

South Carolina
Department of Employment and Workforce
Columbia, South Carolina
Financial Statements
and Independent Auditor's Reports
Year Ended June 30, 2012

State of South Carolina



Office of the State Auditor

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May 24, 2013

The Honorable Nikki R. Haley, Governor
and
Mr. John L. Finan, Agency Administrator
South Carolina Department of Employment and Workforce
Columbia, South Carolina

This report on the audit of the basic financial statements of the South Carolina Department of Employment and Workforce and the accompanying schedule of expenditures of federal awards as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, the fiscal year ended June 30, 2012, was issued by Scott and Company, LLC, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

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

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

RHGjr/trb

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Independent Auditor's Report

Mr. Richard H. Gilbert, Jr. CPA
Deputy State Auditor
South Carolina Office of the State Auditor
Columbia, South Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the South Carolina Department of Employment and Workforce (the "Agency") as of and for the year ended June 30, 2012, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express opinions on these financial statements based on our audit.

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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. 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 2, the financial statements of the Agency are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of governmental activities, the business-type activities, and each major fund of only that portion of the funds of the State of South Carolina (the "State") financial reporting entity that is attributable to the transactions of the Agency. They do not purport to and do not present fairly the financial position of the State as of June 30, 2012, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America and do not include other agencies, divisions, or component units of the State.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and the major funds of the Agency as of June 30, 2012, and the respective changes in financial position and cash flows, where applicable, for the year 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 May 24, 2013 on our consideration of the Agency's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to this 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Agency's basic financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget ("OMB") Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations* and is not a required part of the basic financial statements of the Agency. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Scott and Company LLC

Columbia, South Carolina
May 24, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the South Carolina Department of Employment and Workforce (the "Agency") offers readers this narrative overview and analysis of the financial activities for the year ended June 30, 2012. Please read this information in conjunction with the Agency's financial statements and accompanying notes.

Financial Highlights

- In recent years, the South Carolina Department of Employment and Workforce Unemployment Compensation Fund (the "Trust Fund") generated substantial operating losses and was 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 Trust Fund has been required to obtain advances from the Federal Unemployment Fund of \$0 and \$115,594,636 during the years ended June 30, 2012 and 2011, respectively.
- The health of the Trust Fund has improved dramatically over the last two fiscal years. The Trust Fund has not had to borrow any funds from the federal government to make benefit payments since April of 2011. Tax revenues have been sufficient to allow the state to begin repaying the outstanding federal loan, and benefit payments to unemployed individuals continue to fall as the economy recovers.
- Recent legislative reforms to the State's UI tax structure have been implemented that are specifically designed to assist in putting the Trust Fund back on the path to solvency for the first time since 2009. The legislative reform restructured the State's unemployment tax rates 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 Trust 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 overall financial condition of the Agency improved during the fiscal year ended June 30, 2012. The Agency's liabilities exceeded its assets at fiscal year ending June 30, 2012 by \$377,084,056 (shown as "total net deficit"), which represents a net reduction of the deficit of \$170,644,037 from the prior year. As explained below, the Agency's net deficit is attributable to the Trust Fund.
- Total Unemployment Compensation benefits paid were \$1,059,341,778 and \$2,171,063,209 during the years ended June 30, 2012 and 2011, respectively.

Overview/Discussion of the Annual Financial Report

The discussion and analysis provides an introduction to the Agency's basic financial statements, which include the following parts: (1) entity-wide financial statements; (2) fund financial statements; and (3) notes to the financial statements.

Entity-wide Financial Statements

The entity-wide financial statements present a longer-term view of the Agency's finances as a whole, using accrual-basis accounting; the same accounting methods that most businesses use. There are two entity-wide financial statements:

Entity-wide Financial Statements (continued)

Statement of Net Assets: This statement presents information on all of the Agency's assets and liabilities, both short-term (current) and long-term (non-current). The statement also reports the differences between assets and liabilities as net assets (deficit). Over time, increases or decreases in net assets may indicate whether the Agency's financial health (financial position) is strengthening or weakening. But in order to assess the Agency's overall financial health, you would also need to consider factors such as the State's economy and the condition of the entity's capital assets, such as its buildings.

