FISCAL BRIEF

CONTINGENT FUND, PENALTY AND INTEREST ACCOUNT

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FAST FACTS

- Revenues are received from penalties and interest on delinquent unemployment contributions from employers and wrongfully collected unemployment benefits from claimants.
- Annual revenues peaked at $60.9 million in FY 2015-16.
- Expenditures expanded beyond UIA administration to include Skilled Trades programs starting in FY 2015-16.
- Current appropriation levels exceed annual revenues to the fund which continues to reduce the available fund balance.
- The estimated fund balance at the close of FY 2018-19 is estimated to drop by $57.4 million to $102.7 million.

INTRODUCTION

The Contingent Fund was created under Section 10(6) of the Michigan Employment Security Act (MESA), 1936 PA 1, MCL 421.10, and is administered by the Unemployment Insurance Agency (UIA). The fund has two revenue streams, each deposited into one of two separate accounts within the Contingent Fund:

- Penalties, damages, and interest assessed on claimants and employers for engaging in activities prohibited by the MESA and on outstanding amounts owed to the UIA. Revenues from these sources are placed in the **Penalty and Interest Account (P&I).**
- Solvency taxes levied on employers with negative balances in their experience accounts in the event that the reserves in the state's Unemployment Trust Fund are less than the amount of outstanding federal advances to the state's Trust Fund or when the UIA projects insufficient funds to meet federal interest obligations. The **solvency taxes account** is dedicated to pay interest on federal advances or to repay the State for loans to the UIA for federal interest charges.

The P&I of the UIA Contingent Fund is the scope of this fiscal brief. Appendix A supplements the following narrative on revenues and expenditures.

REVENUES

The P&I receives interest and penalties on delinquent unemployment contributions from employers and misrepresentation penalties and interest on wrongfully collected unemployment benefits from claimants.

Revenue to the P&I increased every year between FYs 2009-10 and 2015-16, rising from $13.1 million in FY 2009-10 to a peak of $61.0 million in FY 2015-16. Increasing revenues initially led to increasing fund balances. In FY 2010-11 the year-end fund balance was $3.1 million. By FY 2017-18, it had risen to $160.1 million.

While over half of the annual revenue increase occurred after the introduction of the Michigan Integrated Data Automated System (MiDAS) in October 2013, problems in the fraud finding process also arose between October 2013 and August 2015. The UIA conducted an initial review of over 22,000 cases in which MiDAS determined a claimant had committed fraud. The review found an error rate of 93% in those determinations. While some legal questions have been addressed, the overall issue continues to be litigated. How much of the revenue increase is due to interest and penalty payments from those wrongly accused of fraud is unknown.

After reaching a peak in FY 2015-16, revenues dropped by almost 50% in FY 2016-17 to a total of $31.2 million. Revenues rebounded to $44.5 million in FY 2017-18 and are estimated to be $36.0 million in FY 2018-19. It is unclear whether the drop in annual revenues was due to increased review of MiDAS fraud findings by the UIA, a reduction in cases due to a clearing of the backlog of cases in need of review, an overall reduction in fraud cases, or some combination of all three. That said, revenues are expected to continue in the $30.0 million to $40.0 million range in future years.

EXPENDITURES

Prior to 2015, the use of P&I revenue was authorized only for expenditures associated with UIA administration. In 2014, Executive Order 2014-12 transferred the UIA from the Department of Licensing and Regulatory Affairs (LARA) to the Talent Investment Agency (TIA) within the new Department of Talent and Economic Development (DTED). As a result of growing annual revenues, changes enacted in 2015 PA 57 expanded the use of the P&I to include administration for all of TIA, rather than just the UIA, including, but not limited to, the development and execution of workforce training programs.

The expanded expenditure authorization allowed for the enactment of a FY 2015-16 budget that appropriated $15.6 million in P&I funds to expand the Skilled Trades Training Program (STTP) (renamed Going Pro in FY 2017-18) from $10.0 million to $25.6 million ($10.0 million GF/GP). In FY 2016-17, P&I appropriations increased by $10.3 million for a total P&I appropriation of $25.9 million which is reflected in Table 1. $5.0 million of the total P&I increase in the Skilled Trades Training Program in FY 2016-17 was used to offset a corresponding reduction in GF/GP.

Use of the P&I was expanded further in FY 2017-18. An additional $24.5 million from the P&I was used to provide another $10.0 million increase to the STTP and offset a total of $14.5 million GF/GP previously used to fund the STTP ($5.0 million) and Community Ventures ($9.5 million). In total, appropriations from the P&I totaled $73.1 million in FY 2017-18.

In the FY 2018-19 budget, appropriations from the P&I were reduced by $1.4 million to a total appropriation of $71.8 million. The allocation of the funds has changed and is reflected in Table 1.

