

South Carolina Employment Security Commission

Unemployment Compensation Fund

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*

for the year ended June 30, 2009

State of South Carolina



Office of the State Auditor

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COLUMBIA, S.C. 29201

RICHARD H. GILBERT, JR., CPA
DEPUTY STATE AUDITOR

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January 28, 2010

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

The 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* of the South Carolina Employment Security Commission – Unemployment Compensation Fund for the fiscal year ended June 30, 2009, was issued by Scott McElveen, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor. The report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with the basic financial statements of the South Carolina Employment Security Commission – Unemployment Compensation Fund for the fiscal year ended June 30, 2009, issued by Scott McElveen, L.L.P., Certified Public Accountants, dated December 2, 2009.

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/cwc

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**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 financial statements of the South Carolina Employment Security Commission Unemployment Compensation Fund (the "Fund") as of and for the year ended June 30, 2009, and have issued our report thereon dated December 2, 2009. 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. We consider the deficiencies described as items 2009-01 through 2009-06 in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting.

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.

CERTIFIED PUBLIC ACCOUNTANTS

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 findings 2009-01 through 2009-06 to be material weaknesses.

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, the Governor of the State of South Carolina, Board of Commissioners, and management of the Fund, 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
December 2, 2009

Schedule of Findings and Responses

2009-1 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 ("GAAP"). These matters include the following:

1. The Fund did not record all adjusting journal entries made by the auditors in its accounting system, and therefore beginning 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 were accurately maintained in the accounting system.
3. The Fund keeps its accounting system on a cash basis of accounting.

Cause:

The Fund's accounting staff as of June 30, 2009 did not have the skills and training necessary to perform the above functions and duties.

Effect:

The Fund's accounting records are not maintained in accordance with GAAP. 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 proposed by the independent auditors and agreed to by management to be made. In addition, 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 GAAP, the Fund's year-end 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 supervised by management so that no significant audit adjustments result from the Fund's year-end audit. If the independent auditors make audit adjustments, management must understand

and agree with these adjustments before they are booked and financial statements issued. Staff who maintain 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.

Subsequent to June 30, 2009, the Fund hired a new accounting manager who has GAAP accounting skills and knowledge, which should improve the Fund's accounting processes during the year and at year-end, and assist the Fund with this recommendation as well as those discussed below.

2009-2 Filing Deadline of Audited Financial Statements as Required by State of South Carolina Office of the Comptroller General Not Met

Condition:

The Fund was unable to meet the draft and final deadlines for completion of its annual financial statements of September 15 and September 30, 2009, respectively, as required by the State of South Carolina's Offices of Comptroller General and State Auditor.

Cause:

Due to an increased workload caused by significant increases in benefits paid, increased Federal funds and retirement of key personnel, the Fund's accounting staff had not been able to perform many of its monthly accounting duties on a timely basis. In many cases, cash accounts had not been reconciled since June 2008. In addition, several months of transactions had not been posted to the general ledger and balance sheet reconciliations for non-cash accounts had not been maintained during the year.

Effect:

The Fund was unable to provide the auditors with an up-to-date and adjusted trial balance to audit in a timely manner. The Fund had to hire an accounting firm and a retired accounting department employee of the Commission to assist its current accounting staff to perform the yearly close of the books, reconcile cash accounts, and post several months of transactions to the trial balance via manual journal entries. The ultimate effect of this was to cause the Fund's financial statements to be issued significantly late, and as a result the Comptroller General missed its deadline for completing the State's Comprehensive Annual Financial Report ("CAFR").

Criteria:

The State of South Carolina's Offices of Comptroller General and State Auditor dictate the deadlines for all South Carolina state agency audited financials so that they can be included in the State of South Carolina's CAFR. The draft financial statements should be issued by September 15 and the final should be issued by September 30.

Recommendation:

The Fund must implement procedures to meet these deadlines so that the Comptroller General can issue the State's CAFR on a timely basis. Such a process must include significant planning, preparation of a timeline, and controls to make sure that the timeline is met.

