Audited Financial Statements

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Year Ended September 30, 2020
with Report of Independent Auditors

CPAs & ADVISORS
ANDREWS HOOPER PAVLIK PLC

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Audited Financial Statements

Year Ended September 30, 2020

Contents

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Report of Independent Auditors

State of Michigan
Office of the Auditor General,
Office of Financial Management, and
Department of Labor and Economic Opportunity,
Unemployment Insurance Agency

Report on the Financial Statements

We have audited the accompanying financial statements of the Unemployment Compensation Fund (Fund) of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency (Agency) as of and for the year ended September 30, 2020, 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, 2020, 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 Matters

Reporting Entity

As discussed in Note 1, the financial statements present only the Unemployment Compensation Fund of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency and do not purport to, and do not, present fairly the financial position of the State of Michigan or the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency in its entirety as of September 30, 2020, 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.

Contingencies, Risks, and Uncertainties

As discussed in Note 7, the Agency is unable to estimate the amount of fraudulent benefit payments issued by the Agency during the fiscal year ended September 30, 2020. Also discussed in Note 7, accounts payable and accrued benefits include benefits payable pending review by the Agency of approximately $960 million as of September 30, 2020. The Agency has adjusted this balance, the corresponding receivable from the Federal government, and the associated revenues and expenses downward by approximately $278 million for claims not expected to be paid. 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 March 10, 2021, on our consideration of the Unemployment Compensation Fund of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance 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 Department of Labor and Economic Opportunity's internal control over financial reporting and compliance.

Andrews Hooper Pavlik PLC

Auburn Hills, Michigan
March 10, 2021

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Management's Discussion and Analysis

September 30, 2020

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 Department of Labor and Economic Opportunity. 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.

During fiscal year ending September 30, 2020, the State of Michigan (State), along with the rest of the nation, was significantly impacted by the COVID-19 pandemic. The Unemployment Insurance Agency (Agency) played a critical role in providing assistance to millions of Michigan residents who found themselves without income during a public health crisis. In addition to the regular unemployment insurance (UI) program, the Agency administered a series of extensions and new federal programs under the Coronavirus Aid, Relief, and Economic Security (CARES) Act that targeted workers not typically covered by unemployment insurance. These programs, including regular UI and the new Lost Wage Assistance (LWA) program, generated benefit payments to over 2.3 million claimants totaling more than $25 billion in benefits.

This historical claim volume, in addition to the speed in which the programs were implemented, created significant challenges for unemployment programs across the country. These factors and others, including the addition of third-party contractors, numerous system changes, and program requirements that limited the verification of claimant information, significantly increased the Agency's potential fraud exposure. In response, the Department of Labor and Economic Opportunity hired an external firm to lead a cybersecurity and forensics assessment of the UI program. On November 25, 2020, a detailed report was issued which identified seven areas that impacted the Agency's ability to identify and manage fraudulent activity. The Department of Labor and Economic Opportunity immediately released the document to the public.

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Management's Discussion and Analysis

September 30, 2020

The U.S. Secret Service, the Federal Bureau of Investigation, the U.S. House of Representatives Committee on Oversight and Reform, along with many major news outlets have all reported on the problem of fraud in the UI program. A final determination as to the magnitude of the fraud exposure in Michigan is unlikely to be available until all instances of high-risk payments and credible reports of fraud are manually investigated. It should be noted that the majority of these losses correspond with claims filed under the CARES Pandemic Unemployment Assistance (PUA) program, and therefore, involve federal funds appropriated by the CARES Act and do not impact the health of Michigan's Unemployment Compensation Trust Fund.

Financial Highlights

- The Fund's net position declined by \$3.5 billion during the year. The current trust fund balance of \$1.3 billion ranks 5th in the nation, down from 3rd at the beginning of the year. Of note is that as of September 30, 2020, Michigan was one of only 35 states that had net trust fund balances above zero.

- The percentage of fund balance to total insured wages decreased from 2.5 percent to 1.0 percent. A higher percentage is generally considered a sign of Trust Fund solvency. During the fiscal year Michigan declined from 10th to 23rd in the nation in Trust Fund solvency.