Statement of Activities: This statement presents information showing how the entity's overall net assets changed during the year. The statement of activities can help to show how much it costs the Agency to provide various services. It can also help to show the extent to which each entity function covers its own costs through user fees, charges, or grants. The net (expense) revenue column on the far right of this statement shows how much a particular function relies on operating and capital grants and contributions.

The entity-wide statements report two different kinds of activities:

Governmental Activities:

The Agency's internal administrative activities are reported as governmental activities including general administration, employment and training services, and unemployment insurance administrative costs. Federal grants finance most of these services.

Business-type Activities:

These activities usually recover all or a significant portion of the costs of their services or goods by charging fees to customers. The activities of the Trust Fund are considered business-type activities. This fund collects money through federal grant revenues, unemployment taxes paid by businesses, and federal loans, when needed.

Fund Financial Statements

The fund financial statements provide detailed information about the Agency's most significant funds, not the entity as a whole. Funds are accounting devices that the Agency uses to track specific funding sources and spending for particular purposes. The Agency uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds:

The Agency reports most of its basic services in governmental funds. Governmental funds account for activities that the entity reports as governmental activities in its entity-wide financial statements. These funds focus on short-term inflows and outflows of expendable resources. All of the Agency's governmental funds are accounted for in the Special Revenue Fund.

The Special Revenue Fund accounts for the various federal grants and other revenues which the Agency receives for administration purposes and special projects.

Proprietary Funds:

Proprietary funds charge customers for the services they provide to generate operating revenue. The principle operating revenue of the Agency's proprietary funds is from assessments to employers and reimbursement from the federal government for the payment of unemployment benefits. The Agency's proprietary fund is used to account for the Trust Fund.

Fund Financial Statements (continued)

A brief description of the fund financial statements is as follows:

The balance sheet is the statement of expendable assets which are assigned to the various governmental and proprietary funds according to the purposes for which they may or may not be used; current liabilities are assigned to the fund for which they are to be paid; and the difference between assets and liabilities is the fund balance.

The statement of revenues, expenses, and changes in fund balances presents the results of the governmental and proprietary activities over the course of the fiscal year and information as to how the net assets changed during the year.

The statement of cash flows presents changes in cash and cash equivalents resulting from operational, financing, and investing activities for the proprietary fund. This statement presents cash receipts and cash disbursements information.

Notes to the Financial Statements

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

Entity-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Agency, liabilities exceeded assets by \$377,084,056 at the year-ended June 30, 2012. In the prior year, liabilities exceeded assets by \$547,728,093.

The Agency's net deficit can be attributed to the Trust Fund due to the effect of increasing unemployment during the recent national recession, coupled with an outdated unemployment insurance tax structure. In response to the net deficit, the Agency has taken advances from the federal government to continue providing unemployment benefits to unemployed citizens of South Carolina. Legislation enacted by the State in 2011 restructured the unemployment insurance tax rate system to bring the Trust Fund back to solvency and to establish an acceptable level of reserve funding in the future. The new rate system also allows the State to repay all federal advances and the associated accrued interest by the required dates each year, and to avoid automatic increases in federal unemployment taxes for state businesses. The Agency expects all federal advances to be repaid by the end of 2015.

The improved overall condition at the Agency is largely attributable to the effectiveness of the new unemployment insurance tax rate structure, effective January 1, 2011. At the end of the 2012 fiscal year, the Agency was able to report positive net asset balances in the governmental activities, which represent capital assets, amounts restricted for debt service and unrestricted net assets.

Governmental Activities

Total assets increased by \$28,991,030 (39.5%) from the prior year, largely due to increases in the amounts reserved for debt service to pay accrued interest on federal advances. Federal regulations require interest payments to be made from administrative agency funds.