2009-3 Timeliness and Difficulty in Reconciling Cash Accounts

Condition:

The Fund's accounting staff did not reconcile cash accounts on a timely basis during the year. As a result, these reconciliations had to be caught up at year-end, which was a very difficult and time consuming process. These reconciliations have now been performed for fiscal year 2009. However, the Fund is behind in performing the reconciliations for fiscal year 2010.

Cause:

Due to the increased workload due to a significant increase of benefits paid, increased Federal funding, and retirement of key personnel, the Fund was unable to complete reconciliations of cash accounts in a timely manner. The use of multiple personnel to reconcile individual cash accounts caused confusion and inefficiency.

Effect:

The amount of time necessary to reconcile the cash balances was significantly greater than in prior years and a large number of audit entries were necessary. The ultimate effect was the Fund could not produce the information necessary to issue its financial statements on time.

Criteria:

Timely, monthly reconciliations of cash accounts are required by State Law and are a best practice of all government and non-government entities. It is a best practice for only one person to reconcile an individual cash account and for each reconciliation to be reviewed by management.

Recommendation:

All cash accounts must be reconciled monthly and as soon as possible after month-end. If possible no more than one person should reconcile an individual cash account. Choosing one person to reconcile all cash accounts should reduce confusion and inefficiency. These reconciliations should also be reviewed on a timely basis by a member of management.

2009-4 Reconciliation of Federal Debt and Other Balance Sheet Accounts to the General Ledger

Condition:

We confirmed the balance of debt with the Federal Government's Office of Public Debt and found that the confirmation did not agree with the Fund's accounting records. In addition, certain other balance sheet account balances per the general ledger had not been reconciled to the Fund's detailed records.

Cause:

The lack of monthly reconciliations of the Federal debt account and other balance sheet accounts resulted in errors in the Fund's accounting records.

Effect:

Material adjustments were required to correct the Fund's trial balance.

Criteria:

Monthly reconciliations of certain accounts are required by State Law and reconciliation of all balance sheet accounts are a best practice of all government and non-government entities. Such practice will alleviate discrepancies between actual balances and internal accounting records.

Recommendation:

All significant balance sheet accounts such as the Federal debt account should be reconciled monthly and as soon as possible after month-end. All GAAP balance sheet accounts should be reconciled at least at year-end.

2009-5 Federal and State Tax Withholdings Not Remitted Timely

Condition:

Management discovered that Federal and State tax withholdings on benefits paid were not remitted for several months during 2009 when a representative from the South Carolina Department of Revenue called to inquire why payments were not being remitted.

Cause:

A member of the Fund's accounting staff decided not to draw down the funds necessary to pay Federal and State tax withholdings on benefits paid when certain data processing reports appeared to be in error.

Effect:

The Fund was delinquent in meeting both Federal and State deadlines and therefore incurred approximately \$900,000 of penalties and \$50,000 of interest from the State of South Carolina. All penalties were forgiven by the State and approximately \$25,000 of interest has not been forgiven. The IRS has yet to determine the amount of penalties and interest due it.

Criteria:

The IRS and the State of South Carolina Department of Revenue have established deadlines for the remittance of withholdings.

Recommendation:

Management must develop procedures to prevent the untimely remittance of tax withholdings in the future. A process of management review must be put in place to ensure that no one person can delay or prevent payments in the future.

2009-6 Reconciliations of Accounting Records to Statewide Accounting and Reporting System ("STARS")

Condition:

The Fund did not perform reconciliations of its accounting records to STARS, the accounting system of the State of South Carolina's Office of the Comptroller General, for several months, during fiscal year 2009, for cash, revenues, and expenditures. These reconciliations have now been prepared for fiscal year 2009, but the Fund is behind in performing these reconciliations for fiscal year 2010.

Cause:

Due to the increased workload caused by a significant increase in benefits paid, increased Federal funding, and retirement of key personnel, the Fund's accounting staff did not perform monthly reconciliations to STARS.

Effect:

The Fund was unaware of differences between its accounting system and STARS which could affect management decisions as well as financial statement balances.