- Operating income decreased by \$4.0 billion during the year to an operating loss of \$3.6 billion. This represents a \$20.6 billion increase in operating revenue and a \$24.6 billion increase in operating expense over the previous fiscal year. The change in operating income is almost entirely due to the increase in unemployment benefits paid as a result of the COVID-19 pandemic.

- As a result of efforts to slow the spread of the virus, the State unemployment rate experienced an unprecedented spike, reaching 24 percent in April 2020. This represented the highest level of unemployment in the State since comparable estimates have been produced; the previous high was 16.5 percent in 1982. Consequently, State-funded unemployment expenses increased by \$4.0 billion (over 500 percent) compared to the prior year, whereas tax revenues were relatively unchanged. The most recent estimate of unemployment for September 2020 is 8.6 percent, which remains significantly elevated compared to the prior year, when the unemployment rate hovered around 4.0 percent.

- In addition to the increase in State-funded benefits, the Agency also implemented several new federal programs as a result of the passage of the CARES Act and the *Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus 2019* Presidential memorandum.

- Major programs created by the CARES Act included Pandemic Unemployment Assistance (PUA), Pandemic Emergency Unemployment Compensation (PEUC), and Federal Pandemic Unemployment Compensation (FPUC).

  - The PUA program was intended to provide 39 weeks of unemployment benefits to individuals who had either exhausted all access to regular unemployment or who were otherwise not eligible, such as the self-employed, "gig workers," or those with limited recent work history. During the fiscal year, this program generated $3.3 billion in operating revenues and expenses.

  - The PEUC program was designed to provide an additional 13 weeks of benefits to individuals who had exhausted their regular unemployment entitlement. During the fiscal year, this program generated $261.2 million in operating revenues and expenses.

  - The FPUC program was designed to provide $600 per week in additional benefits to eligible recipients of other unemployment benefits during certain benefit weeks. During the fiscal year, this program generated $15.4 billion in operating revenues and expenses.

- In addition, the Presidential memorandum made available Federal Emergency Management Agency (FEMA) funds under the Lost Wages Assistance (LWA) program, with the intention that these funds be distributed through states' UI systems. This program was designed to provide $300 per week in additional benefits to recipients of other unemployment benefits during certain benefit weeks. During the fiscal year, this program generated $1.4 billion in operating revenues and expenses.

- On the revenue side, the average tax rate on taxable wages dropped to 2.94 percent in 2020 from 3.07 percent in 2019. This 0.13 percentage point decrease equates to an average tax reduction of $12 per employee to the Fund. In addition to this decline in tax rate, covered employment fell by 831,000 by the second calendar quarter of 2020. This decline appears to have occurred late enough in the fiscal year to have had limited impact on tax revenue.*

- The Fund earned approximately $90 million in interest income. The 2.38 percent average yield on the Fund was unchanged from 2019, but the precipitous decline in the Fund (beginning in April 2020) resulted in less interest income in the second half of the fiscal year.

*Source: USDOL ETA UI Data Summary for Michigan (https://oui.doleta.gov/unemploy/data_summary/DataSum.asp)

Financial Analysis of the Fund

Our analysis provides an overview of the financial performance of the State of Michigan, Department of Labor and Economic Opportunity, Unemployment Insurance 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, the American Recovery and Reinvestment Act Modernization Incentive, Special Administrative distributions, and CARES Act administration. The net position for these distributions is restricted for certain costs of administration of unemployment compensation programs and employment services.

Exhibit A provides the comparative summary of the Fund's net position as of September 30, 2020 and 2019:

Exhibit A

	2020 (In Thousands)	**2019** (In Thousands)
Assets		
Current assets	**$ 2,427,538**	$ 4,879,302
Noncurrent assets	**25,800**	19,200
Total assets	**2,453,338**	4,898,502
Liabilities		
Current liabilities	**1,109,994**	37,674
Noncurrent liabilities	**27,698**	28,656
Total liabilities	**1,137,692**	66,330
Net position		
Restricted for benefit payments	**1,264,518**	4,810,076
Restricted for CARES Act Administrative	**29,109**	-
Restricted for Reed Act	**21,627**	21,627
Restricted for STC Administrative	**392**	469
Total net position	**$ 1,315,646**	$ 4,832,172

The statement of revenues, expenses, and changes in net position presents 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.

