

Audited Financial Statements

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

*Year Ended September 30, 2023
with Report of Independent Auditors*

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

Audited Financial Statements

Year Ended September 30, 2023

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Report of Independent Auditors

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

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of the Contingent Fund of the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency (Fund) as of and for the year ended September 30, 2023, 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, 2023, 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.

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 Contingent 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.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Contingent 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, 2023, 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.

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.

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 Contingent 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.

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 December 14, 2023, on our consideration of the Contingent 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 Contingent 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 Contingent Fund's internal control over financial reporting and compliance.

Andrews Hooper Pavlik PLC

Bloomfield Hills, Michigan
December 14, 2023

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

Management's Discussion and Analysis

September 30, 2023

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 Contingent Fund (Fund) was established under the provisions of the Michigan Employment Security Act of 1936 to account for collections of interest and penalties on delinquent unemployment contributions from employers, misrepresentation penalties on wrongfully collected unemployment benefits from claimants, and a special unemployment tax surcharge imposed on certain employers known as Solvency Tax. 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 auditor's report, and the financial statements of the Fund for the year ended September 30, 2023. The accompanying financial statements present the results of operation 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, Unemployment Insurance Agency. The financial statements also include notes that explain in more detail some of the information in the financial statements. The notes are essential to a full understanding of the data provided in the financial statements.

Financial Highlights

- The Fund's net position decreased by \$9.9 million during the year. The overall decrease is primarily attributable to an increase in the current year operating transfer.
- Operating revenues for the fund increased by \$880 thousand compared to the prior year. Although employer collections increased by \$1.8 million, the gain was offset by a reduction in claimant collections associated with the mandated collection pause.
- Operating expenses for the current year have returned to normal levels after experiencing a \$20 million increase in 2022 due to the settlement of a lawsuit.
- The increase in interest income is attributable to rising interest rates.

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, Contingent Fund.

State of Michigan
 Department of Labor and Economic Opportunity
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Management’s Discussion and Analysis

September 30, 2023

The statement of net position presents information on all 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 and new or changed government legislation.

The net position of the Fund 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, 2023 and 2022:

Exhibit A

	2023	2022
Assets	(In Thousands)	(In Thousands)
Total assets (all current)	\$ 133,104	\$ 163,042
Liabilities		
Total liabilities (all current)	-	20,000
Net position		
Total net position (all restricted)	\$ 133,104	\$ 143,042

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

Exhibit B provides a comparative summary of the changes in net position for the years ended September 30, 2023 and 2022, as reported in the statement of revenues, expenses, and changes in net position.

State of Michigan
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Management’s Discussion and Analysis

September 30, 2023

Exhibit B

	2023 (In Thousands)	2022 (In Thousands)
Revenues		
Operating	\$ 30,328	\$ 29,449
Nonoperating	7,481	989
Total revenues	37,809	30,438
 Expenses		
Operating	4,635	24,635
 Income before transfers	33,174	5,803
 Transfers out	(43,112)	(13,297)
Change in net position	\$ (9,938)	\$ (7,494)

Factors Expected to Have an Effect on Future Operations

Employer collections, which historically have generated most of the Contingent Fund’s revenue, are expected to decline. Historically, employer penalty and interest collections have correlated with overall unemployment tax assessments. However, the non-charging of benefit payments during the pandemic has contributed to a slight reduction in employer tax rates over the past few years, and the 2024 rates are projected to continue that trend. The increase in collections for the past two years are attributable to pandemic era compliance efforts. Claimant collections will continue to lag with the extension of the collection pause into the new year.

There are a few items related to pandemic activity that have the potential to result in expenditures for the Unemployment Insurance Agency. These expenditures 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.

- In 2022, the United States Department of Labor reported a potential questioned cost on the 2020 Single Audit. The agency proposed returning funds as they were recovered from claimants, which would not require a lump sum repayment. Resolution of this item is pending.

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September 30, 2023

- During fiscal year 2023, the agency received an IRS penalty assessment resulting from a major system modification that was implemented in 2022 to accurately report the 2021 1099's. The agency has requested an abatement of this penalty. Resolution of this matter is pending.
- Also pending resolution is the repayment of the Lost Wages Assistance (LWA) overpayment balance. The LWA program, administered by FEMA, requires states to repay any overpayments at the time the program is finalized. The final balance of overpayments requiring repayment will depend both on future overpayment determinations and on overpayment recoveries. The agency expects to receive a billing from the Federal Emergency Management Agency in fiscal year 2024.

