

Report on Audits of Financial Statements of
South Carolina Employment Security Commission
Unemployment Compensation Fund
for the years ended June 30, 2006 and 2005

State of South Carolina



Office of the State Auditor

1401 MAIN STREET, SUITE 1200
COLUMBIA, S.C. 29201

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

(803) 253-4160
FAX (803) 343-0723

September 21, 2006

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Employment Security Commission
Unemployment 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, 2006 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

Table of Contents

Independent Auditors' Report.....	1
Management's Discussion and Analysis.....	3-5
Financial Statements:	
Statements of Net Assets	6
Statements of Revenues, Expenses and Changes in Fund Net Assets.....	7
Statements of Cash Flows	8
Notes to Financial Statements	9-16
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	17-19
Management's Response	20-21

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 statement of net assets of the South Carolina Employment Security Commission Unemployment Compensation Fund (the "Fund") as of June 30, 2006 and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. 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 audit. The financial statements of the Fund as of June 30, 2005 were audited by other auditors whose opinion dated September 6, 2005 was unqualified. As discussed in Note 7, the Fund has restated its June 30, 2005 financial statements during the current year to properly recognize interest income, in conformity with accounting principles generally accepted in the United States of America. The other auditors reported on the June 30, 2005 financial statements before the restatement.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides 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, 2006 and 2005, 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, 2006, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in Note 7 that were applied to restate the June 30, 2005 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2006, 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 audit.

Management's Discussion and Analysis on pages 3 through 5 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 and by the Governmental Accounting Standards Board. 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 15, 2006

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, 2006. Please read this information in conjunction with the South Carolina Employment Security Commission's financial statements and accompanying notes.

Financial Highlights

- 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, penalty, contingency, service charge, 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, 2006 by \$366,115,753 (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 \$364,828,359 and \$366,581,162 during the years ended June 30, 2006 and 2005, respectively.

Overview/discussion of the Financial Statements

Management's Discussion and Analysis serves as an introduction to the basic financial statements and supplementary information. 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 equivalent resulting from operational, financing and investing activities. This statement presents cash receipts and cash disbursement information.

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

Condensed Financial Data

Statement of Net Assets	2006	2005	Change
Assets	<u>\$ 384,352,053</u>	<u>\$ 406,451,635</u>	<u>\$ (22,099,582)</u>
Liabilities	\$ 18,236,300	\$ 21,434,873	\$ 3,198,573
Net assets, 2005 as restated	<u>366,115,753</u>	<u>385,016,762</u>	<u>(18,901,009)</u>
Total liabilities and net assets	<u>\$ 384,352,053</u>	<u>\$ 406,451,635</u>	<u>\$ (22,099,582)</u>

Statement of Revenues, Expenses and Changes in Fund Net Assets

Operating Revenues	2006	2005	Change
Assessments	\$ 276,941,805	\$ 266,910,593	\$ 10,031,212
From Federal Agencies	31,386,372	23,435,493	7,950,879
Other	<u>23,880,283</u>	<u>22,801,432</u>	<u>1,078,851</u>
Total Revenues	332,208,460	313,147,518	19,060,942
Operating Expenses			
Unemployment			
Compensation Benefits	<u>364,828,359</u>	<u>366,581,162</u>	<u>1,752,803</u>
Operating loss	(32,619,899)	(53,433,644)	20,813,745
Non-Operating Revenues			
Interest Income	13,718,890	17,739,474	4,020,584
Transfers	<u>-0-</u>	<u>30,303</u>	<u>(30,303)</u>
Changes in Net Assets	(18,901,009)	(35,663,867)	16,762,858
Total Net Assets –			
Beginning, 2005 as restated	<u>385,016,762</u>	<u>420,680,629</u>	<u>(35,663,867)</u>
Total Net Assets – Ending	<u>\$ 366,115,753</u>	<u>\$ 385,016,762</u>	<u>\$ (18,901,009)</u>

Financial Analysis

Statement of Net Assets:

Total assets declined by \$22 million due primarily to the decline in the cash balance, as a result of the high unemployment rate.

Net assets declined by \$19 million due to the loss for the year.

Revenue, Expenses and Changes in Net Assets:

Assessments increased \$10 million over last year.

Total revenue increased by \$19 million primarily due to the increase of revenue from assessments and federal agencies.

Unemployment Compensation benefits decreased slightly by \$1.7 million.

Operating loss for 2006 was \$33 million as compared to \$53 million loss for the prior year.

