

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

**Financial Statements Together With
Report of Independent Public Accountants**

For the Years Ended June 30, 2013 and 2012



SB & COMPANY, LLC
EXPERIENCE • QUALITY • CLIENT SERVICE

JUNE 30, 2013 AND 2012

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Management
Maryland Unemployment Insurance Trust Fund

Report on the Financial Statements

We have audited the accompanying financial statements of Maryland Unemployment Insurance Trust Fund (the Fund), an enterprise fund of the State of Maryland, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

The Fund's 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.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of 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 June 30, 2013 and 2012, and the changes in financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



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Other Matter

As discussed in Note 1, the financial statement present only the Fund and do not purport to, and do not, present fairly the financial position of the State of Maryland as of June 30, 2013 and 2012, and the change in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Hunt Valley, Maryland
October 1, 2013

SB & Company, LLC

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Statements of Net Position As of June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and cash equivalents	\$ 1,978,936	\$ 1,998,757
Cash on deposit with Federal Unemployment Trust Fund	986,763,745	804,697,311
Accounts receivable, net	230,623,089	274,821,066
Total Assets	<u>1,219,365,770</u>	<u>1,081,517,134</u>
LIABILITIES		
Bank overdrafts	918,783	792,442
Accounts payable for unemployment benefits	62,930,638	64,390,351
Total Liabilities	<u>63,849,421</u>	<u>65,182,793</u>
Net Position		
Restricted for unemployment benefits	<u>\$ 1,155,516,349</u>	<u>\$ 1,016,334,341</u>

The accompanying notes are an integral part of these financial statements.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Statements of Revenue, Expenses, and Change in Net Position For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating Revenue		
Charges for services and sales	\$ 925,345,899	\$ 1,156,834,977
Provision for allowances for uncollectible accounts	25,978,107	20,158,048
Operating Revenue, net of provision	<u>899,367,792</u>	<u>1,136,676,929</u>
Operating Expenses		
Benefits - State	780,622,872	825,453,453
Benefits - Federal	465,884,514	760,041,767
Total Operating Expenses	<u>1,246,507,386</u>	<u>1,585,495,220</u>
Operating Loss	<u>(347,139,594)</u>	<u>(448,818,291)</u>
Non-Operating Revenue		
Federal grants	465,366,582	761,601,557
Interest	20,955,020	14,608,735
Total Non-Operating Revenue	<u>486,321,602</u>	<u>776,210,292</u>
Change in net position	139,182,008	327,392,001
Net position, beginning of year	1,016,334,341	688,942,340
Net Position, End of Year	<u>\$ 1,155,516,349</u>	<u>\$ 1,016,334,341</u>

The accompanying notes are an integral part of these financial statements.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Statements of Cash Flows For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash Flows From Operating Activities		
Receipts from employers	\$ 943,565,769	\$ 1,114,882,690
Payments to claimants	<u>(1,247,967,099)</u>	<u>(1,558,308,539)</u>
Net Cash From Operating Activities	<u>(304,401,330)</u>	<u>(443,425,849)</u>
Cash Flows From Investing Activities		
Interest income	<u>20,955,020</u>	<u>14,608,735</u>
Cash Flows From Non-Capital Financing Activities		
Receipts from Federal grants	465,366,582	761,601,557
Bank overdrafts, net	<u>126,341</u>	<u>(261,904)</u>
Net Cash From Non-Capital Financing Activities	<u>465,492,923</u>	<u>761,339,653</u>
Net Change in Cash and Cash Equivalents	182,046,613	332,522,539
Cash and cash equivalents, beginning of year	<u>806,696,068</u>	<u>474,173,529</u>
Cash and Cash Equivalents, End of Year	<u>\$ 988,742,681</u>	<u>\$ 806,696,068</u>
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	\$ (347,139,594)	\$ (448,818,291)
Net changes in non-cash operating assets and liabilities:		
Accounts receivable	44,197,977	(21,794,239)
Accounts payable for unemployment benefits	<u>(1,459,713)</u>	<u>27,186,681</u>
Net Cash from Operating Activities	<u>\$ (304,401,330)</u>	<u>\$ (443,425,849)</u>

The accompanying notes are an integral part of these financial statements.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

1. REPORTING ENTITY

The accompanying financial statements present only the Maryland Unemployment Insurance Trust Fund (the Fund), an enterprise fund of the State of Maryland, and do not present the financial statements of the State of Maryland as a whole. The Fund is not a separate legal entity from the State of Maryland.

