

Report on Audits of Financial Statements of
South Carolina Employment Security Commission
Unemployment Compensation Fund
for the years ended June 30, 2008 and 2007

State of South Carolina



Office of the State Auditor

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September 29, 2008

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Employment Security Commission
Compensation Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Employment Security Commission – Unemployment Compensation Fund for the fiscal year ended June 30, 2008 was issued by Scott McElveen, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard H. Gilbert, Jr.", written in a cursive style.

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/trb

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Independent Auditors' Report

The Office of the State Auditor and Board of Commissioners
South Carolina Employment Security Commission Unemployment Compensation Fund
Columbia, South Carolina

We have audited the accompanying financial statements of the South Carolina Employment Security Commission Unemployment Compensation Fund (the "Fund") as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion 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 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the financial statements of the Fund are intended to present the financial position and results of operations of only that portion of the funds of the State of South Carolina financial reporting entity that is attributable to the transactions of the Fund. They do not purport to and do not present the financial position of the State of South Carolina as of June 30, 2008 and 2007, and changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America, and do not include any other agencies, divisions or component units of the State of South Carolina.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the Fund as of June 30, 2008 and 2007, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Fund will continue as a going concern. As discussed in Note 1 to the financial statements, under existing circumstances, there is substantial doubt about the ability of the Fund to continue as a going concern at June 30, 2008. Management's plans in regard to that matter also are described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2008, on our consideration of the Fund's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Scott McElveen, L.L.P.

Columbia, South Carolina
September 30, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the South Carolina Employment Security Commission offers readers of this narrative overview and analysis of the financial activities only attributed to the South Carolina Employment Security Commission's Unemployment Compensation Trust Fund for the fiscal year ended June 30, 2008. Please read this information in conjunction with the South Carolina Employment Security Commission Unemployment Compensation Fund's financial statements and accompanying notes.

Financial Highlights

- To date, the Fund has generated substantial operating losses and has been required to use a substantial amount of cash resources to fund its operations. The report of our independent auditors on our audited financial statements included with this report contains a statement noting that our recent history of losses, combined with other factors, raise substantial doubt about our ability to continue as a going concern. Although our plans to address these issues are discussed in Note 1 to the audited financial statements included in this report, these plans are subject to numerous risks and contingencies, many of which are beyond our control, and we can give no assurance as to whether or how long we may be able to succeed in addressing these issues and maintaining our viability as a going concern.
- The Unemployment Compensation Fund was created per Section 41-33-10 of the South Carolina Employment Security Law. The Unemployment Compensation Trust Fund is made up of three separate accounts: (1) a clearing account which is used for the deposit of contributions, interest, penalties, contingency, service charges, recording fees and payments in lieu of contributions received from employers in the State; (2) an unemployment trust fund account which funds are transferred from the clearing account to this account to be held to withdraw for unemployment benefit claims. This account also contains money received from the Federal government as reimbursements pursuant to Section 204 of the Federal-State Extended Compensation Act of 1970 and Reed Act funds received from the Federal government; and (3) a benefit account which receives funds from the Unemployment Compensation Trust Fund to pay unemployment benefit claims.
- Assets exceeded liabilities at June 30, 2008 by \$229,006,482 (shown as "total net assets"). The total amount of these funds is restricted and will be used to meet the South Carolina Employment Security Commission's on-going obligations to the citizens of South Carolina for unemployment benefits.
- Total Unemployment Compensation benefits paid were \$449,511,155 and \$389,823,906 during the years ended June 30, 2008 and 2007, respectively.

Overview/discussion of the Financial Statements

Management's Discussion and Analysis serves as an introduction to the basic financial statements. These financial statements consist of (1) statements of net assets; (2) statements of revenues, expenses and changes to net assets; (3) statements of cash flows; and (4) notes to financial statements. The Management Discussion and Analysis represents management's examination and analysis of the Employment Security Commission's Unemployment Compensation Trust Funds' financial condition.

The statements of net assets provide information about the nature and amount of resources (assets) and obligations (liabilities) at year-end.

The statements of revenues, expense and changes in net assets present the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the year.

The statements of cash flows present changes in cash and cash equivalents resulting from operational, financing and investing activities. This statement presents cash receipts and cash disbursements information.

