Audited Financial Statements

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

Year Ended September 30, 2021
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, 2021

Contents

ANDREWS HOOPER PAVLIK PLC
43252 WOODWARD AVE | SUITE 150 | BLOOMFIELD HILLS, MI 48302
p: 248.340.6050 | f: 248.340.6104 | www.ahpplc.com

Report of Independent Auditors

State of Michigan
Office of the Auditor General,
Office of Financial Management, and
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, 2021, 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, 2021, 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, 2021, 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, 2021. Also discussed in Note 7, accounts payable and accrued benefits include benefits payable pending review by the Agency of approximately $273 million as of September 30, 2021. The Agency has adjusted this balance, the corresponding receivable from the Federal government, and the associated revenues and expenses downward by approximately $110 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, 2022, 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

Bloomfield Hills, Michigan
March 10, 2022

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

Management's Discussion and Analysis

September 30, 2021

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 the fiscal year ending September 30, 2021, the State of Michigan (State), and the rest of the nation, continued to be impacted by the COVID-19 pandemic. The Unemployment Insurance Agency (Agency) played a critical role in aiding 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 CARES, CAA, and ARPA Act that targeted workers not typically covered by unemployment insurance. These programs, including regular UI, the Lost Wage Assistance (LWA) program and various other federal programs, generated benefit payments to over 1 million claimants totaling more than $14 billion in benefits. Under the Continued Assistance Act (CAA) and the American Rescue Plan Act (ARPA), coverage for Federal Assistance was extended until September 4, 2021.

The programs continued to experience extraordinarily high claims volume throughout the fiscal year. The sudden spike in claims activity during the prior year, 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 fraud exposure. The agency's response to this fraudulent activity included the hiring of an external firm to lead a cybersecurity and forensics assessment of the Unemployment Insurance programs. The agency continued to utilize external expertise to supplement internal efforts throughout the year to combat fraudulent activity.

A final determination 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. However, recent projections prepared for the program estimates losses to be in the billions of dollars. It should be noted that losses corresponding with claims filed under the CARES programs involve federal funds appropriated by the CARES Act and do not impact the health of Michigan's Unemployment Trust Fund.

Financial Highlights

- The Fund's net position declined by $298 million during the year. The current trust fund balance is $968 million; as of 9/30/2021, Michigan was ranked 9th in the nation in absolute size, down from 5th at the beginning of the year. Of note is that as of June 30, 2021, Michigan was one of 36 states that had net trust fund balances above zero.

- The percentage of fund balance to total insured wages decreased from 1.0 percent to 0.3 percent. A higher percentage is generally considered a sign of Trust Fund solvency. During the fiscal year, Michigan declined from 23rd to 26th in the nation in Trust Fund solvency.

- Operating loss decreased from a loss of $3.6 billion during fiscal year 2020, to an operating loss of $465 million during fiscal year 2021. This represents a $7.8 billion decrease in operating revenue and a $10.9 billion decrease in operating expense over the previous fiscal year. The reduction in operating loss is almost entirely due to the decrease in unemployment benefits paid as a result of the COVID-19 pandemic.

- While unemployment remained elevated compared to pre-pandemic periods, state-funded benefit costs declined $3.2 billion year-over-year as a result of claimants either returning to work or exhausting their state claims (and thus moving to federal extensions).

- The Agency continued to pay extended benefits from the Coronavirus Aid, Relief, and Economic Security ("CARES") Act and the *Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus 2019* Presidential memorandum. CARES Act programs were twice extended (by the CAA and ARPA acts); the programs ended in September 2021.

- Major programs 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. The program was eventually extended to a maximum duration of 79 weeks. During the fiscal year, this program generated $2.9 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. This was later extended to a maximum duration of 53 weeks. During the fiscal year, this program generated $2.6 billion 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. The extension decreased the benefit payment amount to $400 per week. During the fiscal year, this program generated $6.4 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 $305 million in operating revenues and expenses.