There was a decrease in federal grant activity, decreasing revenue by approximately \$20.9 million, due to reductions in administrative funding received from the United States Department of Labor for the Unemployment Insurance and Emergency Unemployment Compensation programs.

South Carolina Department of Employment and Workforce
Statement of Net Assets
June 30, 2012 and 2011
(Condensed Financial Data)

	Governmental Activities		Business-Type Activities		Total	
	2012	2011	2012	2011	2012	2011
Assets:						
Current & other assets	\$ 81,260,376	\$ 51,181,634	\$ 393,963,364	\$ 406,059,577	\$475,223,740	\$457,241,211
Capital assets	21,167,001	22,254,713	—	—	21,167,001	22,254,713
Total assets	<u>\$ 102,427,377</u>	<u>\$ 73,436,347</u>	<u>\$ 393,963,364</u>	<u>\$ 406,059,577</u>	<u>496,390,741</u>	<u>479,495,924</u>
Liabilities:						
Current	\$ 40,087,914	\$ 32,032,231	\$ 156,787,526	\$ 210,961,526	\$ 196,875,440	\$ 242,993,757
Non-current	911,374	1,036,784	675,687,983	783,193,476	676,599,357	784,230,260
Total liabilities	<u>40,999,288</u>	<u>33,069,015</u>	<u>832,475,509</u>	<u>994,155,002</u>	<u>873,474,797</u>	<u>1,027,224,017</u>
Net assets:						
Invested in capital assets, net of related debt	21,157,542	22,134,274	—	—	21,157,542	22,134,274
Restricted for debt service	17,823,541	13,848,414	—	—	17,823,541	13,848,414
Unrestricted	22,447,006	4,384,644	(438,512,145)	(588,095,425)	(416,065,139)	(583,710,781)
Total net assets (deficit)	<u>61,428,089</u>	<u>40,367,332</u>	<u>(438,512,145)</u>	<u>(588,095,425)</u>	<u>(377,084,056)</u>	<u>(547,728,093)</u>
Total liabilities & net assets	<u>\$ 102,427,377</u>	<u>\$ 73,436,347</u>	<u>\$ 393,963,364</u>	<u>\$ 406,059,577</u>	<u>\$496,390,741</u>	<u>\$479,495,924</u>

Statement of Activities

	Governmental Activities		Business-Type Activities		Total	
	2012	2011	2012	2011	2012	2011
Revenues:						
Program revenues:						
Charges for services	\$ 50,664,213	\$ 30,551,850	\$ 399,009,683	\$ 517,502,522	\$ 449,673,896	\$ 548,054,372
Operating grants & contributions	125,668,528	156,852,702	670,126,587	1,791,424,360	795,795,115	1,948,277,062
General revenues:						
State appropriations	6,678,731	433,307	139,669,463	—	146,348,194	433,307
Total revenues	<u>183,011,472</u>	<u>187,837,859</u>	<u>1,208,805,733</u>	<u>2,308,926,882</u>	<u>1,391,817,205</u>	<u>2,496,764,741</u>
Expenses:						
Employment & training services	161,639,713	179,531,527	—	—	161,639,713	179,531,527
Unemployment compensation	—	—	1,059,341,778	2,171,063,209	1,059,341,778	2,171,063,209
Total expenses	<u>161,639,713</u>	<u>179,531,527</u>	<u>1,059,341,778</u>	<u>2,171,063,209</u>	<u>1,220,981,491</u>	<u>2,350,594,736</u>
Contributed capital	—	—	—	—	—	—
Loss on disposal of capital assets	(46,144)	(35,229)	—	—	(46,144)	(35,229)
Gain on forgiveness of debt	—	—	119,325	35,188,745	119,325	35,188,745
Indirect cost remitted to general fund of the State	(264,858)	(189,091)	—	—	(264,858)	(189,091)
(Decrease) increase in net assets	21,060,757	8,082,012	149,583,280	173,052,418	170,644,037	181,134,430
Net assets (deficit) – beginning	<u>40,367,332</u>	<u>32,285,320</u>	<u>(588,095,425)</u>	<u>(761,147,843)</u>	<u>(547,728,093)</u>	<u>(728,862,523)</u>
Net assets (deficit) – ending	<u>\$ 61,428,089</u>	<u>\$ 40,367,332</u>	<u>\$(438,512,145)</u>	<u>\$(588,095,425)</u>	<u>\$(377,084,056)</u>	<u>\$(547,728,093)</u>

