

Financial Statements of
South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
for the years ended June 30, 2010 and 2009

State of South Carolina



Office of the State Auditor

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September 30, 2010

The Honorable Mark Sanford, Governor
and
Mr. John Finan, Director
South Carolina Department of Employment and Workforce
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Department of Employment and Workforce Unemployment Compensation Fund for the fiscal year ended June 30, 2010 was issued by Scott and Company, LLP, 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

Contents

Independent Auditors' Report.....	1-2
Management's Discussion and Analysis.....	3-6
Financial Statements:	
Statements of Net Assets (Deficit)	7
Statements of Revenues, Expenses and Changes in Fund Net Assets (Deficit).....	8
Statements of Cash Flows	9
Notes to Financial Statements	10-19
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>	20-21

Independent Auditors' Report

The Office of the State Auditor
South Carolina Department of Employment and Workforce Unemployment Compensation Fund
Columbia, South Carolina

We have audited the accompanying financial statements of the South Carolina Department of Employment and Workforce Unemployment Compensation Fund (the "Fund") as of and for the years ended June 30, 2010 and 2009, 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 audits 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, 2010 and 2009, 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 financial position of the Fund as of June 30, 2010 and 2009, and the 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2010, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Scott and Company LLP

Columbia, South Carolina
September 30, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the South Carolina Department of Employment and Workforce (the "Department") offers readers this narrative overview and analysis of the financial activities attributed to the South Carolina Department of Employment and Workforce's Unemployment Compensation Trust Fund (the "Fund") for the fiscal years ended June 30, 2010 and 2009. Please read this information in conjunction with the Fund's financial statements and accompanying notes.

Financial Highlights

- To date, the Fund has generated substantial operating losses and has been required to use most of its cash resources to fund its operations. Due to the increasing unemployment rate and the resulting increased amount of unemployment benefits, and the increased length of time over which the benefits are paid, the Fund has been required to obtain advances from the Federal Unemployment Fund of \$541,780,847 and \$344,881,505 during the years ended June 30, 2010 and 2009, respectively.

Increased tax collections, coupled with decreases in the number of individuals eligible for and claiming state UI benefits, have enabled the Fund to operate without obtaining additional advances from the federal government since April of 2010. Management plans to continue to borrow from the federal government, as needed, to fund its deficits for the foreseeable future. The federal government has not established a maximum amount that the Fund can borrow.

On August 10, 2010, the Fund received \$97,459,490 in unemployment insurance ("UI") modernization incentive funds from the U.S. Department of Labor. The funding stems from various changes made to South Carolina (the "State") unemployment insurance law that will make benefits available to more people, including part-time workers and those who quit work for compelling family reasons. South Carolina qualified for the funds available under the American Recovery and Reinvestment Act ("ARRA"). These funds will be used to pay state UI benefits and will reduce the need for requesting additional advances from the federal government. The Department estimates that it will not require additional advances until mid-November of 2010.

Recent legislative reforms to the State's unemployment insurance tax structure have been implemented that are specifically designed to assist in putting the Fund back on the path to solvency. State unemployment tax rates for future years will be structured to raise revenues that more accurately address the demands of the State's UI system and the changing economic environment in which the system operates. While the Fund remains in federal loan status, required tax revenues will consist of estimated benefit payouts for the subsequent year, an amount required to repay the principal on all outstanding federal advances over five years, and an additional surcharge designated to pay accrued interest on outstanding advances. As the expected level of state UI benefit payments continues to decrease, a greater proportion of state UI tax revenues will be available to repay the advanced funds.

- The Fund was created per Section 41-33-10 of the South Carolina Employment Security Law. The 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 Fund to pay unemployment benefit claims.

