,742 |
| Due to federal agencies | 3,048,276 |
| Due to local governments and nonprofit entities | 963,642 |
| Other liabilities | 2,190,789 |
| Total current liabilities | 29,235,088 |
| Noncurrent liabilities: | |
| Employer overpayments, net of current portion | 47,447,339 |
| Total liabilities | 76,682,427 |
| Net Position | |
| Restricted for benefit payments | 4,299,379,312 |
| Restricted for Reed Act | 21,627,039 |
| Restricted for Short Time Compensation | 660,436 |
| Restricted for American Recovery and Reinvestment Act | 288 |
| Total net position | \$ 4,321,667,075 |

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Statement of Revenues, Expenses, and Changes in Net Position

Year Ended September 30, 2018

| | |
|---|--------------------------------|
| Operating revenues: | |
| Federal: | |
| Unemployment contributions | \$ 1,211,740,452 |
| Federal programs | 7,611,437 |
| Miscellaneous | 19,984,012 |
| Total operating revenues | <u>1,239,335,901</u> |
| | |
| Operating expenses: | |
| Unemployment benefits | 785,758,040 |
| Federal program claimants | 7,611,437 |
| Total operating expenses | <u>793,369,477</u> |
| | |
| Operating income | 445,966,424 |
| | |
| Nonoperating revenues: | |
| Federal credit reduction | 32,351 |
| Interest earned | 87,085,718 |
| Total nonoperating revenues | <u>87,118,069</u> |
| | |
| Income before transfers | 533,084,493 |
| | |
| Transfers out | <u>(331,618)</u> |
| Change in net position | 532,752,875 |
| | |
| Total net position at beginning of year | <u>3,788,914,200</u> |
| Total net position at end of year | <u><u>\$ 4,321,667,075</u></u> |

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Statement of Cash Flows

Year Ended September 30, 2018

| | |
|--|-------------------------|
| Cash flows from operating activities: | |
| Cash received from federal programs | \$ 8,263,620 |
| Cash received from unemployment contributions | 1,215,621,549 |
| Cash received from miscellaneous sources | 19,984,012 |
| Payments of unemployment benefits and to federal program claimants | <u>(790,169,538)</u> |
| Net cash provided by operating activities | 453,699,643 |
| Cash flows from noncapital financing activities: | |
| Transfers out | (375,034) |
| Receipts of FUTA credits | <u>32,351</u> |
| Net cash used in noncapital financing activities | (342,683) |
| Cash flows from investing activities: | |
| Interest earned | <u>87,085,718</u> |
| Net cash provided by investing activities | <u>87,085,718</u> |
| Net increase in cash | 540,442,678 |
| Cash at beginning of year | <u>3,661,512,891</u> |
| Cash at end of year | <u>\$ 4,201,955,569</u> |
| Reconciliation of operating income to net cash provided by operating activities: | |
| Operating income | \$ 445,966,424 |
| Net changes in assets and liabilities: | |
| Receivables | 4,118,470 |
| Due from State of Michigan funds | 168,699 |
| Due from State of Michigan component units | 8,952 |
| Due from federal agencies | 379,052 |
| Benefit overpayments | 3,900,000 |
| Accounts payable and accrued liabilities | 194,208 |
| Due to State of Michigan agencies | 4,993 |
| Due to State of Michigan funds | (3,719,159) |
| Due to State of Michigan component units | (155) |
| Employer overpayments | 3,299,297 |
| Due to federal agencies | 273,131 |
| Other liabilities | <u>(894,269)</u> |
| Net cash provided by operating activities | <u>\$ 453,699,643</u> |
| Schedule of noncash financing activities: | |
| Due to State of Michigan funds | <u>\$ (331,613)</u> |

State of Michigan
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Notes to Financial Statements

September 30, 2018

1. General Activities and Significant Accounting Policies

The Unemployment Compensation Fund of the State of Michigan Talent Investment Agency (Fund) was established under the provisions of the Michigan Employment Security Act of 1936. 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 accounts for unemployment contributions from Michigan employers and the payment of benefits to eligible unemployed workers. The Fund also accounts for the payment of benefits reimbursed under programs sponsored by certain federal government agencies.