The administrative costs related to the Fund are not reported in the financial statements of the Fund. The administrative costs are reported in the State of Maryland General Fund, as assessments earned from employers are not designed to recover the costs of administration.

2. FUND DESCRIPTION

Historical Background

Unemployment Insurance (UI) provides temporary relief for the time that an able-bodied worker is involuntarily unemployed. The goal of such insurance is to provide a minimal livelihood to unemployed workers until they are once again employed.

The United States of America introduced an unemployment insurance program, along with other welfare programs, with the passage of the Social Security Act of 1935. Over the years, Congress has extended the program to many workers initially not covered. Amendments to the Social Security Act provided unemployment insurance for Federal civilian employees (1954) and for ex-servicemen (1958). By 1994, more than 96% of all workers were covered by unemployment insurance. Each state has its own unemployment insurance law and operates its own program.

The total cost is borne by employers in all but a few states. Employers with relative experience of less unemployment (that is, with fewer unemployment benefits paid to their former workers) are rewarded with lower rates. This financing arrangement is intended to promote economic stability by encouraging employers to retain a skilled workforce. The surge in unemployment benefit payments also provides an economic stimulus to the local economy during a recession.

During periods of high unemployment in a state, Federal-State extended benefits are available to workers who have exhausted their regular benefits.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

2. FUND DESCRIPTION (continued)

Unemployment Insurance Financing

Payroll taxes are paid by employers to support UI. There are both Federal and state UI payroll taxes. The State of Maryland UI tax is assessed quarterly based on a rate determined annually per individual employer. The range of rates effective January 1, 2011 and January 1, 2012 was 2.2% to 13.5% on the first \$8,500 of each employee's wages during a calendar year. The range of rates effective January 1, 2013 was 1.0% to 10.5% on the first \$8,500 of each employee's wages during a calendar year. Employers must also pay an annual Federal Unemployment Insurance Tax (FUTA) on the first \$7,000 of each employee's wages during a calendar year. For employers that pay their state UI taxes in a timely manner, the FUTA rate was 0.6% for calendar year 2012 and 2013. Employers that fail to pay state UI taxes were required to pay a FUTA tax using a 6.0% rate for calendar year 2012 and 2013.

Contributions by Maryland employers for state UI are deposited into the Fund's account maintained at the U.S. Treasury. Maryland has one of the 53 state accounts that are the source of monies for paying regular UI benefits and the state share of extended benefits (EB). Contributions by Maryland employers for FUTA are deposited into the Federal Employment Security Administration Account (ESAA). This account finances the administrative costs of UI and the Employment Service programs in the states. The Federal share of EB is paid from a second Federal account and a third Federal account makes loans to states with insolvent trust funds.

Under current law, excess monies in the Federal trust funds are slated for return to the states under the Reed Act. Excess Federal trust fund balances are distributed according to each state's share of Federal taxable UI wages. Reed Act distributions may be used to offset the administrative costs related to the Fund or for unemployment benefits. There was no such allocation for the years ended June 30, 2013 and 2012.

Local Perspective

Maryland employers remit state UI payments directly to a bank lock box. The Maryland Office of Unemployment Insurance (OUI) wires each day's opening available balance in this depository account to the Fund at the Federal Treasury. Additionally, officials in the Maryland OUI determine the amount of funds required for each day's benefit payment account. Only nominal balances are maintained in both the depository (clearing) and benefit payment accounts.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

2. FUND DESCRIPTION (continued)

Local Perspective (continued)

Both the amounts of taxes paid by Maryland employers, and the amount of benefits received by Maryland's unemployed, are products of the economic climate. Benefit payments will usually increase during a recession. Charging those benefits to employer accounts will elevate individual employer tax rates, driving an increase in the payment of employer state UI taxes.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Measurement Focus and Basis of Accounting

The financial statements of the Fund are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 62 (GASB 62) Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements which intended to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The requirements of GASB 62 are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The Fund has implemented GASB 62 and it did not have a material impact on the financial statements.

The Fund distinguishes operating revenue and expenses from non-operating items. Operating revenue and expenses generally result from providing services in connection with the Fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as non-operating revenue and expenses. The principal operating revenue of the Fund is assessments from employers.

Fund Accounting

The financial activities of the State are recorded in individual funds, each of which is deemed to be a separate accounting entity. The State uses fund accounting to report on its financial position and changes in financial position. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fund Accounting (continued)

An enterprise fund accounts for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public, or where sound financial management dictates that periodic determinations of results of operations are appropriate.

