

Audited Financial Statements

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

*Year Ended September 30, 2015
with Report of Independent Auditors*

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Audited Financial Statements

Year Ended September 30, 2015

Contents

Report of Independent Auditors.....	1
Management’s Discussion and Analysis.....	3
Balance Sheet.....	6
Statement of Revenues, Expenditures, and Changes in Fund Balance	7
Notes to Financial Statements.....	8

Report of Independent Auditors

State of Michigan
Office of the Auditor General,
Office of Financial Management, and
Talent Investment Agency,
Unemployment Insurance Agency

Report on the Financial Statements

We have audited the accompanying financial statements of the Obligation Trust Fund of the State of Michigan Talent Investment Agency, Unemployment Insurance Agency as of and for the year ended September 30, 2015, 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 Fund as of September 30, 2015, and the change in financial position 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 Obligation Trust Fund of the State of Michigan Talent Investment Agency, 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 Talent Investment Agency, Unemployment Insurance Agency in its entirety as of September 30, 2015, or the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 4, 2015, on our consideration of the Obligation Trust Fund of the State of Michigan Talent Investment Agency, 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 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 Obligation Trust Fund of the State of Michigan Talent Investment Agency, Unemployment Insurance Agency's internal control over financial reporting and compliance.

Andrews Hooper Pavlik PLC

Auburn Hills, Michigan
December 4, 2015

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency-
Obligation Trust Fund

Management's Discussion and Analysis

Year Ended September 30, 2015

Our discussion and analysis of the Obligation Trust Fund of the State of Michigan Talent Investment Agency, Unemployment Insurance Agency's (Fund) governmental fund financial performance provides an overview of the Fund's activities for the year ended September 30, 2015.

The Fund was created to facilitate the repayment of debt incurred to repay advances received from the Federal Government that were provided to temporarily assist the State of Michigan (State) with unemployment payments that exceeded current revenue collections. The Fund was established as a Special Revenue Fund of the State which accounts for the receipt of the Obligation Assessment Tax (OA), a special unemployment tax surcharge imposed on certain employers. These payments from employers are then transferred to the Michigan Finance Authority who currently holds the bonds and makes regular payments to the bond holders. The accompanying financial statements present the results of operations for the Fund only. Accordingly, these financial statements do not present fairly the financial position or results of operations of the State of Michigan or the State of Michigan Talent Investment Agency, Unemployment Insurance Agency.

Financial Highlights

- The Obligation Assessment bonds are scheduled to be repaid over a ten year period. The Unemployment Insurance Agency determines the obligation assessment rate annually with the expectation to collect approximately \$455 million every year until the bonds are repaid in full. The 2015 and 2014 average obligation assessment rates were approximately 1.32% and 1.43%, respectively.
- The Fund experienced a \$14.6 million increase in revenues in 2015, primarily attributable to an increase in the number of covered employees for which the assessment is based on.
- Employer tax payments are allocated first to OA, allowing for a 99% collection rate.

Using this Annual Financial Report

The annual report includes this management's discussion and analysis report, the independent auditors' report, and the financial statements of the Fund. The financial statements also include notes that explain in more detail some of the information in the financial statements.

Reporting on the Fund

Fund financial statements. 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 Fund, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The Fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting.

Notes to financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements.

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency-
Obligation Trust Fund

Management's Discussion and Analysis

Year Ended September 30, 2015

Financial Analysis of the Fund

Exhibit A provides the comparative summary of the Fund's fund balance as of September 30, 2015 and 2014:

Exhibit A

	2015 (In Thousands)	2014 (In Thousands)
Assets		
Total assets (all current)	<u>\$ 60,816</u>	<u>\$ 67,369</u>
Liabilities		
Total liabilities (all current)	<u>57,180</u>	<u>54,925</u>
Deferred inflows of resources		
Total deferred inflows of resources	<u>3,636</u>	<u>12,444</u>
Fund Balance		
Total fund balance (all restricted)	<u>\$ -</u>	<u>\$ -</u>

The decrease in assets is largely attributable to the increase in the receivable reserve. Since employer OA obligations are satisfied first, any receivables remaining are less likely to be collected. In 2015 the reserve methodology was revised to fully reserve any receivables that are over 3 years old, and recognize a 1% reserve for current years.

The results of this year's operations for the Fund are reported in the Statement of Revenues, Expenditures, and Changes in Fund Balance, as summarized in Exhibit B below, which show the changes in fund balance for the years ended September 30, 2015 and 2014.

Exhibit B

	2015 (In Thousands)	2014 (In Thousands)
Revenues		
Obligation assessment collections	<u>\$ 470,348</u>	<u>\$ 455,736</u>
Interest earned	<u>17</u>	<u>15</u>
Total revenues	<u>470,365</u>	<u>455,751</u>
Expenditures		
Other fees	<u>470,362</u>	<u>455,750</u>
Treasury fees	<u>3</u>	<u>1</u>
Total expenditures	<u>470,365</u>	<u>455,751</u>
Change in fund balance	<u>\$ -</u>	<u>\$ -</u>

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency-
Obligation Trust Fund

Management's Discussion and Analysis

Year Ended September 30, 2015

The increase in revenues/expenditures over the previous year is reflective of the state's employment rate, and a consistent annual assessment on employers. An increase in the number of covered employees during the year generated additional revenues for the fund.