Exhibit B provides a comparative summary of the changes in net position for the years ended September 30, 2020 and 2019, as reported in the statement of revenues, expenses, and changes in net position:

Exhibit B

	2020 (In Thousands)	**2019** (In Thousands)
Revenues		
Operating	**$ 21,727,970**	$ 1,187,232
Nonoperating	**118,685**	104,375
Total revenues	**21,846,655**	1,291,607
Expenses		
Operating	**25,363,104**	780,911
Income (loss) before transfers	**(3,516,449)**	510,696
Transfers in	**36,009**	-
Transfers out	**(36,086)**	(191)
Change in net position	**$ (3,516,526)**	$ 510,505

Factors Expected to Have an Effect on Future Operations

Based on the November 2020 University of Michigan Research Seminar on Quantitative Economics (RSQE) Forecast, the unemployment rate in Michigan is expected to decline to 6.9 percent during fiscal year 2021. This would remain elevated compared to pre-pandemic levels, which would result in higher benefit costs compared to the several years preceding the pandemic; however, the exact impact on the Fund will depend on continued federal response to the pandemic, and on future decisions surrounding employer charging.

As a result of the Fund falling below $2.5 billion as of June 30, 2020, the taxable wage base for employers will revert to $9,500. Based on estimates of covered employment, this is expected to generate approximately $50 million in additional tax revenue.

Broad employer non-charging provisions adopted as part of the response to the Coronavirus pandemic will have a significant impact on future operations. An experience-based tax system is designed to adjust employer tax rates upward in response to increased benefit costs, such that the Fund can recoup the cost of those benefits. Non-charging provisions mean that the Fund has seen a significant increase in benefit costs during the fiscal year, but there will be no resulting tax rate increase to cover the cost of those benefits. While the Fund is not currently projected to become insolvent during the coming fiscal year, absent some intervention, the medium-term outlook for the Fund is concerning.

Future operations will also depend heavily on the continued federal response to the Coronavirus pandemic. As of the end of the fiscal year, programs enacted by the CARES Act had either expired or were expected to expire on December 27, 2020. Subsequent to that date, legislation extended program eligibility in some form into March and April of 2021. Whether those programs are again extended or are allowed to expire will significantly impact the Fund.

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Statement of Net Position

September 30, 2020

Assets	
Current assets:	
Cash	$ 37,967,457
Deposits with federal government	1,381,966,140
Receivable from contributing employers, net of allowance of approximately $51,700,000	121,800,000
Receivable from states under combined wage programs	6,319,546
Due from State of Michigan funds	4,438,169
Due from State of Michigan component units	437,816
Due from federal agencies	818,945,354
Receivable from local governments and nonprofit entities, net of allowance of approximately $5,700,000	55,664,076
Total current assets	2,427,538,558
Noncurrent assets:	
Benefit overpayments, net of allowance of $155,000,000	25,800,000
Total assets	$ 2,453,338,558
Liabilities	
Current liabilities:	
Book cash overdraft	$ 269,380,877
Accounts payable and accrued liabilities	761,879,017
Employer overpayments	24,221,866
Due to State of Michigan component units	391,124
Due to State of Michigan funds	7,117,875
Due to federal agencies	4,494,710
Due to local governments and nonprofit entities	1,285,113
Other liabilities	41,223,419
Total current liabilities	1,109,994,001
Noncurrent liabilities:	
Employer overpayments, net of current portion	27,698,154
Total liabilities	1,137,692,155
Net Position	
Restricted for benefit payments	1,264,517,412
Restricted for CARES Act administration	29,109,491
Restricted for Reed Act	21,627,039
Restricted for Short Time Compensation	392,173
Restricted for American Recovery and Reinvestment Act	288
Total net position	$ 1,315,646,403

See accompanying notes.