The notes to the financial statement provide required disclosures and other information that is essential to a full understanding of the information provided in the statements. The notes present information about the accounting policies, significant account balances and activities.

Condensed Financial Data

Statements of Net Assets	2008	2007	Change
Assets	\$ 246,492,861	\$ 349,609,878	\$ (103,117,017)
Liabilities	\$ 17,486,379	\$ 22,830,765	\$ (5,344,386)
Net assets, restricted	229,006,482	326,779,113	(97,772,631)
Total liabilities and net assets	\$ 246,492,861	\$ 349,609,878	\$ (103,117,017)

Statements of Revenues, Expenses and Changes in Fund Net Assets

Operating Revenues	2008	2007	Change
Assessments	\$ 271,258,639	\$ 273,051,816	\$ (1,793,177)
Federal Agencies	40,883,338	40,631,003	252,335
Other	29,556,194	24,787,591	4,768,603
Total Revenues	341,698,171	338,470,410	3,277,761
Operating Expenses			
Unemployment			
Compensation Benefits	449,511,155	389,823,906	59,687,249
Operating loss	(107,812,984)	(51,353,496)	(56,459,488)
Non-Operating Revenues			
(Expenses)			
Interest Income	10,040,353	12,621,783	(2,581,430)
Intergovernmental Expense - Commission	—	(604,927)	(604,927)
Changes in Net Assets	(97,772,631)	(39,336,640)	(58,435,991)
Total Net Assets – Beginning	326,779,113	366,115,753	(39,336,640)
Total Net Assets – Ending	\$ 229,006,482	\$ 326,779,113	\$ (97,772,631)

Financial Analysis

Statements of Net Assets:

Total assets declined by approximately \$103 million due primarily to the decline in the cash balance, as a result of the increase in unemployment benefit claims paid. Claimants are filing for a longer period of time (average = 11-13 weeks/maximum = 26 weeks).

Net assets declined by approximately \$98 million due to the loss for the year.

Revenues, Expenses and Changes in Net Assets:

Assessments decreased by approximately \$2 million as compared to last year due to experience rating adjustments on employer accounts.

Total revenue increased by approximately \$3 million primarily due to an increase of revenue from other states reimbursements as well as increased focus by field agents to recovery overpayments.

Unemployment Compensation Benefits increased by approximately \$60 million due to Trade Readjustment Act (TRA) claims and the payment of regular claims increasing. TRA allowances are unemployment claims that are paid out to individuals who have lost their jobs due to foreign trade. These payments are made after regular UI benefits and extended benefits have been exhausted.

Operating loss for 2008 was approximately \$108 million as compared to \$51 million loss for the prior year, which was due to the increase in total benefits paid.

Interest income went down approximately \$2.6 million due to a lower Trust Fund balance.

Ending Net Assets for 2008 decreased by approximately \$98 million as compared to a \$39 million decrease for the prior year, as a result of expenditures exceeding revenues.

South Carolina Employment Security Commission
Unemployment Compensation Fund
Statements of Net Assets
as of June 30,

	<u>2008</u>	<u>2007</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 185,079,383	\$ 290,419,908
Assessments receivable, net	50,037,804	50,202,460
Benefit overpayments receivable, net	5,259,362	3,866,739
Due from reimbursable employers, net	819,791	632,991
Intergovernmental receivables, net		
Local governments	1,592,415	1,485,696
Other states	2,362,573	1,512,839
State agencies	1,065,109	998,273
Federal	276,424	490,972
Total assets	<u>\$ 246,492,861</u>	<u>\$ 349,609,878</u>
Liabilities:		
Current liabilities:		
Benefits payable	\$ 2,674,828	\$ 8,417,926
Accounts payable	1,592,546	1,093,945
Contributions payable	7,815,220	6,168,941
Intergovernmental payables:		
Federal	143,834	579,284
Other states	3,553,601	2,772,338
Payable to Commission	1,706,350	3,798,331
Total liabilities	<u>17,486,379</u>	<u>22,830,765</u>
Net Assets:		
Restricted for unemployment benefits	<u>229,006,482</u>	<u>326,779,113</u>
Total liabilities and net assets	<u>\$ 246,492,861</u>	<u>\$ 349,609,878</u>

