

Audited Financial Statements

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

*Year Ended September 30, 2022
with Report of Independent Auditors*

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

Audited Financial Statements

Year Ended September 30, 2022

Contents

Report of Independent Auditors.....	1
Management’s Discussion and Analysis	4
Basic Financial Statements:	
Statement of Net Position	9
Statement of Revenues, Expenses, and Changes in Net Position	10
Statement of Cash Flows	11
Notes to Financial Statements.....	12

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 Audit of the Financial Statements

Opinion

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, 2022, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of September 30, 2022, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the 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, 2022, 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.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Compensation Fund and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management 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 and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Compensation Fund's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Compensation Fund's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Compensation Fund's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 February 1, 2023, on our consideration of the Compensation Fund'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 solely 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 the Compensation Fund's 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 Compensation Fund's internal control over financial reporting and compliance.

Andrews Hooper Paulik PLC

Bloomfield Hills, Michigan
February 1, 2023

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

Management's Discussion and Analysis

September 30, 2022

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.

The effects of the COVID-19 pandemic began to taper off in 2022. Under the Continued Assistance Act and the American Rescue Plan Act, coverage for Federal Assistance ended in late 2021. During fiscal year ending September 30, 2022, blue-collar industries in the State of Michigan essentially recovered to their pre-pandemic employment levels.

Financial Highlights

- The Fund's net position increased by \$665 million during the year. The current trust fund balance is \$1.76 billion; as of 9/30/2022, Michigan was ranked 7th in the nation in absolute size, up from 9th at the beginning of the year. Utilizing Coronavirus Relief funds, the State of Michigan appropriated \$100 million to the trust fund to offset the consequences of fraudulent activity during the pandemic.
- Although the percentage of fund balance to total insured wages (a solvency indicator) increased from 0.3 percent to 0.4 percent, during the fiscal year, Michigan declined from 26th to 35th in the nation in trust fund solvency.

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

Management’s Discussion and Analysis

September 30, 2022

- Operating income increased from a loss of \$465 million during fiscal year 2021, to an operating income of \$563 million during fiscal year 2022. This represents a \$12.5 billion decrease in operating revenue and a \$13.6 billion decrease in operating expense over the previous fiscal year. The overall increase in operating income is almost entirely due to a reduction in unemployment benefits paid to claimants.
- The Agency continued to pay extended benefits from the *Coronavirus Aid, Relief, and Economic Security* (“CARES”) Act and the *Authorizing the Other Needs Assistance (LWA) 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 towards the end of the previous fiscal year. The LWA program closed out in September 2022.
- On the revenue side, the average tax rate on taxable wages dropped from 2.92% in 2021, to 2.87% in 2022. This 0.05 percentage point decrease equates to an average tax reduction of \$5 per employee to the Fund. The wage base remained at \$9,500.
- The Fund earned approximately \$20 million in interest income, which was relatively consistent to the \$19 million earned in the prior year. The 1.61% average yield decreased from 2021’s yield of 2.14%.
- The Agency made significant strides in addressing the backlog of benefit work items; as a result, benefits payable saw a significant decrease from the previous fiscal year.
- The Agency utilized \$21 million of Reed Act funding that was distributed to the trust fund in fiscal years 2000 to 2002 for administrative purposes.

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.

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

Management’s Discussion and Analysis

September 30, 2022

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 the CARES Act. 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, 2022 and 2021:

Exhibit A

	2022	2021
	(In Thousands)	(In Thousands)
Assets		
Current assets	\$ 2,118,537	\$ 1,630,416
Noncurrent assets	22,800	25,100
Total assets	2,141,337	1,655,516
Liabilities		
Current liabilities	431,807	617,045
Noncurrent liabilities	35,274	29,606
Total liabilities	467,081	646,651
Net position		
Restricted for benefit payments	1,654,831	959,040
Restricted for CARES Act Administrative	19,340	28,113
Restricted for Reed Act	-	21,627
Restricted for STC Administrative	85	85
Total net position	\$ 1,674,256	\$ 1,008,865

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.

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

Management’s Discussion and Analysis

September 30, 2022

Exhibit B provides a comparative summary of the changes in net position for the years ended September 30, 2022 and 2021, as reported in the statement of revenues, expenses, and changes in net position:

Exhibit B

	2022 (In Thousands)	2021 (In Thousands)
Revenues		
Operating	\$ 1,446,245	\$ 13,970,617
Nonoperating	19,954	18,546
Total revenues	1,466,199	13,989,163
 Expenses		
Operating	883,460	14,435,867
 Income (loss) before transfers	 582,739	 (446,704)
 Transfers in	 104,279	 150,000
Transfers out	(21,627)	(10,078)
Change in net position	\$ 665,391	\$ (306,782)

Factors Expected to Have an Effect on Future Operations

Based on the November 2022 University of Michigan Research Seminar on Quantitative Economics (RSQE) Forecast, the unemployment rate in Michigan is expected to average 4.1 percent through the middle of 2023, before rising to a peak of 4.7 percent by early 2024. Although a recession is projected in the next two years, economists anticipate that continued strength in the automotive sector will buffer Michigan during a recession. The unemployment rate is expected to decline in late 2024 as the national economy begins to improve.