Business-Type Activities

Statements of Net Deficit:

Total assets increased by approximately \$6.6 million primarily due to a decrease in State funded unemployment benefit claims paid during the 2012 fiscal year and the increased federal receivable amounts. 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.

Current liabilities decreased by approximately \$35 million mainly due to the current portion of advances from the federal government. Amounts due to the Department from the Trust Fund increased at the end of fiscal year 2012, due to increased interest surcharge collections including April, May and June of 2012.

Federal intergovernmental payable includes refunds, cancelled payments, and other items owed to the federal government.

Ending net deficit decreased by approximately \$150 million as compared to a \$173 million decrease for the prior year, largely due to a significant increase in FUTA credit reductions applied to state businesses (shown as gain on forgiveness of debt) in fiscal year 2012. The State's new tax system has allowed the Trust Fund to meet requirements to avoid this credit reduction beginning with the 2011 tax year. Therefore, debt service payments are being funded by unemployment insurance tax revenues (SUTA revenues), and any amounts appropriated by the South Carolina General Assembly to offset SUTA taxes on businesses.

Revenues, Expenses, and Changes in Net Deficit:

Assessments decreased by approximately \$118 million compared to last year due to lower tax rates being assessed on employers as a result of revised tax legislation passed by the legislature. The Agency was required to recalculate business unemployment taxes for 2011 retroactive to January 1, 2011. The recalculation of rates resulted in overpayments from businesses for the first two calendar quarters of 2011. Credits resulting from the lower rates were available to be applied to future quarters. Businesses that were interested in receiving a refund for any overpayments made in the 2nd quarter of 2011 could begin requesting those refunds October 1, 2011.

In July 2012, the General Assembly again required the Agency to revise the unemployment tax rates as a result of General Fund appropriations. The tax rates for 2012 were revised in October 2012 retroactive to January 1, 2012. The recalculation of rates resulted in overpayments for the first and second quarter of 2012. Businesses can use the resulting credits towards future tax liability. Due to the timing of the revision, no refunds will be available per federal law.

Total revenues decreased by approximately \$1.1 billion due to a reduction in the amount of revenue collected from businesses to cover benefit costs and a reduction in federal funded unemployment benefits.

Unemployment compensation benefits decreased by approximately \$1.1 billion due to a number of factors including the end of the federal Extended Benefit program, and a reduction in the number of federal weeks available in the Emergency Unemployment Compensation program. Benefit payments have also fallen due to a general improvement in the South Carolina economy with the unemployment rate falling from a high of 12 percent in December 2009 to 9.4 percent as of June 2012.

Total revenues less total expenses for 2012 was approximately \$149 million as compared to \$138 million for the prior year due to the decrease in unemployment compensation benefit payments. Non-operating revenues decreased by approximately \$35 million for the year 2012 due to the recognition of a gain on refunding of debt of \$35.1 million for fiscal year 2011.

Financial Analysis of the Governments Funds

The Agency uses fund accounting to ensure and demonstrate compliance with finance related legal requirements.

Governmental Funds

The focus of the Agency's governmental fund is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Agency's financing requirements. In particular, the assigned fund balance may serve as a useful measure of an agency's net resources available for spending at the end of the fiscal year. As of the end of the current fiscal year, the Agency's governmental fund reported combined ending fund balances of \$43,854,738, an increase of approximately \$21.8 million for the year.

Assigned fund balance accounts for approximately 58.5%, or \$25.7 million, of ending fund balance and is available for spending at the Agency's discretion, in accordance with federal and state regulations.