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Statement of Revenues, Expenses, and Changes in Net Position

Year Ended September 30, 2020

Operating revenues:	
Federal:	
Unemployment contributions	$ 1,119,816,552
Federal programs	20,569,708,454
Miscellaneous	38,444,579
Total operating revenues	21,727,969,585
Operating expenses:	
Unemployment benefits	4,793,394,702
Federal program claimants	20,569,708,454
Total operating expenses	25,363,103,156
Operating loss	(3,635,133,571)
Nonoperating revenues:	
CARES Act revenue	29,109,491
Federal credit reduction	(84)
Interest earned	89,575,447
Total nonoperating revenues	118,684,854
Loss before transfers	(3,516,448,717)
Transfers in	36,008,914
Transfers out	(36,085,821)
Change in net position	(3,516,525,624)
Total net position at beginning of year	4,832,172,027
Total net position at end of year	$ 1,315,646,403

See accompanying notes.

State of Michigan
Department of Labor and Economic Opportunity
Unemployment Insurance Agency –
Unemployment Compensation Fund

Statement of Cash Flows

Year Ended September 30, 2020

Cash flows from operating activities:	
Cash received from federal programs	$ 19,752,571,214
Cash received from unemployment contributions	1,095,722,731
Cash received from miscellaneous sources	38,444,579
Payments of unemployment benefits and to federal program claimants	(24,573,235,390)
Net cash used by operating activities	(3,686,496,866)
Cash flows from noncapital financing activities:	
Cash received for CARES Act administration	29,109,491
Transfers in	36,008,914
Transfers out	(36,019,158)
Receipts of FUTA credits	(84)
Net cash used in noncapital financing activities	29,099,163
Cash flows from investing activities:	
Interest earned	89,575,447
Net cash provided by investing activities	89,575,447
Net change in cash	(3,567,822,256)
Cash at beginning of year	4,718,374,976
Cash at end of year	$ 1,150,552,720
Reconciliation of cash and cash equivalents:	
Per statement of net position classifications	
Cash	$ 37,967,457
Book cash overdraft	(269,380,877)
Deposits with federal government	1,381,966,140
Equity in State of Michigan Treasurer's common cash	-
Cash at end of year	$ 1,150,552,720
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ (3,635,133,571)
Net changes in assets and liabilities:	
Receivables	(24,452,259)
Due from State of Michigan funds	(3,846,317)
Due from State of Michigan component units	(143,928)
Due from federal agencies	(818,235,140)
Benefit overpayments	(6,600,000)
Accounts payable and accrued liabilities	757,114,955
Due to State of Michigan component units	324,468
Due to State of Michigan funds	2,800,943
Employer overpayments	1,223,272
Due to federal agencies	1,097,900
Other liabilities	39,352,811
Net cash used by operating activities	$ (3,686,496,866)
Schedule of noncash financing activities:	
Due to State of Michigan funds	$ (75,485)

See accompanying notes.

1. General Activities and Significant Accounting Policies

The Unemployment Compensation Fund of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance 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, book cash overdraft, and deposits with the federal government. Cash consists of deposits in transit and cash held in checking accounts. Deposits with the federal government consist 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.

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 which left $21,627,039 funds available as of September 30, 2020.

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 which left $288 funds available as of September 30, 2020.

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 Unemployment Insurance Agency was $76,908, which left a balance of $392,173 for the fiscal year ended September 30, 2020.

CARES Act Administrative Distribution

On April 1, 2020 and April 4, 2020, the Fund received cumulative distributions totaling $29,109,491 that were prescribed by the Families First Coronavirus Response (FFCR) Act, Public Law (Pub. L.) 116-127, specifically Division D, the Emergency Unemployment Insurance Stabilization and Access Act of 2020 (EUISAA). The EUISAA stipulates the Fund may use this money for the costs of administration of the unemployment compensation program. No amounts were released from restriction during the fiscal year ended September 30, 2020.