- In March 2010, Section 41-29-10 of the South Carolina Code of Laws was amended by the General Assembly through Act 146 to replace the Commissioners with an Executive Director, appointed by the Governor for a four year term. The act also renamed the agency the Department of Employment and Workforce (the “Department”), moved it to the Governor’s cabinet, moved the Workforce Investment Act (“WIA”) and Trade Assistance Act (“TAA”) programs back to the agency, and established an appellate panel charged with hearing higher level appeals for unemployment benefits. The General Assembly elects the three-member appellate panelists to four year terms. Although the legislative restructuring affected the organization, governance, and operation of the Department as a whole, the character, operating regulations and responsibilities of the Fund were not changed.
- Liabilities exceeded assets as of June 30, 2010 by \$761,147,843 which is shown as “net (deficit) assets”. The net deficit as of June 30, 2009 was \$(317,266,975).
- Total unemployment compensation benefits paid were \$2,027,711,376 and \$1,332,327,180 during the years ended June 30, 2010 and 2009, 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 in Fund net assets (deficit); (3) statements of cash flows; and (4) notes to financial statements. The Management Discussion and Analysis represents management’s analysis of the Fund’s 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 Fund net assets (deficit) 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	2010	2009	Change
Assets	\$ 166,057,095	\$ 83,368,278	\$ 82,688,817
Current Liabilities	40,542,586	\$ 55,753,748	(15,211,162)
Loan from federal			
Government	886,662,352	344,881,505	541,780,847
Total Liabilities	927,204,938	400,635,253	526,569,685
Net assets, restricted	-	-	-
Net deficit, unrestricted	(761,147,843)	(317,266,975)	(443,880,868)
Total liabilities and net deficit	\$ 166,057,095	\$ 83,368,278	\$ 82,688,817

Statements of Revenues, Expenses and Changes in Fund Net Assets

Operating Revenues	2010	2009	Change
Assessments	\$ 282,915,570	\$ 238,176,573	\$ 44,738,997
Federal Grants	1,235,188,534	496,578,757	738,609,777
Other	65,726,404	48,585,003	17,141,401
Total Revenues	1,583,830,508	783,340,333	800,490,175
Operating Expenses			
Unemployment			
Compensation Benefits	2,027,711,376	1,332,327,180	695,384,196
Operating loss	(443,880,868)	(548,986,847)	105,105,979
Non-Operating Revenues			
(Expenses)			
Interest Income	-	2,326,473	(2,326,473)
Intergovernmental Revenues			
- Department	-	386,917	(386,917)
Changes in Net Assets	(443,880,868)	(546,273,457)	102,392,589
Total Net Assets (Deficit) – Beginning	(317,266,975)	229,006,482	(546,273,457)
Total Net Assets (Deficit) – Ending	\$ (761,147,843)	\$ (317,266,975)	\$ (443,880,868)

Financial Analysis

Statements of Net Assets:

Total assets increased by approximately \$83 million due primarily to the increase in the cash balance, which was the result of both a decrease in state unemployment benefit claims paid during the latter portion of the 2010 fiscal year and the increased amounts assessed to employer accounts. Unemployment continued to increase, with claimants filing for a longer period of time, as required by the federal government. Many individuals exhausted regular state UI benefits during the year, and thereby began receiving benefit payments fully-funded by the federal government instead of being funded by the state.

Federal intergovernmental receivables also increased during the year, largely due to increased expenditures qualifying for federal reimbursement that were receivable at year end. This increase stems from the *Unemployment Compensation Extension Act of 2010*, passed by Congress in late July 2010. As a result of claimants continuing to file for various EUC and EB benefits during the period between the original ending date of federal EUC and EB funding and extension passed on July 22, 2010, a large number of claims for benefit weeks ending prior to June 30, 2010 were paid subsequent to year end. The accrual of these benefit expenses required a corresponding accrual for reimbursable amounts receivable from the federal government.

Net deficit increased by approximately \$444 million, which is the result of the significant increase in total benefits paid relative to assessments collected and federal grants received.

Revenues, Expenses and Changes in Net Assets:

Assessments increased by approximately \$45 million as compared to last year due to higher tax rates being assessed on employers as a result of the increased number of former employees claiming unemployment during the year.

Total revenue increased by approximately \$800 million primarily due to an increase in federal grants relating to federally funded unemployment programs.

Unemployment compensation benefits increased by approximately \$695 million due to increased unemployment and increases in the period of time over which benefits are paid as mandated by the federal government.

Operating loss for 2010 was approximately \$444 million as compared to \$549 million loss for the prior year, which was due primarily from the increase in assessments received.

Interest income decreased by approximately \$2 million due to the Fund's federal loan status, which does not allow interest to be credited to a state's unemployment compensation fund while federal advances are outstanding. The Fund had federal advances outstanding during the entire fiscal year ended June 30, 2010.