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

South Carolina Employment Security Commission
Unemployment Compensation Fund
Statements of Revenues, Expenses and Changes in Fund Net Assets
for the years ended June 30,

	<u>2008</u>	<u>2007</u>
Operating Revenues:		
Assessments	\$ 271,258,639	\$ 273,051,816
Reimbursement of unemployment compensation benefits from employers	3,534,486	3,205,726
Benefit overpayment recoveries	5,750,893	3,901,180
Intergovernmental:		
Federal	40,883,338	40,631,003
State agencies	4,285,778	3,881,685
Other states	8,531,963	6,603,517
Local governments	7,453,074	7,195,483
Total operating revenues	<u>341,698,171</u>	<u>338,470,410</u>
Operating Expenses:		
Unemployment compensation benefits	<u>449,511,155</u>	<u>389,823,906</u>
Total operating expenses	<u>449,511,155</u>	<u>389,823,906</u>
Operating loss	<u>(107,812,984)</u>	<u>(51,353,496)</u>
Non-operating Revenues (Expenses):		
Interest income	10,040,353	12,621,783
Intergovernmental expense - Commission	—	(604,927)
Total non-operating revenues	<u>10,040,353</u>	<u>12,016,856</u>
Changes in net assets	(97,772,631)	(39,336,640)
Total net assets - beginning	<u>326,779,113</u>	<u>366,115,753</u>
Total net assets – ending	<u>\$ 229,006,482</u>	<u>\$ 326,779,113</u>

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

South Carolina Employment Security Commission
Unemployment Compensation Fund
Statements of Cash Flows
for the years ended June 30,

	2008	2007
Cash flows used by operating activities:		
Cash received from assessments	\$ 274,050,466	\$ 280,406,675
Cash received from employers	3,347,686	3,557,305
Cash received from benefit overpayment recoveries	4,358,270	3,797,760
Cash received from Federal, state and local agencies	59,909,962	57,722,541
Benefits paid	(452,328,110)	(386,785,551)
Refund overpayment of assessments	(2,627,171)	(2,091,271)
Net cash used by operating activities	<u>(113,288,897)</u>	<u>(43,392,541)</u>
Cash flows used by non-capital financing activities:		
Payments to Commission	(2,091,981)	(1,631,552)
Net cash used by non-capital financing activities	<u>(2,091,981)</u>	<u>(1,631,552)</u>
Cash flows provided by investing activities:		
Interest received	10,040,353	12,621,783
Net cash provided by investing activities	<u>10,040,353</u>	<u>12,621,783</u>
Net decrease in cash	(105,340,525)	(32,402,310)
Cash and cash equivalents – beginning	<u>290,419,908</u>	<u>322,822,218</u>
Cash and cash equivalents – ending	<u><u>\$ 185,079,383</u></u>	<u><u>\$ 290,419,908</u></u>
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (107,812,984)	\$ (51,353,496)
Net changes in assets and liabilities:		
Assessments receivable	164,656	2,227,802
Benefit overpayments receivable	(1,392,623)	(103,420)
Due from reimbursable employers	(186,800)	351,579
Intergovernmental receivables:		
Local governments	(106,719)	222,169
Other states	(849,734)	(12,662)
State agencies	(66,836)	(81,630)
Federal	214,548	(263,973)
Benefits payable	(5,743,098)	1,458,298
Accounts payable	498,601	12,737
Contributions payable	1,646,279	1,409,307
Payable to Commission	—	3,035,785
Intergovernmental payable:		
Federal	(435,450)	(453,051)
Other states	781,263	158,014
Net cash used by operating activities	<u><u>\$ (113,288,897)</u></u>	<u><u>\$ (43,392,541)</u></u>

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

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Going Concern

To date, the Fund has generated substantial operating losses and has been required to use a substantial amount of cash resources to fund its operations. At June 30, 2008, the Fund had cash and cash equivalents of approximately \$185,000,000. However, due to the increasing unemployment rate and the increased amount of unemployment benefits, without a corresponding increase in assessment revenue, the Fund anticipates that it will be unable to operate without acquiring additional capital.