Criteria:

State Law requires that monthly reconciliations of certain of the Fund's cash, revenue, and expenditures accounts to STARS be performed on a timely basis after each month end.

Recommendation:

Cash, revenue, and expenditure reconciliations of the Fund's accounting records to STARS must be performed monthly on a timely basis and reviewed and approved by management.

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

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1550 Gadsden Street
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December 2, 2009

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, 2009 performed by the independent accounting firm:

Scott McElveen, LLP
1441 Main Street, Suite 800
Columbia, South Carolina 29202

Audit period: July 1, 2008 to June 30, 2009

Schedule of Findings and Responses

2009-1 Weakness in Maintenance of Accounting Records in Accordance with GAAP

Condition:

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

1. The Fund did not record all adjusting journal entries made by the auditors in its accounting system, and therefore beginning 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 were accurately maintained in the accounting system.
3. The Fund keeps its accounting system on a cash basis of accounting.

Management's Response:

(Condition 1.)

The Fund's management will review, approve and post entries proposed by the independent auditors, subject to certain technical limitations. Restrictions inherent in the Fund's current general ledger system currently preclude the posting of certain types of journal entries after yearend closing. The Commission's IT department has begun working on a new, all-inclusive accounting and reporting system that will address this issue.

In addition, management will book all necessary year-end journal entries, including accrual entries, required in order for the financial statements to be presented in accordance with GAAP.

(Condition 2.)

In addition to a new accounting manager with a working knowledge of GAAP, the Commission has also hired an accounting firm, separate from the Fund's independent auditors, to assist in the manual preparation of the year-end trial balance and financial statements for the Fund.

When finalized, tested and implemented, the new accounting system being developed by the Commission's IT department will include the necessary functionality to generate customized reports, including a trial balance, at a given date. The accuracy of these reports will be tested by management to ensure that a usable trial balance will be available for the annual audit.

(Condition 3.)

The Fund is required to report its activities and balances on a cash basis for Federal reporting purposes. Therefore, the Fund's internal records must be kept using the cash basis of accounting. The State of South Carolina has begun implementing a new statewide accounting system that will allow for real-time reporting of activities and balances using the accrual method of accounting; however, the Fund has not yet implemented this system due to problems encountered during the initial roll-out of the program.

The Fund's management and staff will make every effort to post the proper year-end journal entries necessary to convert the Fund's books from the cash basis to the accrual basis as required by GAAP.

*2009-2 Filing Deadline of Audited Financial Statements as Required by State of South Carolina
Office of the Comptroller General Not Met*

Condition:

The Fund was unable to meet the draft and final deadlines for completion of its annual financial statements of September 15 and September 30, 2009, respectively, as required by the State of South Carolina's Offices of Comptroller General and State Auditor.

Management's Response:

Management is making every effort to implement procedures to ensure all required information is accurate and provided in a timely manner for audit procedures to be completed and financial statements drafted and issued within the allowable period prior to the State's deadline. The new accounting manager for the Fund is currently undertaking efforts to update and automate several key processes, currently performed manually, that will assist in bringing all internal accounting and reporting processes up to date. It is management's goal to show marked improvement in the timeliness and accuracy of financial information by the end of the current fiscal year.

2009-3 Timeliness and Difficulty in Reconciling Cash Accounts.

Condition:

The Fund's accounting staff did not reconcile cash accounts on a timely basis during the year. As a result, these reconciliations had to be caught up at year-end, which was a very difficult and time consuming process. These reconciliations have now been performed for fiscal year 2009. However, the Fund is behind in performing the reconciliations for fiscal year 2010.

Management's Response:

As mentioned in the response to issue 2009-2, the improved accuracy and timeliness of the Fund's financial information has assumed top-priority under the accounting unit's new management. Although the Fund is still dealing with a significant backlog of work, including the reconciliations of cash accounts, management is making every effort to perform the reconciliations immediately following the recording of each month's transactions.