Interest income went down almost \$4 million due to a lower Trust Fund balance.

Ending Net Assets for 2006 decreased by \$19 million as compared to \$40 million decrease for the prior year.

Although the unemployment rate increased during the current year, the taxable wage base increased resulting in higher assessments.

As a result of growth in employment, there were fewer claimants and a decrease in Unemployment Compensation Benefits paid.

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

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 322,822,218	\$ 343,995,473
Assessments receivable, net	52,430,262	52,265,921
Benefit overpayments receivable, net	3,763,319	3,738,448
Due from reimbursable employers, net	984,570	1,166,670
Intergovernmental receivables, net		
Local governments	1,707,865	2,043,968
Other states	1,500,177	1,154,539
State agencies	916,643	967,949
Federal	226,999	1,118,667
Total assets	<u>\$ 384,352,053</u>	<u>\$ 406,451,635</u>
Liabilities:		
Current liabilities:		
Cash overdraft	\$ —	\$ 549,529
Benefits payable	6,976,055	6,554,394
Accounts payable	1,081,208	1,141,484
Contributions payable	4,759,634	4,017,503
Intergovernmental payables:		
Federal	1,032,335	934,034
Other states	2,614,324	3,098,364
Interfund payable – Commission	1,772,744	5,139,565
Total liabilities	<u>18,236,300</u>	<u>21,434,873</u>
Net Assets:		
Restricted for unemployment benefits, 2005 as restated	<u>366,115,753</u>	<u>385,016,762</u>
Total liabilities and net assets	<u>\$ 384,352,053</u>	<u>\$ 406,451,635</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>2006</u>	<u>2005</u>
Operating Revenues:		
Assessments	\$ 276,941,805	\$ 266,910,593
Reimbursement of unemployment compensation benefits from employers	3,809,874	3,276,834
Benefit overpayment recoveries	4,047,113	3,155,892
Intergovernmental:		
Federal	31,386,372	23,435,493
State agencies	3,681,451	4,001,791
Other states	5,377,123	5,119,030
Local governments	6,964,722	7,247,885
Total operating revenues	<u>332,208,460</u>	<u>313,147,518</u>
Operating Expenses:		
Unemployment compensation benefits	364,828,359	366,581,162
Total operating expenses	<u>364,828,359</u>	<u>366,581,162</u>
 Operating loss	 <u>(32,619,899)</u>	 <u>(53,433,644)</u>
Nonoperating Revenues:		
Interest income	13,718,890	17,739,474
Total nonoperating revenues	<u>13,718,890</u>	<u>17,739,474</u>
 Loss before transfer	 <u>(18,901,009)</u>	 <u>(35,694,170)</u>
 Transfer from Commission	 <u>—</u>	 <u>30,303</u>
 Changes in net assets	 <u>(18,901,009)</u>	 <u>(35,663,867)</u>
Total net assets - beginning, 2005 as restated	<u>385,016,762</u>	<u>420,680,629</u>
Total net assets – ending	<u>\$ 366,115,753</u>	<u>\$ 385,016,762</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,

	<u>2006</u>	<u>2005, as restated</u>
Cash flows used by operating activities:		
Cash received from assessments	\$ 278,753,193	\$ 268,300,822
Cash received from employers	3,991,974	3,199,869
Cash received from benefit overpayment recoveries	4,022,242	3,805,500
Cash received from federal, state and local agencies	48,441,408	39,389,935
Benefits paid	(364,208,883)	(364,498,441)
Refund overpayment of assessments	(1,975,729)	(1,715,096)
Net cash used by operating activities	<u>(30,975,795)</u>	<u>(51,517,411)</u>
Cash flows used by non-capital financing activities:		
Funding of cash overdraft	—	549,529
Repayment of cash overdraft	(549,529)	(49,449)
(Repayments) borrowings to/from Commission	(44,950)	40,241
Transfers from general fund	—	30,303
Transfers to Commission	(3,321,871)	(3,103,519)
Net cash used by non-capital financing activities	<u>(3,916,350)</u>	<u>(2,532,895)</u>
Cash flows provided by investing activities:		
Interest received	13,718,890	17,739,474
Net cash provided by investing activities	<u>13,718,890</u>	<u>17,739,474</u>
Net decrease in cash	(21,173,255)	(36,310,832)
Cash and cash equivalents – beginning	<u>343,995,473</u>	<u>380,306,305</u>
Cash and cash equivalents – ending	<u><u>\$ 322,822,218</u></u>	<u><u>\$ 343,995,473</u></u>
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (32,619,899)	\$ (53,433,644)
Net changes in assets and liabilities:		
Assessments receivable	(164,341)	(324,867)
Benefit overpayments receivable	(24,871)	649,609
Due from reimbursable employers	182,100	(76,965)
Intergovernmental receivables:		
Local governments	336,103	(160,215)
Other states	(345,638)	182,643
State agencies	51,306	139,626
Federal	891,668	(787,116)
Benefits payable	421,661	1,471,909
Accounts payable	(60,276)	370,307
Contributions payable	742,131	407,811
Intergovernmental payable:		
Federal	98,301	210,798
Other states	(484,040)	(167,307)
Net cash used by operating activities	<u><u>\$ (30,975,795)</u></u>	<u><u>\$ (51,517,411)</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