Broad employer non-charging provisions adopted as part of the response to the Coronavirus pandemic will continue to have an impact on future revenues. 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 during the pandemic meant that the fund experienced a significant increase in benefit costs, but there was 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, the fund will need to be closely monitored if a recession occurs.

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

Management's Discussion and Analysis

September 30, 2022

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 once the program is complete. The grant was closed out as of September 27, 2022. The final balance of overpayments requiring repayment will depend both on future overpayment determinations and on collections. The overpayment amount for the LWA program at the time of the closeout was approximately \$173 million. This amount cannot be repaid from the unemployment trust fund but could potentially be paid from the Contingent Fund of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency. The final source of funds will depend on state appropriation decisions.

On December 22, 2023, the Agency implemented a collection pause for claimants on benefits that resulted in overpayments because of a recent court order. The pause is to allow time for the agency to address protests and appeals of overpayment determinations before collection activity commences. The pause will include all debts established on claims since March 1, 2020, to protect claimants' rights to due process while the agency addresses pending protests and appeals. The length of the pause is undetermined but will be ceased upon elimination of the backlog. In the short term, the pause is expected to reduce funding to the Trust Fund and repayments due to the federal programs. The agency intends to refund amounts previously collected on overpayments associated with the period beginning March 1, 2020. The estimated refund amount is \$27.5 million and has been recorded as a liability in the fiscal year 2022 financial statements.

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

Statement of Net Position

September 30, 2022

Assets

Current assets:

Cash	\$ 77,794,158
Deposits with federal government	1,765,510,647
Receivable from contributing employers, net of allowance of approximately \$40,500,000	150,200,000
Receivable from states under combined wage programs	1,430,712
Due from State of Michigan funds	4,528,707
Due from State of Michigan component units	1,713,706
Due from federal agencies	45,265,583
Receivable from local governments and nonprofit entities, net of allowance of approximately \$5,200,000	8,531,811
Other current assets	<u>63,561,397</u>
Total current assets	<u>2,118,536,721</u>

Noncurrent assets:

Benefit overpayments, net of allowance of \$3,033,500,000	<u>22,800,020</u>
Total assets	<u><u>\$ 2,141,336,741</u></u>

Liabilities

Current liabilities:

Accounts payable and accrued liabilities	\$ 260,135,961
Employer overpayments	27,849,454
Due to State of Michigan component units	18,861
Due to Administration fund, Reed Act	21,627,039
Due to State of Michigan funds	3,067,229
Due to federal agencies	28,613,267
Due to local governments and nonprofit entities	7,620,199
Other liabilities	<u>82,874,520</u>
Total current liabilities	431,806,530

Noncurrent liabilities:

Employer overpayments, net of current portion	<u>35,274,308</u>
Total liabilities	467,080,838

Net Position

Restricted for benefit payments	1,654,830,896
Restricted for CARES Act administration	19,339,907
Restricted for Short Time Compensation	84,812
Restricted for American Recovery and Reinvestment Act	288
Total net position	<u><u>\$ 1,674,255,903</u></u>

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, 2022

Operating revenues:	
Federal:	
Unemployment contributions	\$ 1,192,507,205
Federal programs	253,738,279
Total operating revenues	<u>1,446,245,484</u>
Operating expenses:	
Unemployment benefits	629,743,988
Federal program claimants	253,716,168
Total operating expenses	<u>883,460,156</u>
Operating income	562,785,328
Nonoperating revenues:	
Federal credit reduction	63
Interest earned	19,953,967
Total nonoperating revenues	<u>19,954,030</u>
Income before transfers	582,739,358
Transfers in	104,278,851
Transfers out	<u>(21,627,039)</u>
Change in net position	665,391,170
Total net position at beginning of year, as restated	<u>1,008,864,733</u>
Total net position at end of year	<u><u>\$ 1,674,255,903</u></u>