Management's plans with respect to addressing the matter discussed above are to ask the State of South Carolina to adjust the taxable wage base of employers in order to raise additional employer contributions to continue the operations of the Fund. If successful, management does not expect such an adjustment to take effect before cash resources are depleted completely. In such an event, the Fund plans to raise additional cash resources from the federal government through temporary short-term loans.

As a result, there is substantial doubt about the Fund's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or amounts and classification of liabilities that may result from this uncertainty. However, management believes that any adjustments to reflect the possible future effects on the recoverability and classification of assets and amounts of liabilities would not materially change the Fund's financial statements.

Reporting Equity

The accounting policies of the Fund conform to accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body in the United States of America for establishing governmental accounting and financial reporting principles. The more significant of the Fund's accounting principles related to the Fund are described below.

The core of the financial reporting entity is the primary government, which has a separately elected governing body. As required by GAAP, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The South Carolina Employment Security Commission (the "Commission") has determined it has no component units. The primary government is the State of South Carolina. The State has determined that the Commission is a part of the primary government.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity.

The primary government or entity is financially accountable if it appoints a voting majority of the organization's governing body, including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex-officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally independent if it holds all three of the following powers:

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

- (1) Determines its budget without another government having the authority to approve and modify that budget;
- (2) Levies taxes or sets rates or charges without approval by another government; or,
- (3) Issues bonded debt without approval by another government.

Otherwise, the organization is fiscally dependent on the primary entity that holds one or more of these powers.

Enactment of the first South Carolina Unemployment Compensation Law followed action by Congress in passing the Social Security Act on August 14, 1935. The original South Carolina law, which established a free public employment service and a system of unemployment insurance, became effective June 6, 1936. In 1966, the name of the Law was changed to the South Carolina Employment Security Law.

The Commission was created by Section 41-29-10 of the South Carolina Code of Laws to administer the South Carolina Employment Security Law which provides for the payment of unemployment insurance benefits, the collection of the unemployment tax from subject employers, and the operation of a statewide employment service.

These financial statements include only the portion of the activities of the Commission attributable to the Fund. All administrative costs of the programs are paid from the General Fund of the Commission.

The Commission, a primary entity, is an Agency and is part of the primary government of the State of South Carolina. The funds of the Commission, including the Fund, are included in the Comprehensive Annual Financial Report of the State of South Carolina. The South Carolina General Assembly elects the three-member commission for four-year terms.

The laws of the State and the policies and procedures specified by the State for State agencies are applicable to the activities of this entity. The reporting entity operates somewhat autonomously, but lacks full corporate powers. The accompanying financial statements present the financial position and results of operations, cash flows and note disclosures of only those transactions of the State of South Carolina, the primary government, that are attributable to the Commission's Unemployment Compensation Fund.

The Fund accounts for all financial transactions related to employer tax contributions, employer reimbursements in lieu of tax contributions, and Federal and other funds used for the payment of unemployment compensation benefits. Interest income earned on excess funds on deposit with the U.S. Treasury is retained in the Fund for the payment of unemployment compensation benefits. The Fund includes the following:

Basic Unemployment Compensation (UI) – This accounts for regular unemployment benefits paid to individuals. It is funded by quarterly tax remittances from employers within the State, as well as reimbursement from other states, recoupment on overpayments, and interest received on the Trust Fund.

Unemployment Compensation for Federal Employees (UCFE) – This accounts for unemployment paid to ex-Federal employees. It is funded by the Federal government.

Unemployment Compensation for Ex-Servicemen (UCX) – This accounts for unemployment paid to ex-servicemen. It is funded by the Federal government.

Trade Readjustment Allowance (TRA) – This fund accounts for unemployment paid to individuals who have lost their jobs due to foreign trade. These payments are made after regular UI benefits and extended benefits have been exhausted. It is funded by the Federal government.

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Emergency Unemployment Compensation (EUC) – This provides unemployment benefits to individuals who had no rights to the regular, extended, or additional benefits under State law. It is funded 100% by the Federal government.

Alternative Trade Adjustment Assistance Program (ATAA) - This account provides eligible individuals over the age of 50 who obtain new employment within 26 weeks of their separation with a wage subsidy to help bridge the salary gap between their old and new employment. It is funded by the Federal government.