Ending Net Assets for 2010 decreased by approximately \$444 million as compared to a \$546 million decrease for the prior year, as a result of expenditures exceeding revenues.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Statements of Net Assets
as of June 30,

	2010	2009
Assets:		
Current assets:		
Cash and cash equivalents	\$ 71,232,244	\$ 7,532,195
Assessments receivable, net	49,409,725	41,754,037
Benefit overpayments receivable, net	6,664,877	7,640,290
Due from reimbursable employers, net	1,576,638	1,824,889
Intergovernmental receivables, net		
Local governments	3,942,077	3,709,385
State agencies	4,270,715	2,710,676
Other states	2,405,088	4,463,377
Federal	26,555,731	13,733,429
Total assets	\$ 166,057,095	\$ 83,368,278
Liabilities:		
Current liabilities:		
Benefits payable	\$ 20,684,580	\$ 7,796,013
Tax withholdings payable	83,713	22,822,761
Contributions payable	6,808,134	8,806,606
Intergovernmental payables:		
Other states	4,743,719	6,859,420
Interfund payable – Department	8,222,440	9,468,948
Total current liabilities	40,542,586	55,753,748
Advances from federal government	886,662,352	344,881,505
Total liabilities	927,204,938	400,635,253
Net (Deficit) Assets:		
Unrestricted	(761,147,843)	(317,266,975)
Total liabilities and net assets	\$ 166,057,095	\$ 83,368,278

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

South Carolina Department of Employment and Workforce
 Unemployment Compensation Fund
 Statements of Revenues, Expenses and Changes in Fund Net Assets (Deficit)
 for the years ended June 30,

	2010	2009
Operating Revenues:		
Assessments	\$ 282,915,570	\$ 238,176,573
Reimbursement of unemployment compensation benefits from employers	6,396,890	5,088,872
Benefit overpayment recoveries	13,449,679	6,648,623
Intergovernmental:		
Federal	1,235,188,534	496,578,757
State agencies	9,510,740	7,269,078
Other states	16,994,946	15,925,297
Local governments	19,374,149	13,653,133
Total operating revenues	1,583,830,508	783,340,333
Operating Expenses:		
Unemployment compensation benefits	2,027,711,376	1,332,327,180
Total operating expenses	2,027,711,376	1,332,327,180
Operating loss	(443,880,868)	(548,986,847)
Non-operating Revenues (Expenses):		
Interest income	-	2,326,473
Intergovernmental revenues – Department	-	386,917
Total non-operating revenues	-	2,713,390
Changes in net assets	(443,880,868)	(546,273,457)
Total net (deficit) assets – beginning	(317,266,975)	229,006,482
Total net assets (deficit) – ending	\$ (761,147,843)	\$ (317,266,975)

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

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Statements of Cash Flows
for the years ended June 30,

	2010	2009
Cash flows used by operating activities:		
Cash received from assessments	\$ 277,077,463	\$ 249,274,102
Cash received from employers	6,645,141	4,083,774
Cash received from benefit overpayment recoveries	14,425,092	4,267,695
Cash received from federal, state and local agencies	1,268,511,624	520,923,478
Benefits paid	(2,041,676,029)	(1,301,678,576)
Refund overpayment of assessments	(3,064,089)	(2,012,556)
Net cash used by operating activities	(478,080,798)	(525,142,083)
Cash flows provided (used) by non-capital financing activities:		
Proceeds from advances from federal government	541,780,847	344,881,505
Cash received from Department	-	2,125,900
Cash paid to Department	-	(1,738,983)
Net cash provided by non-capital financing activities	541,780,847	345,268,422
Cash flows provided by investing activities:		
Interest received	-	2,326,473
Net cash provided by investing activities	-	2,326,473
Net increase (decrease) in cash	63,700,049	(177,547,188)
Cash and cash equivalents – beginning	7,532,195	185,079,383
Cash and cash equivalents – ending	\$ 71,232,244	\$ 7,532,195
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (443,880,868)	\$ (548,986,847)
Net changes in assets and liabilities:		
Assessments receivable	(7,655,688)	8,283,767
Benefit overpayments receivable	975,413	(2,380,928)
Due from reimbursable employers	248,251	(1,005,098)
Intergovernmental receivables:		
Local governments	(232,692)	(2,116,970)
State agencies	(1,560,039)	(348,103)
Other states	2,058,289	(3,398,268)
Federal	(12,822,302)	(13,600,839)
Benefits payable	12,888,567	5,121,185
Tax withholdings payable	(22,739,048)	21,230,215
Contributions payable	(1,998,472)	991,386
Interfund payable – Department	(1,246,508)	7,762,598
Intergovernmental payable:		
Other states	(2,115,701)	3,305,819
Net cash used by operating activities	\$ (478,080,798)	\$ (525,142,083)