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 financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this measurement focus, revenues are recognized when they are earned and expenses are recognized when incurred, regardless of the timing of related cash flows.

Cash

For the purposes of the statement of cash flows, the amount reported as cash is equal to the total of the amounts on the statement of net position classified as cash and deposits with the federal government. Cash consists of deposits in transit and cash held in checking accounts. The Deposits with the federal government consists of highly liquid investments and functions as both a cash management pool and demand deposit account.

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.

Operating Revenues and Expenses

Operating revenues and expenses primarily result from the collection of unemployment contributions and payment of unemployment benefits. Revenues and expenses not meeting this definition are reported as nonoperating revenue and transfers out.

State of Michigan
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Notes to Financial Statements

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1. General Activities and Significant Accounting Policies (continued)

Reed Act Distribution

On March 13, 2002, the Fund received a distribution of \$295,823,400, which is described as a Reed Act distribution. Federal law governs how the Fund may use this money, which is generally available for the payment of unemployment compensation benefits and the administration of unemployment compensation law and employment services offices. No amounts were released from restriction during the fiscal year ended September 30, 2018.

American Recovery and Reinvestment Act Distribution

During 2009, the Fund received a distribution of \$84,304,851 that was prescribed by the American Recovery and Reinvestment Act (ARRA) Section 2003. This amount, referred to as a Modernization Incentive and Special Administrative distribution, is to be used for certain costs of administration of unemployment compensation law and employment services, as defined in the American Recovery and Reinvestment Act. No amounts were released from restriction during the fiscal year ended September 30, 2018.

Short Time Compensation Administrative Distribution

On November 6, 2014, the Fund received a distribution of \$2,840,535 which is described as a Short Time Compensation (STC) administrative distribution. Federal law governs how the Fund may use this money, which is strictly for the implementation and promotion of the Work Share program. The amount released and transferred to the Administrative Fund of the State of Michigan Talent Investment Agency was \$331,618 for the fiscal year ended September 30, 2018.

Federal Unemployment Tax Act (FUTA) Credit Reduction

In addition to unemployment taxes paid by employers to the State of Michigan Talent Investment Agency Fund, employers pay a federal unemployment tax to the Internal Revenue Service, authorized under the Federal Unemployment Tax Act. The tax is paid annually on IRS Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*. The revenue from this tax is used to: (1) pay administrative costs of federal and state workforce agencies, (2) pay the federal share of Extended Benefits (under the Federal-State Extended Unemployment Compensation Act of 1970) during periods of high unemployment, and (3) provide loans to states with insolvent unemployment Trust Funds.

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September 30, 2018

1. General Activities and Significant Accounting Policies (continued)

Federal Unemployment Tax Act (FUTA) Credit Reduction (continued)

Employers pay FUTA on the first \$7,000 of each employee's annual wages. The FUTA tax is a flat rate of 6.0%, but employers who pay their state unemployment tax timely and in full receive a 5.4% credit. Therefore, the net FUTA rate is normally 0.6%. Federal law provides for a reduction in the FUTA tax credit when a state has outstanding federal loans for two years. The reduction in the FUTA tax credit is 0.3% for the first year and an additional 0.3% for each succeeding year until the loan is repaid. The FUTA credit reduction was effective between January 1, 2009 and December 31, 2011.

Receipts from the FUTA credit reduction were \$32,351 for the year ended September 30, 2018.

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.

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 so will not be recognized as an inflow of resources (revenue) until that time. The Fund has no items that qualify for reporting in this category.

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2. Cash

Custodial Credit Risk

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

The carrying amount of deposits on the balance sheet as of September 30, 2018 is \$5,490,424. The deposits reflected in the accounts at the bank were \$14,780,011 as of September 30, 2018. Of the bank balance, all amounts are covered by federal depository insurance and by collateral held in book-entry securities by pledging custodial banks at a Federal Reserve Bank.