Reporting Entity - 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:

- (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.

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

Note 1. Summary of Significant Accounting Policies (continued)

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.

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. This program ended in the prior fiscal year and the activity now consists of collecting overpayment benefits.

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:

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

Note 1. Summary of Significant Accounting Policies (continued)

Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation, costs to be recovered from future revenues, and unamortized debt expense 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.

Restricted – 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.

Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

All of the Fund's net assets are restricted.

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.

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.

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

Note 1. Summary of Significant Accounting Policies (continued)

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 includes those amounts attributable to the actual benefits paid on behalf of certain non-profit employers to former employees.

Intergovernmental Receivables - 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.

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

Other States - The benefit reimbursement receivable from other states and local governments is based on the prorata share of wages earned by the employees to which 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.

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.

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

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>2006</u>	<u>2005</u>
Deposits held by State Treasurer	\$ 2,673,495	\$ 2,683,434
Deposits held by U.S. Treasury	314,184,987	332,675,478
Other deposits	<u>5,963,736</u>	<u>8,636,561</u>
Total, 2005 as restated	<u>\$ 322,822,218</u>	<u>\$ 343,995,473</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.

Note 3. Interfund Payable - Commission

The amount shown on the financial statements as being interfund payable 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, 2005. Amounts due to the Commission as of June 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Reed Act Funds	\$ 1,676,282	\$ 4,998,156
Contingency Assessments	25,228	29,034
Penalty and Interest	<u>71,234</u>	<u>112,375</u>
Totals	<u>\$ 1,772,744</u>	<u>\$ 5,139,565</u>

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

Note 4. Reed Act Funds

The Commission has funds totaling approximately \$100,680,344 available under the Reed Act. 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. \$13,327,461 of these funds 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 \$13,327,461 is shown as a transfer from the Unemployment Compensation Fund to the Commission upon Legislative appropriation. \$8,329,305 was transferred in prior years and \$3,321,871 was transferred during the current year. As of June 30, 2006 and 2005, \$1,676,285 and \$4,998,156, respectively of the funds appropriated in prior years had not been transferred to the Commission.

Note 5. Receivables

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

	2006		
	Receivables at June 30, 2006	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	\$ 57,663,272	\$ 5,233,010	\$ 52,430,262
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	5,374,796	1,953,111	3,421,685
Federal employees (UCFE)	20,758	7,856	12,902
Ex-servicemen (UCX)	79,460	44,077	35,383
Trade readjustment (TRA)	103,449	45,714	57,735
Emergency Unemployment Compensation (EUC)	239,160	3,546	235,614
Totals	\$ 5,817,623	\$ 2,054,304	\$ 3,763,319
Due from reimbursable employers (UI)	\$ 996,803	\$ 12,233	\$ 984,570
Intergovernmental receivables (UI):			
Local governments	\$ 1,727,510	\$ 19,645	\$ 1,707,865
Other states	\$ 1,500,177	\$ —	\$ 1,500,177
State agencies	\$ 916,643	\$ —	\$ 916,643
Federal	\$ 226,999	\$ —	\$ 226,999

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

Note 5. Receivables (continued)

	2005		
	Receivables at June 30, 2006	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	\$ 57,880,166	\$ 5,614,245	\$ 52,265,921
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	5,652,223	2,364,528	3,287,695
Federal employees (UCFE)	25,462	13,452	12,010
Ex-servicemen (UCX)	73,012	45,549	27,463
Trade readjustment (TRA)	39,010	7,393	31,617
Emergency Unemployment Compensation (EUC)	504,226	124,563	379,663
Totals	\$ 6,293,933	\$ 2,255,485	\$ 3,738,448
Due from reimbursable employers (UI)	\$ 1,186,996	\$ 20,326	\$ 1,116,670
Intergovernmental receivables (UI):			
Local governments	\$ 2,063,613	\$ 19,645	\$ 2,043,968
Other states	\$ 1,154,539	\$ —	\$ 1,154,539
State agencies	\$ 967,949	\$ —	\$ 967,949
Federal	\$ 1,118,667	\$ —	\$ 1,118,667