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

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Liquidity

To date, the Fund has generated substantial operating losses and has been required to use all of its cash resources to fund its operations. Cash balances at June 30, 2010 consist significantly of funds advanced from the federal government. Due to the increasing unemployment rate and the resulting increased amount of unemployment benefits, and the increased length of time over which the benefits are paid, the Fund has been required to obtain advances from the Federal Unemployment Fund of \$541,780,847 and \$344,881,505 during the years ended June 30, 2010 and 2009, respectively.

Increased tax collections, coupled with decreases in the number of individuals eligible for and claiming state UI benefits, have enabled the Fund to operate without obtaining additional advances from the federal government since April of 2010. The federal government has not established a maximum amount that the Fund can borrow.

Legislative reforms to the State's unemployment insurance tax structure, effective on tax assessments for the first quarter of the 2011 calendar year, have been implemented and are specifically designed to assist in putting the Fund back on the path to solvency. These changes are addressed in Note 7.

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 Department of Employment and Workforce (the "Department") has determined it has no component units. The primary government is the State of South Carolina. The State has determined that the Department 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.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Reporting Entity (continued)

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 Employment Security 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. Section 41-29-10 was amended by the South Carolina General Assembly in 2010 through Act 146 to replace the Commissioners with an Executive Director. The act also renamed the agency the Department of Employment and Workforce (the “Department”), moved it to the Governor’s cabinet, moved the Workforce Investment Act (“WIA”) and Trade Assistance Act (“TAA”) programs back to the agency from another state agency, and established an appellate panel charged with hearing higher level appeals for unemployment benefits.

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

The Department is part of the primary government of the State of South Carolina. The funds of the Department, 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-members of the appellate panelist for four-year terms, while the Governor appoints the Executive Director for a four-year term.

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 is attributable to the Department’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 as long as the fund is not indebted to the federal government for unemployment compensation advances. 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 Fund.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

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.

Disaster Unemployment Assistance (“DUA”) – This program provides unemployment benefits to individuals who have lost their jobs due to a disaster, such as, a hurricane or a flood. 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.

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.

Reemployment Trade Adjustment Assistance (“RTAA”) - Program implemented in fiscal year 2010 as a wage option available to older workers under the TAA program to eventually replace ATAA. Consists of monies paid to individuals age 50 + who had lost their jobs due to imports but are now working again at a lower salary. They are paid 50 % of the difference in their old and new salary. It is funded by the federal government.

Extended Benefits (“EB”) - This is a permanent program to pay benefits to unemployed workers who are no longer eligible for other types of unemployment claims during times of high unemployment. This program is available when the state insured unemployment rate reaches a predetermined level and stops when the level drops below this predetermined level. The minimum time period for these benefits is a thirteen week period. All benefits which are not reimbursable by other states are funded by the federal government and partially funded with ARRA funds.

Emergency Unemployment Compensation Tier I (“EUC 08”) - The Emergency Unemployment Compensation (“EUC”) program, created in June 2008 and expanded in November 2008, provides up to 20 weeks of benefits to eligible jobless workers in all states and up to 13 additional weeks of benefits in states with high unemployment. It was set to expire on March 31, 2009. The ARRA extended the date for new EUC claims to December 31, 2009, with payments on those claims ending on May 31, 2010. The Unemployment Compensation Extension Act of 2010 extended the date for new EUC claims to November 30, 2010, with payments on those claims ending April 30, 2011. It is funded by the federal government and partially funded with ARRA funds.