Basis of Presentation - The Fund reports under the provisions of Statement No. 34 ("Statement 34") of the GASB, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a classification of net assets into three components – invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. These classifications are defined as follows:

Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds. The Fund does not have any capital assets, thus this classification is not used.

Restricted net assets – This component of net assets consists of constraints placed on net assets used through external constraints imposed by creditors (such as through debt covenants), contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. All of the Fund's net assets fall into this classification.

Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted net assets" or "invested in capital assets, net of related debt." The Fund has no unrestricted assets.

The financial statements of the Fund are prepared as an enterprise fund using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The Fund applies all applicable GASB pronouncements and has elected to apply only those standards issued by the Financial Accounting Standards Board ("FASB") on or before November 30, 1989 unless those pronouncements conflict or contradict GASB pronouncements.

Cash and Cash Equivalents - The amounts shown in the financial statements as cash and cash equivalents represent cash on hand with the State Treasurer, cash invested in various instruments by the State Treasurer as part of the State's internal cash management pool and cash on deposit with the U.S. Treasury and in various banks.

Most State agencies, including the Commission, participate in the State's internal cash management pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. The pool operates as a demand deposit.

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. The Commission records and reports its deposits in the general deposit account at cost.

Some State Treasurer accounts are not included in the State's internal cash management pool because of restrictions on the use of the funds. For those accounts, cash equivalents include investments in short-term highly liquid securities having an initial maturity of three months or less.

Receivables - Receivables consist of the following:

Assessments Receivable - Unemployment tax contributions are assessed each quarter based on covered wages during the quarter. Taxes for a quarter are due on or before the end of the month following the close of the quarter. Amounts not paid by such date are considered delinquent and the Commission is required to notify employers of such tax delinquencies. If the delinquent amount is not paid within ten days thereafter, the Commission is directed to issue a warrant of execution upon real and personal property of the employer.

Benefit Overpayments Receivable - Overpayments of unemployment compensation benefits occur due to changes in facts or estimates upon which benefits were originally paid or by claimant fraud. Overpayments are due upon detection or discovery and are recovered by cash recoupments or withheld from subsequent benefits due the claimants. During 1986, the State enacted a law which provides for recovery of overpayments by the South Carolina Department of Revenue from State income tax refunds. Benefit overpayment recoupments attributable to reimbursable employers or Federal programs are due to such employers or the Federal government. Refunds are made only when there are no current benefit obligations.

Due from Reimbursable Employers - The amounts due from reimbursable employers include those amounts attributable to the actual benefits paid on behalf of certain non-profit employers to former employees.

Intergovernmental Receivables, Federal - The Federal receivable amount represents reimbursements due under various Federal grant programs in which the Commission participates. Revenues and related receivables are recognized at the time and to the extent that allowable expenditures are incurred under such programs.

Intergovernmental Receivables, State Agencies - The amounts due from the State represent unemployment benefit reimbursements due from other South Carolina state agencies.

Intergovernmental Receivables, Other States and Local Governments - The benefit reimbursement receivable from other states and local governments is based on the prorata share of wages earned by the employees to whom benefits are being paid by South Carolina in those states and localities.

Payables – Payables consist of the following:

Benefits Payable - Benefits payable represent amounts paid after year-end for unemployment compensation benefits for periods ending prior to June 30.

Contributions Payable - Contributions payable includes amounts received from employers in excess of current unemployment tax liabilities. The Commission maintains the "credits" on account to cover future tax liabilities.

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Intergovernmental Payables - The amounts reported as intergovernmental payables – states represents amounts due as reimbursements to other states as reimbursements for benefits paid by those states to South Carolina claimants.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2. Cash and Cash Equivalents

The amounts shown as cash and cash equivalents on the balance sheet at June 30, are composed of the following:

	<u>2008</u>	<u>2007</u>
Deposits held by State Treasurer	\$ 8,354,318	\$ 16,366,670
Deposits held by U.S. Treasury	182,892,907	269,362,836
(Bank overdraft) other deposits	<u>(6,167,842)</u>	<u>4,690,402</u>
Total	<u>\$ 185,079,383</u>	<u>\$ 290,419,908</u>

Deposits held by State Treasurer - State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days.