Future Considerations

In 2023, the State of Michigan, Department of Labor and Economic Opportunity Unemployment Insurance Agency began discussions and planning with Deloitte for its new programed software system. This system will replace our current system for workers and employers. The new system is expected to become fully operational in 2025.

State of Michigan
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Statement of Net Position

September 30, 2023

Assets

Current assets:

Equity in State of Michigan Treasurer's common cash	\$ 116,540,188
Receivables from contributing employers	8,747,915
Receivables from claimants	5,100,000
Due from State of Michigan funds	2,716,159
Total assets	<u>\$ 133,104,262</u>

Net Position

Restricted	\$ 133,104,262
Total net position	<u>\$ 133,104,262</u>

State of Michigan
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Statement of Revenues, Expenses, and Changes in Net Position

Year Ended September 30, 2023

Operating revenues:	
Interest and penalties on delinquent unemployment contributions	\$ 28,232,214
Interest and penalties on claimant overpayments	2,095,632
Solvency collections	284
Total operating revenues	30,328,130
Operating expenses:	
Other administrative costs and fees	4,635,200
Total operating expenses	4,635,200
Operating income	25,692,930
Nonoperating revenues and expenses:	
Interest earned	7,481,312
Income before transfers	33,174,242
Transfers out	(43,112,271)
Change in net position	(9,938,029)
Total net position at beginning of year	143,042,291
Total net position at end of year	\$ 133,104,262

State of Michigan
 Department of Labor and Economic Opportunity
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Statement of Cash Flows

Year Ended September 30, 2023

Cash flows from operating activities:	
Cash received from interest and penalties on delinquent unemployment contributions	\$ 28,300,000
Cash received from interest and penalties on claimant overpayments	4,000,000
Payments of other fees	<u>(4,635,200)</u>
Net cash provided by operating activities	27,664,800
Cash flows from noncapital financing activities:	
Lawsuit settlement payment	(20,000,000)
Transfers out	<u>(43,112,271)</u>
Net cash used in noncapital financing activities	(63,112,271)
Cash flows from investing activities:	
Interest earned	<u>7,481,312</u>
Net cash provided by investing activities	<u>7,481,312</u>
Net change in cash	(27,966,159)
Cash at beginning of the year	<u>144,506,347</u>
Cash at end of the year	<u><u>\$ 116,540,188</u></u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 25,692,930
Net changes in assets and liabilities:	
Receivables from contributing employers	751,454
Receivables from claimants	1,640,000
Due from State of Michigan funds	<u>(419,584)</u>
Net cash provided by operating activities	<u><u>\$ 27,664,800</u></u>

State of Michigan
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Notes to Financial Statements

September 30, 2023

1. General Activities and Significant Accounting Policies

The Contingent 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 collections of interest and penalties on delinquent unemployment contributions from employers, misrepresentation penalties and interest on wrongfully collected unemployment benefits from claimants, and a special unemployment tax surcharge imposed on certain employers known as Solvency Tax.

The Fund's financial statement amounts are included in the combined financial statements contained in the State of Michigan (State) 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 and cash equivalents is equal to the amount on the statement of net position classified as equity in State of Michigan Treasurer's common cash. The State common cash pool consists of highly liquid investments and functions as both a cash management pool and demand deposit account.

Receivables from Contributing Employers

Receivables from contributing employers represent the amount of interest and penalties and solvency tax owed from employers that management has deemed collectible as of September 30, 2023.

Receivables from Claimants

Receivables from claimants represent the amount of misrepresentation penalties and interest owed on wrongfully collected unemployment benefits that management has deemed collectible as of September 30, 2023.

State of Michigan
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Notes to Financial Statements

September 30, 2023

1. General Activities and Significant Accounting Policies (continued)

Restricted Net Position

Net position is restricted for administration of unemployment insurance provided by the State of Michigan Department of Labor and Economic Opportunity, Unemployment Insurance Agency funds and for the career development of unemployed individuals.

Operating Revenues and Expenses

Operating revenues primarily result from the collection of interest and penalties on delinquent unemployment contributions and misrepresentation penalties and interest on wrongfully collected unemployment benefits. Operating expenses are specifically appropriated by the legislature. Revenues and expenses not meeting these definitions are reported as nonoperating revenues and transfers.

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 thus, 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
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Notes to Financial Statements

September 30, 2023

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

Equity in State of Michigan Treasurer’s common cash pool represents the Fund’s interest, at fair market value, in an investment pool managed by the Treasurer of the State of Michigan. The Fund is credited quarterly with investment earnings and interest based upon average daily balances.