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 Fund deposits be held in a financial institution which maintains a principal office or branch office located in the State of Michigan. The Fund had no deposits subject to foreign currency risk as of September 30, 2018.

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3. Deposits with Federal Government

Deposits with the federal government represent the Fund's interest, at fair market value, in a U.S. Treasury trust fund pool managed by the U.S. Secretary of the Treasury, pursuant to Title IX, Section 904 {42 USC 1104}(b) of the Social Security Act, which includes deposits from the unemployment compensation funds of various states. The Fund is credited quarterly with investment earnings and interest as computed on a daily basis. The Fund does not earn interest when there are outstanding Title XII advances.

The U.S. Secretary of the Treasury invests the unemployment compensation funds of the various states in accordance with the above described Title IX of the Social Security Act. Title IX allows for investments only in interest bearing obligations of the United States Government or in obligations guaranteed as to both principal and interest by the United States Government. This U.S. Treasury trust fund pool typically contains a daily "residual" cash amount of less than \$1,000. The "residual" cash is the amount left over after the investment and redemption activity. The investment is rounded to the nearest thousand.

The Fund's pro-rata share of the above described U.S. Treasury trust fund pool was \$4,196,465,145 as of September 30, 2018. The specific risks and investments described below represent the risks and total amount of all investments contained in this U.S. Treasury trust fund pool as of September 30, 2018.

U.S. Treasury Trust Fund Pool Investments

Types of Investments

The U.S. Treasury trust fund pooled investments include Special Issue Certificates of Indebtedness and Special Issue Bonds.

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.

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3. Deposits with Federal Government (continued)

U.S. Treasury Trust Fund Pool Investments (continued)

Custodial Credit Risk (continued)

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 Fund does not have an investment policy for managing custodial credit risk. As of September 30, 2018, the U.S. Treasury trust fund 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 U.S. Treasury trust fund pooled investments are unrated, but are interest bearing obligations of the United States Government and are obligations guaranteed as to both principal and interest by the United States Government.

Interest Rate Risk

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

All of the investments in this U.S. Treasury trust fund pool, including their interest rate and maturity, as of September 30, 2018 were:

Special Issue Bonds:

\$23,022,085 – 2.250% maturing June 30, 2019

\$41,362,985 – 2.250% maturing June 30, 2020

The U.S. Treasury trust fund pool does not have an interest rate risk policy because they can only invest in interest bearing obligations of the United States Government or obligations guaranteed as to both principal and interest by the United States Government.

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3. Deposits with Federal Government (continued)

U.S. Treasury Trust Fund Pool Investments (continued)

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 of United States Government securities in a U.S. Treasury trust fund, 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 Fund's investment policy does not allow for investment in foreign investments or currency; therefore, the Fund is not exposed to foreign currency risk.

4. Employer Overpayments

Employer overpayments represent management's estimate of the liability resulting from excess payments received from contributing employers. The current portion is the amount of the overpayments expected to be repaid to employers within the next fiscal year.

5. Transfers

The Fund records expenses to other State of Michigan agencies for services received as transfers, in accordance with accounting policies established by the State of Michigan.

6. 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 ten fiscal years.

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6. Risk Management (continued)

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 a loss is due and payable.

For unemployment claims, the Unemployment Compensation Fund of the State of Michigan Talent Investment Agency bills the State of Michigan for the actual amount of claims paid to former State employees. The State of Michigan accrues liabilities in the governmental fund financial statements for unemployment compensation, only to the extent paid by the Fund through September 30.

7. Contingencies

The Fund participates in a number of federal financial assistance programs, which could lead to a request for reimbursement to the federal grantor agencies for disallowed expenditures. In the opinion of management, the amount of such requests, if any, will not have a material effect on the financial position of the Fund.

The Fund is currently involved in a lawsuit where a contingent liability is reasonably possible, but the loss cannot be estimated at this time. Although it is not possible to predict the outcome of these proceedings, they could, if unfavorably resolved from the point of view of Fund management, have a material effect on the financial position of the Fund.