Emergency Unemployment Compensation Tier II (“EUC 2”) – This is an expansion of the Emergency Unemployment Compensation Tier I for individuals who had no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2010, with payments on those claims ending on May 31, 2011. It is funded by the federal government and partially funded with ARRA funds.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Emergency Unemployment Compensation Tier II, wk 14 (“EUC 2 wk 14”) - This is the 14th week of EUC2 which was granted subsequent to EUC3 and EUC4 and allows an extra week of EUC2 claims to be paid to eligible claimants. It is funded by the federal government.

Emergency Unemployment Compensation Tier III (“EUC 3”) - This is an additional 13 week expansion of the EUC for individuals who had no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through November 30, 2010 with payments on those claims ending on April 30, 2011. It is funded by the federal government.

Emergency Unemployment Compensation Tier IV (“EUC 4”) - This is an additional 6 week expansion of the EUC for individuals who had no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through November 30, 2010 with payments on those claims ending on April 30, 2011. It is funded by the federal government.

Federal Additional Compensation (“FAC”) – This provides a \$25 weekly supplement to the unemployment compensation of eligible claimants. It is funded by the federal government through stimulus funds under ARRA. The June 2, 2010 end date for new FAC claims was not extended under the Unemployment Compensation Extension Act of 2010.

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.

Unrestricted net assets – This component of net assets consists of net assets or deficits that do not meet the definition of “restricted net assets” or “invested in capital assets, net of related debt.” Since the Fund has a net deficit, this deficit is included in unrestricted net deficit at June 30, 2010 and 2009.

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.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

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 Fund, 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 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 Fund 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 Department is required to notify employers of such tax delinquencies. If the delinquent amount is not paid within ten days thereafter, the Department 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 - 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 under which the Department pays unemployment benefits. 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.

South Carolina Department of Employment and Workforce
 Unemployment Compensation Fund
 Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Receivables (continued)

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 Department 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.

Operating and Nonoperating Revenues and Expenses

The Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with an enterprise fund's principal ongoing operations. The Fund's primary operating revenues are from assessments and federal grants. Operating expenses include unemployment compensation benefits paid. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

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 are composed of the following at June 30:

	2010	2009
Deposits held by State Treasurer	\$ 7,049,273	\$ 3,612,840
Deposits held by U.S. Treasury	59,403,469	27,168,948
Other deposits	4,779,502	(23,249,593)
Total	\$ 71,232,244	\$ 7,532,195

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 2. Cash and Cash Equivalents (continued)

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 Fund. These funds also include federal loan and stimulus funds. However, states are not due any interest while carrying federal unemployment advances on their books.

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. Funds are transferred on a regular basis from the deposits held by U.S. Treasury to cover all benefit payments from this account.

Note 3. Payable to Department

The amount shown on the financial statements as being payable to Department represents amounts which were collected for penalties and interest and contingency assessments in tax remittances from employers and special administration funds. Special administration funds are funds received from the federal government that are payable to the Department to support its administration of the Fund. Amounts due to the Department as of June 30, 2010 and 2009 are as follows:

	2010	2009
Penalty and interest loan	629,708	-
Contingency assessments	2,478,929	2,347,206
Penalty and interest	212,502	160,350
Special administration funds	4,901,301	6,961,392
Total	\$ 8,222,440	\$ 9,468,948

Note 4. Reed Act Funds

The Fund has no funds available under the Reed Act as of June 30, 2010 and 2009. During 2009, due to the Fund becoming insolvent, all funds remaining were used to pay benefits. These funds were granted to the Fund from the federal government from federal unemployment tax collections to be used for unemployment benefits should they become needed. Upon appropriation by the State legislature and after approval of the Governor, these funds could 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 Fund to the Department upon Legislative appropriation prior to the fiscal year ended June 30, 2009.