- On the revenue side, the average tax rate on taxable wages dropped from 2.94% in 2020, to 2.92% in 2021. This 0.02 percentage point decrease equates to an average tax reduction of $2 per employee to the Fund. The wage base also increased from $9,000 to $9,500 due to the Trust Fund balance falling below $2.5 billion. The increase in wage base would be expected to generate an additional $15 of tax revenue per covered worker.

- The Fund earned approximately $19 million in interest income compared to $90 million in the prior year. The 2.14% average yield for 2021 decreased from 2020's yield of 2.38% on the Unemployment Trust Fund; however, the primary driver of the drop in earnings was the precipitous decline in the Trust Fund (beginning in April 2020).

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 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, 2021 and 2020:

Exhibit A

	2021 (In Thousands)	**2020** (In Thousands)
Assets		
Current assets	**$ 1,630,416**	$ 2,427,538
Noncurrent assets	**25,100**	25,800
Total assets	**1,655,516**	2,453,338
Liabilities		
Current liabilities	**608,272**	1,109,994
Noncurrent liabilities	**29,606**	27,698
Total liabilities	**637,878**	1,137,692
Net position		
Restricted for benefit payments	**967,813**	1,264,518
Restricted for CARES Act Administrative	**28,113**	29,109
Restricted for Reed Act	**21,627**	21,627
Restricted for STC Administrative	**85**	392
Total net position	**$ 1,017,638**	$ 1,315,646

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 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, 2021 and 2020, as reported in the statement of revenues, expenses, and changes in net position:

Exhibit B

	2021 (In Thousands)	**2020** (In Thousands)
Revenues		
Operating	**$ 13,970,617**	$ 21,727,970
Nonoperating	**18,546**	118,685
Total revenues	**13,989,163**	21,846,655
Expenses		
Operating	**14,435,867**	25,363,104
Income (loss) before transfers	**(446,704)**	(3,516,449)
Transfers in	**150,000**	36,009
Transfers out	**(1,304)**	(36,086)
Change in net position	**$ (298,008)**	$ (3,516,526)

Factors Expected to Have an Effect on Future Operations

Based on the November 2021 University of Michigan Research Seminar on Quantitative Economics (RSQE) Forecast, the unemployment rate in Michigan is expected to average 6.0 percent during the first quarter of fiscal year 2022, declining to 5.0 percent by fiscal year 2023. This would remain somewhat elevated compared to pre-pandemic levels, which would result in higher benefit costs compared to the years preceding the pandemic. However, this is a significant improvement from the record highs observed during the pandemic.

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 additional benefits that were paid. While the Fund is not currently projected to become insolvent during the coming year, absent some intervention, the medium-term outlook for the Fund is concerning.

Future operation will also depend heavily on future unemployment surges related to the ongoing pandemic, and the federal response (if any) to surges. While there are currently no mandated provisions impacting employment, COVID-19 case counts in Michigan have recently increased dramatically. The consequences of this increase in case counts could have a significant impact on unemployment, including both in terms of tax revenues and benefit costs. Currently, none of the federal unemployment programs implemented in response to the pandemic are in effect; thus, future benefit operations will be limited to regular unemployment programs and continued efforts to pay out accrued federal benefits.

During the fiscal year, the State requested and was awarded two extensions of the period of performance for the Lost Wages Assistance (LWA) program. The purpose of these extensions was to allow the State to continue to assess and approve or deny pending payments under the program, and to attempt to collect any overpayments. Unlike other federal unemployment programs, the terms of LWA require the State to repay any uncollected overpayments when the grant is closed out. The grant will have to be closed out and liquidated as of June 27, 2022. The balance of overpayments requiring repayment will depend both on future overpayment determinations and subsequent collections. The overpayment amount for the LWA program is estimated to be more than $170 million. This amount cannot be repaid from the unemployment trust fund but could potentially be paid from the Michigan Employment Security Act Contingent fund. The final source of funds will depend on state appropriation.

In January 2022, the Agency revised the programming for the calendar year 2021 Form 1099 statements. The accompanying financial statements have been updated and revised to properly reflect the adjustments allocable to fiscal year 2021 tax withholding activity. The overall impact of these adjustments is an increase in the due from federal agencies and total assets of $167.6 million, a net increase in current liabilities for tax withholdings and other current liabilities of $168.5 million, as well as increases in federal revenue, federal expenses, and unemployment benefit expenses. The impact of this change is a decrease in net position by $917,000 for the year ended September 30, 2021.