Factors Expected to Have an Effect on Future Operations

The State's regular unemployment claims have been trending downward in recent years and are expected to decline again slightly in 2016 causing no major impact to this fund. The Obligation Assessment Rate for rate year 2016 was determined in November 2015 and is set at a level that is expected to generate the required \$455 million in revenue.

The recent reduction in the taxable wage base from \$9,500 to \$9,000 for non-delinquent employers (as a result of the UI Compensation Fund exceeding \$2.5 billion as of June 30, 2015) is not expected to have an impact on future revenues. This reduction was factored in to the 2016 rate setting process.

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Balance Sheet

September 30, 2015

Assets

Current assets:

Equity in State of Michigan Treasurer's common cash	\$ 1,008,732
Receivable from contributing employers – net of allowance of approximately \$16,000,000	58,943,121
Due from State of Michigan funds	<u>863,834</u>

Total assets \$ 60,815,687

**Liabilities, Deferred Inflows of Resources, and
Fund Balance**

Liabilities

Current liabilities:

Due to State of Michigan component units	<u>\$ 57,179,659</u>
--	----------------------

Total liabilities 57,179,659

Deferred inflows of resources

Obligation assessment collections	3,636,028
-----------------------------------	-----------

Fund Balance

Fund balance – restricted	<u>-</u>
---------------------------	----------

Total liabilities, deferred inflows of resources, and fund balance \$ 60,815,687

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Statement of Revenues, Expenditures, and Changes in Fund Balance

Year Ended September 30, 2015

Revenues:	
Obligation assessment collections	\$ 470,348,393
Interest earned	<u>16,673</u>
Total revenues	470,365,066
Expenditures:	
Other fees	470,361,766
Treasury fees	<u>3,300</u>
Total Expenditures	470,365,066
Change in fund balance	-
Fund balance at beginning of year	<u>-</u>
Fund balance at end of year	<u><u>\$ -</u></u>

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2015

1. General Activities and Significant Accounting Policies

The Obligation Trust Fund (Fund) was created by Michigan Compiled Laws (MCL) section 421.10a to facilitate the repayment of debt incurred through a bond issuance authorized under MCL 421.26a and the Employment Security Financing Act, MCL 12.271 *et seq.* This debt was issued in order to repay advances received from the Federal Government that were provided to temporarily assist the State of Michigan (State) with unemployment payments that exceeded current revenue collections. Revenues within the Fund are generated from annual assessments on employers. Payments are transferred to the Michigan Finance Authority who currently holds the bonds and makes regular payments to the bond holders. 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 is a Special Revenue fund which accounts for the receipt of a special unemployment tax surcharge imposed on certain employers known as Obligation Assessment Tax.

The Fund is not subject to an annual appropriation from the State. Therefore, the Fund does not have an annual budget and no budget to actual schedule is included in the report.

The Fund's financial statement amounts are included in the combined financial statements contained in the State of Michigan Comprehensive Annual Financial Report.

Basis of Accounting

The Fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Fund considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

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.

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2015

1. General Activities and Significant Accounting Policies (continued)

Deferred Outflows and Inflows of Resources

In addition to assets, the balance sheet will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of fund balance that applies to a future period(s) and thus, will not be recognized as an outflow of resources (expense/expenditure) until then. The Fund has no items that qualify for reporting in this category.

In addition to liabilities, the balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of fund balance that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Fund had one item that qualified for reporting in this category. The Fund reports unavailable revenue, which arise only under the modified accrual basis of accounting, from receivables related to contributing employers. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

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 State Treasurer's 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 located in the State.

The Fund's pro-rata share of the State Treasurer's common cash pool was \$1,008,372 as of September 30, 2015. 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 Comprehensive Annual Financial Report.

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2015

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

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 State’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 or federal law and maintain a principal office or branch office in the State. No deposit in any financial organization may be in excess of 50% of the net worth of the organization.

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 pool deposits subject to foreign currency risk as of September 30, 2015.

Common Cash Investments

Types of Investments

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

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2015

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

Common Cash Investments (continued)

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.

The State Treasurer’s common cash pool does not have an investment policy for managing custodial credit risk. As of September 30, 2015, the State Treasurer’s common cash 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 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 is evidenced by unrated notes held by the State in the State’s name. In addition, as of September 30, 2015, prime commercial paper investments were rated at A-1, P-1, or above.

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2015

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

Common Cash Investments (continued)

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 into the special loan programs.

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 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 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.

State of Michigan
Talent Investment Agency
Unemployment Insurance Agency –
Obligation Trust Fund

Notes to Financial Statements

September 30, 2015

3. Risk Management

The State of Michigan has established internal service funds to account for certain aspects of its risk management program. The Fund transfers money to these internal service funds to pay for coverage on these types of risks.

The State of Michigan does not carry 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. The State of Michigan purchases some level of insurance coverage for portions of the state employee insurance benefits program, boiler and machinery coverage, and employee bonding. Information regarding current year claims and changes in estimates, claim payments, and amount of claims liability is included in the State of Michigan Comprehensive Annual Financial Report.