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are required to be insured or registered or are investments for which the securities are held by the State or its agent in the State's name. Information pertaining to the reported amounts, fair values, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

Deposits held by U.S. Treasury - Under the provisions of Section 904(e) of the Social Security Act, the Secretary of the Treasury is authorized to credit to the account of each state agency, on a quarterly basis, a proportionate part of the earnings of the Unemployment Trust Fund.

Other Deposits - Custodial credit risk for deposits is the risk that in the event of a bank failure, the Fund's deposits may not be returned or the Fund will not be able to recover collateral securities in the possession of an outside party. Section 11-13-60 of the South Carolina Code of Laws requires these funds be fully insured or collateralized. All deposits of the Fund met these requirements and are either covered by federal depository insurance or collateralized with securities held by the depository financial institution's trust department or agent in the Fund's name. At June 30, 2008, the cash balances are in a bank overdraft position. Funds are transferred on a regular basis from the deposits held by U.S. Treasury to cover all benefit payments from this account. Subsequent to year-end, funds were transferred to put this account back in a positive cash position.

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 3. Payable to Commission

The amount shown on the financial statements as being payable to Commission represents amounts which were collected for penalties and interest and contingency assessments in tax remittances from employers. In addition, the Fund has not transferred all of the Reed Act Funds which were appropriated to the Commission as of June 30, 2008. Amounts due to the Commission as of June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Reed Act Funds	\$ 507,388	\$ 544,730
Contingency Assessments	1,060,492	2,965,707
Penalty and Interest	<u>138,470</u>	<u>287,894</u>
Total	<u>\$ 1,706,350</u>	<u>\$ 3,798,331</u>

Note 4. Reed Act Funds

The Commission has funds totaling approximately \$98,499,446 available under the Reed Act as of June 30, 2008. These funds are granted to the Fund from the Federal government from Federal unemployment tax collections to be used for unemployment benefits if they are needed. Upon appropriation by the State legislature and after approval of the Governor, these funds can be used for other purposes. Of these funds \$13,827,461 were appropriated by the General Assembly in prior fiscal years to partially fund the purchase of new software and information technology equipment, land acquisition, and office expansion. The \$13,827,461 was shown as a transfer from the Unemployment Compensation Fund to the Commission upon Legislative appropriation prior to the fiscal year ended June 30, 2008. As of June 30, 2008, \$13,320,073 of the appropriated amount under this appropriation had been transferred. During the fiscal year ended June 30, 2007, a \$500,000 appropriation was made by the General Assembly for the purchase of land. This amount is included in Transfer to Commission on the Statement of Revenues, Expenses, and Changes in Fund Balance for 2007. Of the funds appropriated, \$507,388 and \$544,730 had not been transferred to the Commission as of June 30, 2008 and 2007, respectively and are included in interfund payable – Commission on the Statements of Net Assets.

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 5. Receivables

The receivable balances at June 30, and the related amounts for the allowances for uncollectibles are as follows:

	2008		
	Receivables at June 30, 2008	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	\$ 56,937,530	\$ 6,899,726	\$ 50,037,804
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	9,408,643	4,357,668	5,050,975
Federal employees (UCFE)	45,447	24,309	21,138
Ex-servicemen (UCX)	100,849	49,415	51,434
Trade readjustment (TRA)	172,809	91,110	81,699
Emergency Unemployment Compensation (EUC)	247,690	193,574	54,116
Totals	\$ 9,975,438	\$ 4,716,076	\$ 5,259,362
Due from reimbursable employers (UI)	\$ 852,497	\$ 32,706	\$ 819,791
Intergovernmental receivables (UI):			
Local governments	\$ 1,629,796	\$ 37,381	\$ 1,592,415
Other states	\$ 2,362,573	\$ —	\$ 2,362,573
State agencies	\$ 1,065,109	\$ —	\$ 1,065,109
Federal	\$ 276,424	\$ —	\$ 276,424

South Carolina Employment Security Commission
Unemployment Compensation Fund
Notes to Financial Statements

Note 5. Receivables (continued)