Table 1: Contingent Fund, Penalty and Interest Account Appropriations and Expenditures FY 2016-17 through FY 2018-19

	FY 2016-17		FY 2017-18		FY 2018-19
Appropriation	**Appropriation**	**Expenditures***	**Appropriation**	**Expenditures***	**Appropriation**
UIA Administration	$22,735,300	*$1,174,806*	$22,721,100	*$1,335,672*	$22,725,900
2016 PA 517 Transfer to GF	10,000,000	*10,000,000*	0	*0*	0
Going Pro	25,900,000	*25,900,000*	40,908,300	*40,908,300*	25,918,800
At-Risk Youth Grants	0	*0*	0	*0*	3,000,000
Community Ventures	0	*0*	9,500,000	*9,500,000*	4,000,000
Statewide Data System Integration	3,978,500	*3,978,500*	0	*0*	0
Community College Skilled Trades	0	*0*	0	*0*	4,600,000
Workforce Program Administration	0	*0*	0	*0*	1,524,800
Workforce Development Programs	0	*0*	0	*0*	10,000,000
TOTAL	**$52,613,800**	***$41,053,306***	**$73,129,400**	***$51,743,972***	**$71,769,500**

**Expenditures account for actual expenditures and total work project carry forward authorization.*

Table 1 provides budget appropriation levels, by line item, from the P&I. It should be noted that appropriation amounts may not equal actual expenditure levels in any fiscal year. Expenditures related to UIA Administration have been significantly less than the amount appropriated in most fiscal years due to the availability of federal funds to cover necessary expenditures. As an example, in FY 2016-17, despite appropriating $22.7 million for UIA administration, actual expenditures for UIA administration totaled $1.2 million (See Table 1). That said, it is expected that expenditures for UIA administration will increase beginning in FY 2018-19 as federal fund support diminishes.

Prospects for Future Use

As revenues increased and expenditures decreased immediately following FY 2010-11, the P&I fund balance grew significantly; from a low of $3.1 million at the close of FY 2010-11 to a peak of $160.1 million at the close of FY 2017-18.

Appropriations for FY 2018-19 exceed expected revenues. Even if it is assumed that UIA administration expenditures will be far below FY 2018-19 appropriations, overall expenditures are still expected to exceed revenues which will reduce the fund balance. In addition, approximately $21.6 million still remains in active work project authorization for expenditure. The unencumbered balance of the fund at the close of FY 2018-19 is estimated at $102.7 million which is $57.4 million below the FY 2017-18 ending balance. Appendix A provides both a historical and future look at fund balances.

In addition to increased budget expenditures, the ongoing litigation related to the UIA and the use of the MiDAS system could result in additional court ordered settlements or payments. At this time, no estimates are available.

Pressures exist on the revenue side as well. In addition to reductions in annual revenues after FY 2015-16, a package of bills recently passed by the legislature and signed by the Governor (Public Acts 225-232 of 2017) are expected to further reduce revenues to the P&I by doing the following:

- Significantly lowering damages related to unemployment fraud.
- Redistributing the penalties associated with unpaid employer contributions and unpaid restitution of benefit overpayments from just the P&I to a split distribution to the Unemployment Compensation Fund, the P&I, and for liability for benefit overpayment, in accordance with the distributions established in Section 54(k)[1].
- Lowering potential interest payment revenues associated with unpaid restitution of benefit overpayments by delaying interest accrual until one year after the date of a final order.
- Requiring that no interest be collected for improperly paid benefits resulting from an administrative or clerical error made by the UIA.
- Requiring refunds and waivers for interest payments made by a claimant due to a clerical or administrative error by the UIA.

Future budgets will need to address the expenditure and revenue imbalance associated with the P&I.

[1] See MCL 421.54.

Appendix A

FY 2009-10 to FY 2018-19 Contingent Fund, Penalty and Interest Account Revenues, Appropriations, and Expenditures

	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19 (est.)
Beginning Balance	$10,769,337	$18,758,433	$3,080,097	$10,282,166	$35,149,611	$63,469,718	$110,036,153	$159,459,329	$159,884,226	$160,065,227
Revenue	13,095,464	16,695,680	18,536,484	26,719,872	29,400,214	47,658,444	60,989,891	31,160,566	44,531,240	36,000,000
Appropriated	(18,253,300)	(5,225,400)	(5,264,600)	(5,354,600)	(5,354,600)	(23,354,600)	(38,436,100)	(52,613,800)	(73,129,400)	(71,769,500)
Expenditures	(5,106,368)	(32,374,016)	(11,334,415)	(1,852,427)	(1,080,107)	(1,092,009)	(11,566,715)	(30,735,669)	(44,350,239)	(71,769,500)
Work Project Auth										(21,632,061)
Ending Balance	**$18,758,433**	**$3,080,097**	**$10,282,166**	**$35,149,611**	**$63,469,718**	**$110,036,153**	**$159,459,329**	**$159,884,226**	**$160,065,227**	**$102,663,666**

Source: Talent Investment Agency

Notes:

(1) Appropriated reflects amount appropriated in relevant budget act.

(2) Expenditures reflect actual expenditures during fiscal year; FY 2018-19 expenditure match amount appropriated due to incomplete fiscal year.

(3) Work Project Authorization includes the total of all prior year work project authorizations.