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

Statement of Cash Flows

Year Ended September 30, 2022

Cash flows from operating activities:	
Cash received from federal programs	\$ 543,868,611
Cash received from unemployment contributions	1,264,057,431
Payments of unemployment benefits and to federal program claimants	<u>(1,082,191,247)</u>
Net cash provided by operating activities	725,734,795
Cash flows from noncapital financing activities:	
Transfers in	104,278,851
Transfers out	(9,769,584)
Receipts of FUTA credits	<u>63</u>
Net cash provided by noncapital financing activities	94,509,330
Cash flows from investing activities:	
Interest earned	<u>19,953,967</u>
Net cash provided by investing activities	<u>19,953,967</u>
Net change in cash	840,198,092
Cash at beginning of year	<u>1,003,106,713</u>
Cash at end of year	<u>\$ 1,843,304,805</u>
Reconciliation of cash and cash equivalents:	
Per statement of net position classifications	
Cash	\$ 77,794,158
Deposits with federal government	<u>1,765,510,647</u>
Cash at end of year	<u>\$ 1,843,304,805</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 562,785,328
Net changes in assets and liabilities:	
Receivables	(3,204,827)
Due from State of Michigan funds	145,555,729
Due from State of Michigan component units	(1,692,083)
Due from federal agencies	274,980,293
Other current assets	(63,561,397)
Benefit overpayments	2,299,980
Accounts payable and accrued liabilities	(232,331,393)
Due to State of Michigan component units	(175,886)
Due to State of Michigan funds	(3,125,101)
Employer overpayments	(2,246,209)
Due to federal agencies	15,150,039
Other liabilities	<u>31,300,322</u>
Net cash provided by operating activities	<u>\$ 725,734,795</u>
Schedule of noncash financing activities:	
Due to State of Michigan funds	<u>\$ (21,627,039)</u>

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

Notes to Financial Statements

September 30, 2022

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.

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

Notes to Financial Statements

September 30, 2022

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. During the year, \$21,627,039 of funds were released from restriction, which left no funds available as of September 30, 2022.

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, 2022.

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. No amounts were released from restriction during the fiscal year, which left a balance of \$84,812 for the fiscal year ended September 30, 2022.

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, which left a balance of \$19,339,907 for the fiscal year ended September 30, 2022.

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

Notes to Financial Statements

September 30, 2022

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 \$63 for the year ended September 30, 2022.

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.

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

Notes to Financial Statements

September 30, 2022

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 \$84,292,060 as of September 30, 2022. Of the bank balance, \$84,292,060 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, 2022.

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

Notes to Financial Statements

September 30, 2022

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 \$1,765,510,647 as of September 30, 2022. 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, 2022.

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.

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

Notes to Financial Statements

September 30, 2022

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, 2022, 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, 2022 were:

Certificates of Indebtedness (in thousands):

\$ 59,583,192 – 1.625% maturing June 30, 2023

\$ 2,737,073 – 1.750% maturing June 30, 2023

\$ 11,267,163 – 1.875% maturing June 30, 2023

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.

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

Notes to Financial Statements

September 30, 2022

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.

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

Notes to Financial Statements

September 30, 2022

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. During fiscal year 2022, expenditures for payments to former State employees (not including university employees) were \$3.4 million. The potential liability for future payments cannot be estimated.

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. 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 Coronavirus pandemic has had an economic impact on the United States and the international community, significantly impacting unemployment across the country. 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 created a surge in claim volume that had never been experienced by the Agency. Due to the speed of implementation of the previously mentioned programs, the limited requirements of the new PUA program, and additional benefits provided by the PUC program, unemployment insurance programs throughout the country became a target for large-scale impostor fraud 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.

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

Notes to Financial Statements

September 30, 2022

7. Contingencies, Risks, and Uncertainties (continued)

As of September 30, 2022, the Agency had over 531,000 open potential fraud investigation cases. 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 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. During the fiscal year, the State of Michigan made a voluntary \$100 million deposit into the Trust Fund to mitigate the impact of fraudulent cases on the solvency 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 but pending staff review were recorded to an accrued payable account pending resolution. As of September 30, 2022, the gross accrued benefits payable to claimants pending review was approximately \$130 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 by approximately \$32 million for claims not expected to be paid. As this adjustment relates only to federally funded benefits, this adjustment has had no impact on the Fund's net position.

Although the pandemic programs were discontinued at the end of fiscal year 2021, a significant amount of the agency's efforts during the current fiscal year has been spent addressing backlogs, adjudications, and protests associated with these programs. During the fiscal year ended September 30, 2022, the Agency paid approximately \$883 million in unemployment benefits to over 239,000 claimants. These benefits include approximately \$630 million in regular unemployment benefits and approximately \$253 million in federal program benefits.

In December 2022, the Agency implemented a collection pause for claimant overpayments resulting from benefits paid during the pandemic. The pause will allow time for the agency to address protests and appeals of overpayment determinations before collection activity commences. The length of the pause is undetermined but will be ceased upon elimination of the backlog. In addition to the short-term reduction in overpayment collections, the agency intends to refund amounts previously collected on overpayments associated with the period beginning March 1, 2020. An estimated \$27.5 million is expected to be refunded back to claimants in 2023, which has been recorded as a liability in the fiscal year 2022 financial statements.

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

Notes to Financial Statements

September 30, 2022

8. Prior Period Adjustment

Net Position was adjusted at the beginning of the fiscal year to recognize the effect of an allocation error associated with the CARES Act administrative grant in the prior year financial statements. The correction has no effect on the results of the current year's activities; however, the cumulative effect decreases beginning net position by \$8,773,394. Had the error not occurred, the change in Net Position – Restricted for CARES Act administration would have been decreased by \$8,773,394 and Transfers out would have been increased by \$8,773,394 within the 2021 financial statements of the Compensation Fund of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency. Previously issued financial statements were not restated to reflect this adjustment.