South Carolina Department of Employment and Workforce
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:

	2010		
	Receivables at June 30, 2010	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	<u>\$ 57,358,179</u>	<u>\$ 7,948,454</u>	<u>\$ 49,409,725</u>
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	9,386,239	3,333,083	6,053,156
Federal employees (UCFE)	42,371	26,546	15,825
Ex-servicemen (UCX)	73,791	41,809	31,982
Trade readjustment (TRA)	109,510	35,013	74,497
Emergency Unemployment Compensation (EUC)	<u>5,301,065</u>	<u>4,811,648</u>	<u>489,417</u>
Totals	<u>\$ 14,912,976</u>	<u>\$ 8,248,099</u>	<u>\$ 6,664,877</u>
Due from reimbursable employers (UI)	<u>\$ 1,680,234</u>	<u>\$ 103,596</u>	<u>\$ 1,576,638</u>
Intergovernmental receivables (UI):			
Local governments	<u>\$ 3,979,460</u>	<u>\$ 37,383</u>	<u>\$ 3,942,077</u>
State agencies	<u>\$ 4,270,715</u>	<u>\$ -</u>	<u>\$ 4,270,715</u>
Other states	<u>\$ 2,405,088</u>	<u>\$ -</u>	<u>\$ 2,405,088</u>
Federal	<u>\$ 26,555,731</u>	<u>\$ -</u>	<u>\$ 26,555,731</u>
	2009		
	Receivables at June 30, 2009	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	<u>\$ 49,582,635</u>	<u>\$ 7,828,598</u>	<u>\$ 41,754,037</u>
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	11,284,470	4,401,681	6,882,789
Federal employees (UCFE)	34,464	4,396	30,068
Ex-servicemen (UCX)	83,746	24,046	59,700
Trade readjustment (TRA)	175,704	46,934	128,770
Emergency Unemployment Compensation (EUC)	<u>2,213,258</u>	<u>1,674,295</u>	<u>538,963</u>
Totals	<u>\$ 13,791,642</u>	<u>\$ 6,151,352</u>	<u>\$ 7,640,290</u>
Due from reimbursable employers (UI)	<u>\$ 1,866,372</u>	<u>\$ 41,483</u>	<u>\$ 1,824,889</u>
Intergovernmental receivables (UI):			
Local governments	<u>\$ 3,746,766</u>	<u>\$ 37,381</u>	<u>\$ 3,709,385</u>
State agencies	<u>\$ 2,710,676</u>	<u>\$ —</u>	<u>\$ 2,710,676</u>
Other states	<u>\$ 4,463,377</u>	<u>\$ —</u>	<u>\$ 4,463,377</u>
Federal	<u>\$ 13,733,429</u>	<u>\$ —</u>	<u>\$ 13,733,429</u>

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

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, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Charges for services	\$ 1,583,830,508	\$ 783,340,333
Interest income	-	2,326,473
Less: expenses	(2,027,711,376)	(1,332,327,180)
Net program expense	(443,880,868)	(546,660,374)
Transfers:		
Net Transfers from Department	-	386,917
Total transfers	-	386,917
Change in net assets	(443,880,868)	(546,273,457)
Net (deficit) assets-beginning of year	(317,266,975)	229,006,482
Net (deficit) assets-end of year	\$ (761,147,843)	\$ (317,266,975)

Note 7. Advances from Federal Government

On December 26, 2008, the Fund began to obtain advances from the federal government in order to pay unemployment benefits due the exhaustion of all other funds to pay benefits. These advances were obtained due to the significant increase in unemployment benefits resulting from a significant increase in the unemployment rate in the State of South Carolina and the extension of the period by the federal government that benefits are paid to claimants. Section 1201 of Title XII of the Social Security Act provides that an advance from the Federal Unemployment Fund to the account of a state's unemployment trust fund is allowed if the governor of a state applies for payment for any 3-month period. Only amounts actually drawn down for benefit payments must be repaid. At June 30, 2010 and 2009, the outstanding balance of these advances was approximately \$887 million and \$345 million, respectively. Principal payments are required to begin on September 30, 2011 with interest accruing at an interest rate of approximately 4% beginning on January 1, 2011. The loan is considered noncurrent since the first principal payment is due one or more years after June 30, 2010.

Under Section 1201 of Title XII of the Social Security Act, if a balance of advances to a state is outstanding on January 1, in two consecutive years and not fully repaid prior to November 10 of the second year, employers subject to contributions under such state's unemployment compensation law will be subject to additional federal unemployment taxes determined by a formula of reductions in credit against the tax. Such credit reduction will apply beginning with the second consecutive January 1 as of the beginning of which there is a balance of such advances. The credit reductions, pursuant to Section 3302(c) (2) of FUTA, increase employers' federal tax liability each year. The amount equal to the reduced credits, excluding penalty and interest, will be applied to reduce the state's balance of advances.