As soon as the current backlog of work has been brought up to date and the required personnel put into place, new procedures will immediately take effect requiring that one individual be responsible for reconciling every bank account to the Fund's general ledger for each month, by the mid-point of the following month, to be reviewed by management. Management will ensure that the individual responsible for performing bank reconciliations has the required knowledge and resources to perform these procedures, on time, without exception. The same individual will also be required to represent an understanding of the legal requirements and best-practices related to this process, as well as the ramifications for any deviation from policy resulting from negligence on his or her part.

2009-4 Reconciliation of Federal Debt and Other Balance Sheet Accounts to the General Ledger

Condition:

We confirmed the balance of debt with the Federal Government's Office of Public Debt and found that the confirmation did not agree with the Fund's accounting records. In addition, certain other balance sheet account balances per the general ledger had not been reconciled to the Fund's detailed records.

Management's Response:

As mentioned before, new systems, policies and procedures are currently being developed by the Fund's management to enable the accurate and timely performance of general accounting duties during the normal course of business. As soon as the Fund's employees have brought all reconciliations up to date, these policies will take immediate effect. Staff with requisite accounting knowledge will be individually assigned to perform timely reconciliations of the Federal debt and all other balance sheet accounts. The level of knowledge required and responsibility assumed will be considered individually for each account, and staff members will be assigned accordingly based on their level of experience and their history of performance within the organization.

Again, the importance of the accurate, timely performance of these duties will be emphasized as they are assigned, along with the ramifications for any unreasonable exceptions to the unit's policies and procedures.

2009-5 Federal and State Tax Withholdings Not Remitted Timely

Condition:

Management discovered that Federal and State tax withholdings on benefits paid were not remitted for several months during 2009 when a representative from the South Carolina Department of Revenue called to inquire why payments were not being remitted.

Management's Response:

As emphasized by our auditors in their report, the criteria for the remittance of Federal and State withholdings to the taxing authorities is clearly defined by the IRS and SC Department of Revenue. The Fund's management will not tolerate any unreasonable delay or failure in drawing-down and remitting these funds within the specified time periods.

Problems obtaining accurate withholding figures due to data processing issues should be addressed immediately by accounting personnel and should assume top priority in all cases. Management continues to notify the Commission's data processing department of all known issues that caused (or could cause) delays in determining proper remittance amounts. Accounting

staff assigned to calculate, draw-down, and remit withholdings will be assigned such duties in accordance with their history of performance, understanding of the specific procedures, and knowledge of the legal requirements and ramifications for non-compliance.

2009-6 Reconciliations of Accounting Records to Statewide Accounting and Reporting System ("STARS")

Condition:

The Fund did not perform reconciliations of its accounting records to STARS, the accounting system of the State of South Carolina's Office of the Comptroller General, for several months, during fiscal year 2009, for cash, revenues, and expenditures. These reconciliations have now been prepared for fiscal year 2009, but the Fund is behind in performing these reconciliations for fiscal year 2010.

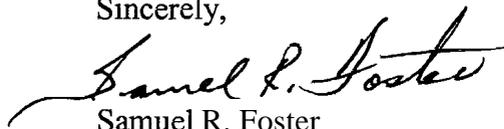
Management's Response:

Policies and procedures for monthly reconciliation of the Fund's general ledger to STARS will be clearly outlined by management to prevent any delays in performance. Employees of the Fund's accounting unit will be specifically assigned to reconcile cash, revenues, and expenditures to STARS based on their level of experience and responsibility.

Overall, management will continue its efforts to address all weaknesses in internal controls identified in our auditor's report. The hiring of new staff, automation of manual processes, and implementation of strict policies and procedures should allow for consistent improvement in all areas addressed in this report. It is management's intention to instill in all of the Fund's employees the level of importance in acting as fiduciaries for the State of South Carolina's employers and employees. Newly established policies and the individual assignment of duties to accounting staff will work to make each employee accountable for the accurate and timely performance of his or her duties. Management will make every effort to assist the Fund's staff in improving both its level of performance, and level of understanding as to how our work affects the agency as whole.

If there are any questions, or if additional information is needed, please contact Don Grant, Manager - UI Control Accounts, at (803) 737-3088.

Sincerely,



Samuel R. Foster
Interim Executive Director