The investment authority for the common cash pool is found in Public Act 105 of 1855, as amended. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States Government and its agencies; and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is in the State of Michigan.

The Fund’s pro-rata share of the State Treasurer’s common cash pool was \$116,540,188 as of September 30, 2023. For the total amount of deposits and investments in the State Treasurer’s common cash pool and their specific risks, please refer to the State of Michigan Annual Comprehensive Financial Report.

Common Cash Deposits

Custodial Credit Risk

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

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Notes to Financial Statements

September 30, 2023

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

Common Cash Deposits (continued)

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Public Act 35 of 1997 requires State deposits be held in a financial institution which maintains a principal office or branch office located in the State. The State had no common cash pooled deposits subject to foreign currency risk as of September 30, 2023.

Common Cash Investments

Types of Investments

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

Risk

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them.

The custodial credit risk, credit risk, interest rate risk, concentration of credit risk, and foreign currency risk are discussed in the following paragraphs.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure by a counterparty, the Fund will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:

The counterparty, or

The counterparty’s trust department or agent but not in the government’s name.

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Notes to Financial Statements

September 30, 2023

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

Common Cash Investments (continued)

Custodial Credit Risk (continued)

The State Treasurer’s common cash pool does not have an investment policy for managing custodial credit risk. As of September 30, 2023, the State Treasurer’s common cash pool investments were not exposed to custodial credit risk.

Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

The State Treasurer’s common cash pool requires prime commercial paper investments be rated A-1 or P-1 at the time of purchase as rated by the two major rating services: Standard and Poor’s (A-1) and Moody’s (P-1). Borrowers must also have at least \$400 million in commercial paper outstanding and the State Treasurer may not invest in more than 10% of a borrower’s outstanding debt. The State Treasurer’s common cash pool investments are further limited to \$200 million in any borrower, unless the borrower has an A-1+ rating, in which case the investment is not to exceed \$300 million.

The State Treasurer’s investment in emergency municipal loans are evidenced by unrated notes held by the State in the State’s name. In addition, as of September 30, 2023, prime commercial paper investments were rated at A-1, P-1, or above.

Interest Rate Risk

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

The State Treasurer’s common cash pool policy states that cash equivalents are to be invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

The State Treasurer does not have a policy for controlling interest rate risk regarding the State Treasurer’s common cash pool investments in special loan programs (Emergency Financial Assistance Loan Program, Michigan Marina Dredging Loan Program, and Agriculture Disaster Relief Program). These loan programs are investments created through legislation. Although some interest rate risk exposure exists, interest rate risk is not a consideration when entering special loan programs.

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Notes to Financial Statements

September 30, 2023

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

Common Cash 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 in the State Treasurer’s common cash pool, which is excluded from the concentration of credit risk disclosure requirements.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments.

The State Treasurer’s common cash pool investment policy does not allow for investment in foreign investments or currency; therefore, the Fund is not exposed to foreign currency risk.

3. Transfers

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

4. Risk Management

The State of Michigan has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State of Michigan is self-insured for most general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers’ compensation and unemployment compensation claims. Areas of risk where some level of insurance coverage is purchased include aircraft liability, property and loss rental insurance that may be required by bond or lease agreements, portions of the State employee insurance benefits program, certain State artifacts, builder's risk coverage, boiler and machinery coverage, and employee bonding. Settled claims have not exceeded commercial coverage in any of the past 10 fiscal years.

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September 30, 2023

4. Risk Management (continued)

The State of Michigan has established two internal service funds to account for certain aspects of the risk management program. Fund expenditures (expenses) are recognized in the paying funds in a manner similar to purchased commercial insurance. For other uninsured losses not covered by an internal service fund program, such as general liability and property losses, the Fund recognizes liabilities and records expenditures when a loss is due and payable.

5. Contingencies, Risks, and Uncertainties

The Fund is currently involved in litigation where there is the potential for a contingent liability. Although it is not possible to predict the outcome of these proceedings, if unfavorably resolved it could have a material effect on the financial position of the Fund.

The Lost Wages Assistance (LWA) grant was closed out as of September 27, 2022. The LWA program, administered by FEMA, requires states to repay any overpayments at the time the program is finalized. 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, the current balance is now approximately \$140 million. This amount 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, 2022, the Agency implemented a collection pause for claimants who have been deemed to be overpaid and received benefits 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 is dependent on pending litigation. Although the collections pause is not expected to impact employer penalties and interest, it is expected to negatively impact collections on claimant penalty and interest which funds the Contingent Fund.