Restricted fund balance accounts for approximately 41.2%, or \$18.1 million, of ending fund balance and includes amounts that can only be spent for specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

Non-spendable fund balance accounts for .3%, or \$0.1 million, of ending fund balance and accounts for prepaid and inventory items.

Proprietary Fund

The Agency's proprietary fund provides the same type of information found in the entity-wide financial statements in more detail for the Trust Fund. Unrestricted net deficit of the Trust Fund at the end of the year amounted to approximately \$439 million. Other information concerning this fund has been addressed in the discussion of the Agency's business-type activities.

Capital Assets and Debt Administration

Primary changes in capital amounts during the year were related to incurring expenses related to development of internally generated/modified computer software currently classified as construction in progress ("CIP"). In addition, a significant amount of computer software equipment was disposed of during the year.

Long-term liabilities fell into three areas as follows:

Advances from the federal government;
Capital leases payable; and
Accrued compensated absences and related benefits.

More detailed information about the Agency's capital assets is presented in Note 6 to the financial statements. More detailed information about the Agency's debt administration is presented in Notes 7, 8 and 14 to the financial statements.

Economic Factors and Next Year's Rate

Tax rates for 2012 were set to raise sufficient revenues to cover projected benefit costs, estimated loan repayments, interest owed on outstanding federal advances and to increase net trust fund solvency as required to avoid FUTA credit reductions for state businesses. The State anticipates being able to pay off all outstanding debt to the federal government by the end of fiscal year 2015 based on current economic projections and enacted legislation. The Trust Fund's net assets are projected to slowly increase as additional loans are repaid in each year and revenues are sufficient to meet projected obligations. The maximum number of weeks of state UI trust fund unemployment compensation was reduced from 26 weeks to 20 weeks, effective June 14, 2011. This, combined with an overall decrease in the State's unemployment rate, has resulted in a reduction of total available weeks of state and federally funded benefits to 49 weeks (20 state-funded weeks and up to 29 federally-funded weeks.)

Request for Information

This management's discussion and analysis is designed to provide a general overview of the South Carolina Department of Employment and Workforce's finances for all those with interest in the Agency's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the CFO, 1550 Gadsden Street, Post Office Box 995, Columbia, South Carolina 29202.

South Carolina Department of Employment and Workforce
Statement of Net Assets
June 30, 2012

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Totals</u>
Assets:			
Current assets:			
Cash and cash equivalents	\$ —	\$ 256,422,471	\$ 256,422,471
Restricted cash	17,823,541	—	17,823,541
Assessments receivable, net	12,364,724	125,178,418	137,543,142
Benefit overpayments receivable, net	—	13,163,467	13,163,467
Due from reimbursable employers, net	—	954,120	954,120
Internal balances	18,713,389	(18,713,389)	—
Intergovernmental receivables, net:			
Federal	31,576,217	12,433,843	44,010,060
State agencies	634,420	1,268,276	1,902,696
Local governments	—	2,191,508	2,191,508
Other states	—	1,064,650	1,064,650
Prepaid and inventory items	148,085	—	148,085
Total current assets	<u>81,260,376</u>	<u>393,963,364</u>	<u>475,223,740</u>
Non-current assets:			
Capital assets, net of accumulated depreciation	<u>21,167,001</u>	<u>—</u>	<u>21,167,001</u>
Total assets	<u>\$ 102,427,377</u>	<u>\$ 393,963,364</u>	<u>\$ 496,390,741</u>
Liabilities:			
Current liabilities:			
Benefits payable	\$ —	\$ 18,210,229	\$ 18,210,229
Accounts payable	9,890,536	—	9,890,536
Tax withholdings payable	—	14,619	14,619
Bank overdraft	3,529,342	—	3,529,342
FUTA credit overage payable	—	61,692	61,692
Contributions payable	—	20,431,690	20,431,690
Accrued salaries and related benefits	4,150,609	—	4,150,609
Intergovernmental payables:			
Federal	19,835,151	6,963,004	26,798,155
Other states	—	4,606,292	4,606,292
Current portion of capital leases payable	9,459	—	9,459
Advances from federal	—	106,500,000	106,500,000
Current portion of accrued compensated absences and related benefits	2,672,817	—	2,672,817
Total current liabilities	<u>40,087,914</u>	<u>156,787,526</u>	<u>196,875,440</u>
Non-current liabilities:			
Advances from federal government, net of current portion	—	675,687,983	675,687,983
Accrued compensated absences and related benefits	911,374	—	911,374
Total non-current liabilities	<u>911,374</u>	<u>675,687,983</u>	<u>676,599,357</u>
Total liabilities	<u>40,999,288</u>	<u>832,475,509</u>	<u>873,474,797</u>
Net Assets (Deficit):			
Invested in capital assets, net of related debt	21,157,542	—	21,157,542
Restricted for debt service	17,823,541	—	17,823,541
Unrestricted	22,447,006	(438,512,145)	(416,065,139)
Total net assets (deficit)	<u>61,428,089</u>	<u>(438,512,145)</u>	<u>(377,084,056)</u>
Total liabilities and net assets	<u>\$ 102,427,377</u>	<u>\$ 393,963,364</u>	<u>\$ 496,390,741</u>