1. General Activities and Significant Accounting Policies (continued)

Federal Unemployment Tax Act (FUTA) Credit Reduction

In addition to unemployment taxes paid by employers to the Unemployment Insurance Agency, 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.

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.

There was a FUTA adjustment ($84) for the year ended September 30, 2020.

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 statement of net position 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 statement of net position 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.

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 deposits 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 deposits reflected in the accounts at the bank were $41,813,463 as of September 30, 2020. Of the bank balance, $41,422,546 was covered by federal depository insurance or by collateral held in book-entry securities by pledging custodial banks at a Federal Reserve Bank and $390,917 was not covered.

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, 2020.

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 $1,381,966,140 as of September 30, 2020. 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, 2020.

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.

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, 2020, 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, 2020 were:

Special Issue Bonds:

$ 8,102,006,000 – 1.875% maturing June 30, 2021
$42,412,520,000 – 2.500% maturing June 30, 2021

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.

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.

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 Unemployment Insurance 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, Risks, and Uncertainties

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 current Coronavirus pandemic has had an economic impact on the United States and the international community, significantly impacting unemployment across the country. The extent of the ultimate impact of the pandemic on the Fund’s operational and financial performance will depend on various developments, including duration and spread of the outbreak and its impact on contributing employers and claimants, all of which cannot be reasonably predicted at this time.

In early March 2020, the Coronavirus pandemic had the Agency quickly moving to implement several new federal programs designed to assist workers impacted by the pandemic. These programs included Pandemic Unemployment Assistance (PUA), Pandemic Unemployment Compensation (PUC), Pandemic Emergency Unemployment Compensation (PEUC), Extended Benefits, and then later the Lost Wage Assistance (LWA) programs. The PUA program in particular covered workers who were not previously covered by unemployment insurance. These programs created a surge in claims volume not previously experienced in the unemployment system. Between March 2020 and February 2021, approximately 4.6 million claims were filed by approximately 3.2 million unique claimants. During the fiscal year ended September 30, 2020, the Agency paid approximately $25.4 billion in unemployment benefits (including approximately $4.8 billion in regular unemployment benefits and approximately $20.6 billion under federal programs) to over 2.3 million claimants.

7. Contingencies, Risks, and Uncertainties (continued)

Due to the speed of implementation of these new programs, the limited requirements of the new PUA program, and the increased benefits provided by the PUC program, unemployment insurance programs throughout the country became a target for large-scale impostor fraud (identity theft) activity. These factors and others, including the addition of third-party contractors, numerous system changes, and program requirements that limited the verification of claimant information, contributed to a potentially significant increase in the Agency's fraud exposure. As of February 23, 2021, the Agency had over 600,000 open potential fraud investigation cases attributable to the pandemic period. Almost 83 percent of these cases involve PUA claims. The total amount of fraudulent benefits issued by the Agency will not be known until all of the suspected cases have been thoroughly investigated. Losses attributable to federal funds appropriated by the CARES Act would have no impact on the health of the Fund. The Agency has not reclassified any amount of benefits expense for losses from fraudulent benefit payments.

In response to the increased fraud activity and benefit recipients who typically do not qualify for regular unemployment benefits, the Agency implemented additional staff reviews of claims prior to the release of payments. Payments authorized during the year but pending staff review were recorded to an accrued payable account pending resolution. As of September 30, 2020, the gross accrued benefits payable to claimants pending review was approximately $960 million. Based on estimated rates of eventual approval for similar claims, the Agency has adjusted this balance, the corresponding receivable from the Federal government, and the associated revenues and expenses downward by approximately $278 million for claims not expected to be paid. As this adjustment relates only to federally funded benefits (which are ultimately revenue neutral to the Agency), this adjustment has had no impact on the Fund’s net position.

8. Obligation Assessment Bond Redemption

The Unemployment Insurance Agency transferred to the Michigan Finance Authority funds from the Compensation Fund sufficient to fully redeem the remaining outstanding obligation bonds with a redemption date of December 30, 2019. In January of 2020, the Obligation Trust Fund repaid these funds to the Compensation Fund. Consequently, no obligation assessment tax was assessed for the 2020 rate year.