	2007		
	Receivables at June 30, 2007	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	\$ 56,700,825	\$ 6,498,365	\$ 50,202,460
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	5,903,933	2,277,913	3,626,020
Federal employees (UCFE)	27,522	13,623	13,899
Ex-servicemen (UCX)	83,100	35,577	47,523
Trade readjustment (TRA)	72,160	40,944	31,216
Emergency Unemployment Compensation (EUC)	190,603	42,522	148,081
Totals	\$ 6,277,318	\$ 2,410,579	\$ 3,866,739
Due from reimbursable employers (UI)	\$ 645,252	\$ 12,261	\$ 632,991
Intergovernmental receivables (UI):			
Local governments	\$ 1,505,341	\$ 19,645	\$ 1,485,696
Other states	\$ 1,512,839	\$ —	\$ 1,512,839
State agencies	\$ 998,273	\$ —	\$ 998,273
Federal	\$ 490,972	\$ —	\$ 490,972

Note 6. Information on Business-Type Activities

The following information is provided for incorporation in the State of South Carolina Comprehensive Annual Financial Report for the year ended June 30, 2008 and 2007:

	2008	2007
Charges for services	\$ 341,698,171	\$ 338,470,410
Interest income	10,040,353	12,621,783
Less: expenses	(449,511,155)	(389,823,906)
Net program expense	(97,772,631)	(38,731,713)
Transfers:		
Transfer to Commission	—	(604,927)
Total transfers	—	(604,927)
Change in net assets	(97,772,631)	(39,336,640)
Net assets-beginning of year	326,779,113	366,115,753
Net assets-end of year	\$ 229,006,482	\$ 326,779,113

Note 7. Subsequent Events

On June 12, 2008, Congress passed the Emergency Extended Unemployment Compensation Act. As of July 6, 2008, unemployed individuals whose benefits have expired can get up to 13 additional weeks of unemployment benefits if they qualify. This increases the number of eligible weeks from 13 to 26. The extended benefits are federally funded and will run through March 2009.

Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements Performed
in Accordance with *Government Auditing Standards*

**Report on Internal Control Over Financial Reporting and on Compliance and Other
Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing
Standards***

The Office of the State Auditor and Board of Commissioners
South Carolina Employment Security Commission Unemployment Compensation Fund
Columbia, South Carolina

We have audited the accompanying financial statements of the South Carolina Employment Security Commission Unemployment Compensation Fund (the "Fund") as of and for the year ended June 30, 2008, and have issued our report thereon dated September 30, 2008. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Fund's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepting accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Fund's internal control. We consider the deficiency described as item 2008-01 in the accompanying schedule of findings and responses to be a material weakness in internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We consider finding 2008-01 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Fund's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Fund's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Office of the State Auditor, Board of Commissioners, management of the Fund, and the elected officials and management of the State of South Carolina and is not intended to be and should not be used by anyone other than these specified parties.

Scott McElveen, L.L.P.

Columbia, South Carolina
September 30, 2008

Schedule of Findings and Responses

2008-1 Weaknesses in Maintenance of Accounting Records in Accordance with Generally Accepted Accounting Principles

Condition:

Our audit identified certain matters attributable to the maintenance of accounting records in accordance with Generally Accepted Accounting Principles. These weaknesses include the following:

1. The Fund did not record all adjusting journal entries as proposed by the auditors in its accounting system, and therefore fund balances provided to the auditors did not agree with the financial statements issued by the Fund for the year ended June 30, 2007.
2. The Fund did not maintain complete trial balances or perform periodic analyses of the trial balances in order to ensure they are accurately maintained in the accounting system that it maintains.
3. The Fund keeps its accounting system on a cash basis of accounting.
4. The Fund does not prepare its own financial statements.

Cause:

The Fund's accounting staff does not currently have the necessary, skills, training and certification to perform the above functions and duties.

Effect:

The Fund's accounting records are not maintained in accordance with Generally Accepted Accounting Principles. Because management does not prepare the financial statements, errors are not detected and the independent auditors find numerous audit adjustments. The Fund must make numerous journal entries to its accounting records at year-end to adjust its records to the accrual basis of accounting. Some of the required journal entries were not made by management and adjustments were found by the independent auditors and agreed by management to be made. In addition, additional audit adjustments found by the independent auditors in prior years were not made by management which in turn caused the beginning fund balances to be incorrect in the next audit year.