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

Statement of Net Position

September 30, 2021

Assets		
Current assets:		
Cash	$	89,274,822
Deposits with federal government		913,831,891
Receivable from contributing employers, net of allowance of approximately $40,500,000		144,900,000
Receivable from states under combined wage programs		1,089,532
Due from State of Michigan funds		150,084,436
Due from State of Michigan component units		21,623
Due from federal agencies		320,245,876
Receivable from local governments and nonprofit entities, net of allowance of approximately $5,300,000		10,968,164
Total current assets		1,630,416,344
Noncurrent assets:		
Benefit overpayments, net of allowance of $737,100,000		25,100,000
Total assets	$	1,655,516,344
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	$	492,467,354
Employer overpayments		25,424,732
Due to State of Michigan component units		194,747
Due to State of Michigan funds		7,188,520
Due to federal agencies		13,463,228
Due to local governments and nonprofit entities		17,959,010
Other liabilities		51,574,198
Total current liabilities		608,271,789
Noncurrent liabilities:		
Employer overpayments, net of current portion		29,606,428
Total liabilities		637,878,217
Net Position		
Restricted for benefit payments		967,812,687
Restricted for CARES Act administration		28,113,301
Restricted for Reed Act		21,627,039
Restricted for Short Time Compensation		84,812
Restricted for American Recovery and Reinvestment Act		288
Total net position	$	1,017,638,127

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, 2021

Operating revenues:	
Federal:	
Unemployment contributions	$ 1,089,063,646
Federal programs	12,866,005,695
Miscellaneous	15,547,249
Total operating revenues	13,970,616,590
Operating expenses:	
Unemployment benefits	1,569,839,599
Federal program claimants	12,866,027,806
Total operating expenses	14,435,867,405
Operating loss	(465,250,815)
Nonoperating revenues:	
Federal credit reduction	550
Interest earned	18,545,541
Total nonoperating revenues	18,546,091
Loss before transfers	(446,704,724)
Transfers in	150,000,000
Transfers out	(1,303,552)
Change in net position	(298,008,276)
Total net position at beginning of year	1,315,646,403
Total net position at end of year	$ 1,017,638,127

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, 2021

Cash flows from operating activities:	
Cash received from federal programs	$ 13,373,673,691
Cash received from unemployment contributions	989,090,736
Cash received from miscellaneous sources	15,547,249
Payments of unemployment benefits and to federal program claimants	(14,694,228,289)
Net cash used by operating activities	(315,916,613)
Cash flows from noncapital financing activities:	
Transfers in	150,000,000
Transfers out	(75,485)
Receipts of FUTA credits	550
Net cash provided by noncapital financing activities	149,925,065
Cash flows from investing activities:	
Interest earned	18,545,541
Net cash provided by investing activities	18,545,541
Net change in cash	(147,446,007)
Cash at beginning of year	1,150,552,720
Cash at end of year	$ 1,003,106,713
Reconciliation of cash and cash equivalents:	
Per statement of net position classifications	
Cash	$ 89,274,822
Deposits with federal government	913,831,891
Cash at end of year	$ 1,003,106,713
Reconciliation of operating income to net cash provided by operating activities:	
Operating loss	$ (465,250,815)
Net changes in assets and liabilities:	
Receivables	26,825,926
Due from State of Michigan funds	(145,646,267)
Due from State of Michigan component units	416,193
Due from federal agencies	498,699,478
Benefit overpayments	700,000
Accounts payable and accrued liabilities	(269,411,663)
Due to State of Michigan component units	(196,377)
Due to State of Michigan funds	(1,157,422)
Employer overpayments	19,785,037
Due to federal agencies	8,968,518
Other liabilities	10,350,779
Net cash used by operating activities	$ (315,916,613)
Schedule of noncash financing activities:	
Due to State of Michigan funds	$ (1,303,552)

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 Annual Comprehensive 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. 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 of funds available as of September 30, 2021.