As mentioned in Note 1, comprehensive changes to the State's UI tax structure have been implemented and specifically designed to assist in putting the Fund back on the path to solvency. State unemployment tax rates for future years will be structured to raise revenues that more accurately address the demands on the Fund and the changing economic environment in which the Fund operates. While the Fund remains in federal loan status, required tax revenues will consist of estimated benefit payouts for the subsequent year, an amount required to repay the principal on all outstanding federal advances over five years, and an additional surcharge designated to pay accrued interest on outstanding advances. As the expected level of state UI benefits continues to decrease, a greater proportion of state UI tax revenues will be available to repay the advanced funds.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Notes to Financial Statements

Note 7. Advances from Federal Government (continued)

Increased tax collections coupled with decreases in the number of individuals eligible for and claiming state UI benefits have enabled the Fund to operate without obtaining additional advances from the federal government since April of 2010. Management plans to continue to borrow from the federal government, as needed, to fund its deficits for the foreseeable future; however, it is estimated that no additional advances will be required until the fourth quarter of the 2010 calendar year. The federal government has not established a maximum amount that the Fund can borrow.

A summary of changes in noncurrent liabilities for the year ended June 30, 2010 is as follows:

	Balance, July 1, 2009	Additions	Reductions	Balance, June 30, 2010	Due within one year
Advances from federal government	\$344,881,505	\$541,780,847	\$ —	\$886,662,352	\$ —

Note 8. Contingencies

Federal Grants – The various programs administered by the Fund for fiscal years June 30, 2010 and years prior to that are subject to audit by the federal grantor agencies. At the present time, amounts, if any, which may be due to federal grantors have not been determined but the Fund believes that any such amounts in the aggregate would not have a material adverse effect on the financial position of the Fund. Furthermore, there is no evidence to indicate that a liability should be recorded at year-end.

Tax Withholdings – During fiscal year 2009 the Fund remitted late certain federal and State of South Carolina tax withholdings, and did not remit certain withholding taxes until after June 30, 2009. The amounts paid are reflected as reductions in tax withholdings payable in the accompanying statement of net assets. The Department paid penalties and interest to the South Carolina Department of Revenue during 2010 of approximately \$280,000 as a result of the 2009 failure to timely deposit state tax withholdings. The final amount of penalties and interest due to the IRS for federal tax withholdings is unknown; however, it is management’s opinion that this amount would be immaterial to these financial statements.

Note 9. Subsequent Events

The balance of advances from federal government is \$886,662,352 at September 30, 2010. The Fund has not taken any additional advances from the federal government since April of 2010.

Subsequent to year end on July 22, 2010 Congress passed P.L. 111-205 (*Unemployment Compensation Extension Act of 2010*), which extended the end date for the EUC program for new entrants from June 2, 2010, to November 30, 2010. This act also authorized continued general revenue funding of EUC benefits and administrative costs and extended the end date for 100% federal funding of EB and expanded EB eligibility provisions from June 2, 2010, to December 1, 2010.

Subsequent to year end, on August 10, 2010, the Fund received \$97,459,490 in UI modernization incentive funds from the U.S. Department of Labor. The funding stems from various changes made to state unemployment insurance law that will make benefits available to more people, including part-time workers and those who quit work for compelling family reasons. South Carolina qualified for the funds available under the American Recovery and Reinvestment Act. The additional amounts will assist in offsetting the need to obtain additional advances from the federal government until the fourth quarter of the 2010 calendar year.

**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
South Carolina Department of Employment and Workforce Unemployment Compensation Fund
Columbia, South Carolina

We have audited the financial statements of the South Carolina Department of Employment and Workforce Unemployment Compensation Fund (the "Fund") as of and for the year ended June 30, 2010 and have issued our report thereon dated September 30, 2010. 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.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is reasonable possibility that a material misstatement of the Fund's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies in internal control or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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, the Governor of the State of South Carolina, and management of the Fund, and is not intended to be and should not be used by anyone other than these specified parties.

Scott and Company LLP

Columbia, South Carolina
September 30, 2010