Criteria:

In accordance with Generally Accepted Accounting Principles, financial statements should be prepared using the accrual basis of accounting.

Recommendation:

The Fund's accounting system must be converted to the accrual basis of accounting at year-end for financial reporting purposes. This conversion should be performed by management so that no significant audit adjustments result from the Fund's year-end audit. If the independent auditors find audit adjustments, management must understand and agree with these adjustments before they are booked and financial statements issued. Staff who maintains the accounting system of the Fund should make efforts to record the audit adjustments made by the auditors and reconcile the trial balance to the issued financial statements. Governmental Auditing Standards require that management take responsibility for the financial statements. The material weakness noted above is attributable to the Fund's management and staff not recording audit adjustments and not maintaining its accounting systems on an accrual basis. In

order to correct this weakness, the Fund should identify and hire accountants who have the requisite knowledge and experience to perform all necessary functions of the Fund's accounting department.

COMMISSIONERS
J. William McLeod
Becky D. Richardson
McKinley Washington, Jr.

EXECUTIVE DIRECTOR
Roosevelt T Halley
803.737.2617



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1550 Gadsden Street
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Columbia, SC 29202

September 30, 2008

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
SC Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, SC 29201

Dear Mr. Gilbert:

The South Carolina Employment Security Commission respectfully submits the following comments and Corrective Action Plan for the audit of the Unemployment Compensation Fund for the year ended June 30, 2008.

Name and address of the independent public accounting firm:
Scott McElveen, LLP
1441 Main Street, Suite 800
Columbia, South Carolina 29202

Audit period: July 1, 2007 through June 30, 2008

NOTES TO FINANCIAL STATEMENTS

Condition:

1. The Fund did not record all adjusting journal entries as proposed by the auditors in its accounting system, and therefore, fund balances provided to the auditors did not agree with the financial statements issued by the fund for the year ended June 30, 2008.
2. The Fund did not maintain complete trial balances or perform periodic analyses of the trial balances in order to ensure they are accurately maintained in the accounting system that it maintains.
3. The Fund keeps its accounting system on a cash basis of accounting
4. The Fund does not prepare its own financial statements.

Recommendation:

The Fund's accounting system must be converted to the accrual basis of accounting at year-end for financial reporting purposes. This conversion should be performed by management so that no significant audit adjustments result from the Fund's year-end audit. If the independent auditors find audit adjustments, management must understand and agree with these adjustments before they are booked and

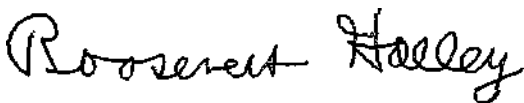
financial statements issued. Staff who maintains the accounting system of the Fund should make efforts to record the audit adjustments made by the auditors and reconcile the trial balance to the issued financial statements. Governmental Auditing Standards require that management take responsibility for the financial statements. The material weakness noted above is attributable to the Fund's management and staff not recording audit adjustments and not maintaining its accounting systems on an accrual bases. In order to correct this weakness, the Fund should identify and hire accountants who have the requisite knowledge and experience to perform all necessary functions of the Fund's accounting department.

Response:

1. The Commission will make every effort to ensure the adjusting entries proposed by the auditors to reconcile the Fund's general ledger are reviewed and approved by management to ensure the Commission maintains an accurate Fund balance. .
2. The Commission will take the necessary steps to ensure at least one trial balance is performed each year prior to the scheduled audit to make sure the records are properly maintained.
3. The Commission must report the financial information related to the Fund on a cash basis for federal reporting purposes. Therefore, the Commission must maintain its records on a cash basis of accounting. However, the state's financial accounting reporting system has scheduled the Commission to move to an accrual basis of accounting within the next two years.
4. The Commission has plans to prepare its own financial statements for the Fund.

If there are any questions, or if additional information is needed, please contact Patrick Holmes, UI Tax Director, at (803) 737-3070.

Sincerely,

A handwritten signature in black ink that reads "Roosevelt Halley". The signature is written in a cursive, slightly slanted style.

Roosevelt T. Halley
Executive Director