The Fund accounts for the deposit of monies for the Maryland Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits. The Maryland Unemployment Insurance Trust Fund is an enterprise fund.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Receivables

Taxes receivable in the Fund represents unemployment taxes due at year-end, net of an allowance for uncollectible amounts. The uncollectible amounts are based on collection experience and a review of the status of existing receivables.

Operating Revenue

Revenue is recorded when earned. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. Operating revenue is inclusive of provision for allowances for uncollectible accounts.

Net Position

The net position of the Fund is reported as restricted net position, as the laws of the State of Maryland restrict the use of the Fund for payment of unemployment benefits only.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

4. DEPOSITS

Collateral Risk

The Fund has \$986,763,745 and \$804,697,311, on deposit with the U.S. Treasury as of June 30, 2013 and 2012, respectively, which represents book and bank balances. Because these balances are on deposit with the U.S. Treasury, these amounts are not categorized in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements* or Statement No. 40, *Deposits and Investment Risks Disclosures*.

Additionally, the Fund maintains escrow, clearing, benefit payment, and other miscellaneous accounts with local financial institutions. As of June 30, 2013 and 2012, the book balances of these accounts were \$1,025,389 and \$1,191,187 and the associated bank balances were \$2,087,430 and \$2,055,211, respectively, of which \$500,000 was collateralized by depository insurance, and \$1,587,430 and \$1,555,211, were collateralized by securities held by pledging financial trust department or agent in the Fund's name. For cash management purposes, the Fund seeks to keep a zero balance in this account; so excess funds can be placed on deposit with the U.S. Treasury.

The State Treasurer requires that financial institutions deposit collateral securities to secure the deposits of the State in each such institution. The amount of collateral to be pledged shall be established by rules and regulations promulgated by the State Treasurer.

Interest Rate Risk

Amounts on deposit with the U.S. Treasury are not subject to interest rate risk.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

5. ACCOUNTS RECEIVABLE

Accounts receivable balances as of June 30, 2013 and 2012, have been disaggregated by type and presented separately in the table below:

ACCOUNTS RECEIVABLE

	<u>2013</u>	<u>2012</u>
Employer taxes receivable	\$ 257,135,820	\$ 291,353,648
Benefit overpayments receivable	227,573,063	211,194,105
Other receivables	<u>2,288,000</u>	<u>2,669,000</u>
Total accounts receivable	486,996,883	505,216,753
Less: allowance for uncollectible	256,373,794	230,395,687
Total accounts receivable, net	<u>\$ 230,623,089</u>	<u>\$ 274,821,066</u>

6. CONTINGENCIES

The employer contribution operations and benefit payment functions of the Fund are subject to Federal compliance audits and related oversight. In addition, the Fund receives significant financial assistance from the U.S. Government. Entitlement to the resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits by the grantor. Any disallowances as a result of these audits and audits of the employer contribution operations and benefit payment functions become a liability of the Fund. As of June 30, 2013 and 2012, Fund management does not anticipate that material liabilities will result from such audits.

The financial assistance received from the U.S. Government to fund the administrative costs of the Fund is subject to audits. However, any disallowances resulting from these audits would be liabilities of the State's general fund and not the Fund as administrative costs are borne by the State's general fund.

MARYLAND UNEMPLOYMENT INSURANCE TRUST FUND

Notes to the Financial Statements June 30, 2013 and 2012

7. NEW PRONOUNCEMENTS

The Governmental Accounting Standards Board (GASB) issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre- November 30, 1989 FASB and AICPA Pronouncements, in December 2010, effective for financial statement periods beginning after December 15, 2011. In November 2010, the GASB issued Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, and Statement No. 61, The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34, effective for periods beginning after December 15, 2011 and June 15, 2012, respectively. In addition, in June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, effective for periods beginning after December 15, 2011. UI has implemented the above GASB statements, and they have no material effect on the financial position of UI.

In March 2012, the GASB issued Statement No. 65, Items Previously Reported as Assets and Liabilities, and Statement No. 66, Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62, effective for periods beginning after December 15, 2012. In June 2012, the GASB issued Statement No. 67, Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25, and Statement No. 68, Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27, effective for periods beginning after June 15, 2013, and 2014, respectively. In January 2013, GASB issued Statement No. 69, Government Combination and Disposals of Government Operations, effective for periods beginning after December 15, 2013. In April 2013, GASB issued Statement No. 70, Accounting and Financial Reporting for Non-exchange Guarantees, effective for periods beginning after June 15, 2013. UI will implement these statements as of their effective dates. UI is still in the process of determining the effect of implementing these GASB statements.