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, 2006 and 2005:

	2006	2005
Charges for services	\$ 332,208,460	\$ 313,147,518
Interest income, 2005 as restated	13,718,890	17,739,474
Less: expenses	(364,828,359)	(366,581,162)
Net program expense	(18,901,009)	(35,694,170)
Transfers:		
Transfer from general fund	—	30,303
Total general revenue and transfers	—	30,303
Change in net assets	(18,901,909)	(35,663,867)
Net assets-beginning of year, as restated	385,016,762	420,680,629
Net assets-end of year	\$ 366,115,753	\$ 385,016,762

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

Note 7. Restatement of Financial Statements

Following a review of the Fund's interest revenue received for fiscal year 2006, the Fund identified revenue that was improperly excluded from revenue for fiscal year 2005. The Fund determined that, because the cumulative adjustments resulting from these corrections would have been material to the financial statements for the year ended June 30, 2005, it was required to restate its financial statements for fiscal year 2005 (the "Restatement").

The US Treasury deposit account is credited with interest quarterly. The Fund did not make an entry to record the interest relating to the quarter ending June 30, 2005 in its accounting records.

The following is a summary of the line items impacted by the restatement for the 2005 Statement of Net Assets and 2005 Statement of Revenues, Expenses and Changes in Net Assets:

	<u>As Previously Reported</u>	<u>Adjustments</u>	<u>Restated</u>
June 30, 2005			
Cash	\$ 339,721,858	4,273,615	\$ 343,995,473
Net assets restricted for unemployment benefits	380,743,147	4,273,615	385,016,762
Interest income	13,465,859	4,273,615	17,739,474
Loss before transfer	(39,967,785)	4,273,615	(35,694,170)
Changes in net assets	(39,937,482)	4,273,615	(35,663,867)

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, 2006, and have issued our report thereon dated September 15, 2006. 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of finding as item 2006-01.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition described above 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*.

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 15, 2006

Schedule of Finding

2006-01 – Cash Basis Accounting Records

Condition: The Fund keeps its accounting system on a cash basis of accounting.

Cause: Keeping the accounting system on a cash basis makes it easier for the fund to report its cash receipts and expenditures relating to its Federal programs.

Effect: 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 missed and adjustments were made by the independent auditors.

Criteria: In accordance with generally accepted accounting principles, revenues and expenses should be recorded based on the accrual basis of accounting.

Recommendation: The Fund's accounting system should be kept on the accrual basis of accounting for financial reporting purposes. Accordingly, a separate set of records should be maintained to report cash receipts and expenditures of Federal program funds.

COMMISSIONERS

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

EXECUTIVE DIRECTOR

Roosevelt T. Halley
803.737.2617



Your
onestOp
for Workforce Solutions!
www.sces.org

1550 Gadsden Street
Post Office Box 995
Columbia, South Carolina 29202

September 26, 2006

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, 2006.

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, 2005 through June 30, 2006

NOTES TO FINANCIAL STATEMENTS

2006-01 — Cash Basis Accounting Records

Condition: The Fund keeps its accounting system on a cash basis of accounting

Recommendation: The Fund's accounting system should be kept on the accrual basis of accounting for financial reporting purposes. Accordingly, a separate set of records should be maintained to report cash receipts and expenditures of Federal program funds.

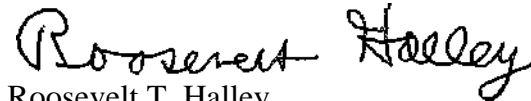
Response: The Commission's UI Fund has monthly federal reporting requirements that are prepared using a cash basis accounting system. We feel it would be too time consuming to operate on a dual accounting system *as* well as not have the appropriate information monthly to record the accruals. We will work with the independent auditors to determine the appropriate

Corrective Action Plan
Page 2

accrual entries to make at year end to the trial balances to ensure that the year end financial reports are prepared on an accrual basis.

If there are any questions, or if additional information is needed, please contact James Singleton, 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, flowing style.

Roosevelt T. Halley
Executive Director

RTH:wh

REF: UI-4