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 of funds available as of September 30, 2021.

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 $307,361, which left a balance of $84,812 for the fiscal year ended September 30, 2021.

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. The amount released and utilized by the State of Michigan Unemployment Insurance Agency was $996,190, which left a balance of $28,113,301 for the fiscal year ended September 30, 2021.

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 of $550 for the year ended September 30, 2021.

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 $107,207,814 as of September 30, 2021. Of the bank balance, $107,207,814 was covered by federal depository insurance or by collateral held in book-entry securities by pledging custodial banks at a Federal Reserve Bank and no deposit amounts were 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, 2021.

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 $913,831,891 as of September 30, 2021. 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, 2021.

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, 2021, 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, 2021 were:

Special Issue Bonds:

$ 52,365,128,000 – 1.625% maturing June 30, 2022
$ 769,907,000 – 1.500% maturing June 30, 2022

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 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 several federal financial assistance programs, which could lead to a request for reimbursement to the federal grantor agencies for disallowed expenditures.

The ongoing 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) program. The PUA program in particular covered workers who were not previously covered by unemployment insurance. These programs were all extended during 2021. During the fiscal year ended September 30, 2021, the Agency paid approximately $14.4 billion in unemployment benefits (including approximately $1.5 billion in regular unemployment benefits and approximately $12.9 billion under federal programs) to over 1.2 million claimants.

The U.S. Department of Labor issued an Initial Determination on the 2020 Single Audit that includes the tentative disallowance of $11.4 million primarily attributable to the PUA program. To recover the questioned costs, the Agency has set up restitution on all accounts impacted. These receivables are being recovered via 50% recoupments from future benefits. As the amounts are recovered, they are returned to the appropriate federal program. The Final Determination to this audit will be issued during the 2022 fiscal year. It has yet to be determined whether reimbursement of the questioned costs will be required prior to collection from the claimants.

7. Contingencies, Risks, and Uncertainties (continued)

The Lost Wage Assistance (LWA) program requires states to reimburse FEMA for any overpayments that are not attributable to claimant error. Unlike other federal programs, this reimbursement must be made when the period of performance ends and the LWA program is closed. The agency estimates a potential liability exceeding $170 million that will need to be returned to FEMA during the 2022 fiscal year. The repayment of overpaid LWA claims is a national issue impacting states that administered the LWA program.

In the opinion of management, reimbursement requirements will not have a material effect on the financial position of the Fund. Reimbursement for these potential liabilities cannot be made from the U.I. Trust Fund, thus other state funds must be appropriated. The state funding source utilized would then be reimbursed from subsequent collection activity on the associated overpayments.

Due to the speed of implementation of the new programs, the expanded eligibility requirements of the PUA program, and the additional 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.

The total amount of fraudulent benefits issued by the Agency will not be known until all suspected cases have been thoroughly investigated. As of November 1, 2021, the Agency had over 544,000 open potential fraud investigation cases attributable to the pandemic period. Approximately 90 percent of these cases involve PUA claims. As of December 2021, over $4 billion in new restitution receivables has been established. All collection tools available to the agency will be utilized to recover these overpayments; however, most of the losses associated with identity theft claims are unlikely to be recovered. Losses attributable to federal funds appropriated by the CARES Act would have no impact on the health of the Fund. The State of Michigan made a $150 million voluntary payment to the fund to mitigate some of the impact of the pandemic activity.

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, 2021, the gross accrued benefits payable to claimants pending review was approximately $273 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 $110 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. Income Tax Withholding Adjustment

In January 2022, the Agency revised the programming for the calendar year 2021 Form 1099 statements. The accompanying financial statements have been updated and revised to properly reflect the adjustments allocable to fiscal year 2021 tax withholding activity. The overall impact of these adjustments is an increase in the due from federal agencies and total assets of $167.6 million, a net increase in current liabilities for tax withholdings and other current liabilities of $168.5 million, as well as increases in federal revenue, federal expenses, and unemployment benefit expenses. The impact of this change is a decrease in net position by $917,000 for the year ended September 30, 2021