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

South Carolina Department of Employment and Workforce
Statement of Activities
Year ended June 30, 2012

Function/Program	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-type Activities
Governmental activities: Employment, workforce development, and training services	\$ 161,639,713	\$ 50,664,213	\$ 125,668,528	\$ 14,693,028	\$ —
Business-type activities: Unemployment benefits	<u>1,059,341,778</u>	<u>399,009,683</u>	<u>670,126,587</u>	<u>—</u>	<u>9,794,492</u>
Totals	<u>\$ 1,220,981,491</u>	<u>\$ 449,673,896</u>	<u>\$ 795,795,115</u>	<u>14,693,028</u>	<u>9,794,492</u>
		General revenues (expenses):			
			State appropriations	6,678,731	139,669,463
			Loss on disposal of capital assets	(46,144)	—
			Gain on forgiveness of debt	—	119,325
			Indirect costs remitted to General Fund of the State	<u>(264,858)</u>	<u>—</u>
			Total general revenue (expenses) and transfers	<u>6,367,729</u>	<u>139,788,788</u>
			Increase in net assets	21,060,757	149,583,280
			Net assets (deficit) – beginning	<u>40,367,332</u>	<u>(588,095,425)</u>
			Net assets (deficit) – ending	<u>\$ 61,428,089</u>	<u>\$ (438,512,145)</u>

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

South Carolina Department of Employment and Workforce
Balance Sheet
Governmental Fund – Special Revenue
June 30, 2012

Assets:	
Cash and cash equivalents	\$ —
Restricted cash	17,823,541
Assessments receivable, net	12,364,724
Intergovernmental receivables:	
Federal	31,576,217
State agencies	634,420
Interfund receivable – unemployment compensation fund	18,713,389
Prepaid and inventory items	<u>148,085</u>
 Total assets	 <u>\$ 81,260,376</u>
 Liabilities and Fund Balances:	
Liabilities:	
Accounts payable	\$ 9,890,536
Bank overdraft	3,529,342
Intergovernmental payables:	
Federal	19,835,151
Accrued salaries and related benefits	<u>4,150,609</u>
 Total liabilities	 <u>37,405,638</u>
 Fund balances:	
Non-spendable:	
Prepaid and inventory items	148,085
Restricted:	
Debt service	17,823,541
Reed Act expenditures	47,779
South Carolina Occupational Information Coordinating Committee	177,729
Assigned fund balance	<u>25,657,604</u>
 Total fund balances	 <u>43,854,738</u>
 Total liabilities and fund balances	 <u>\$ 81,260,376</u>

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

South Carolina Department of Employment and Workforce
 Reconciliation of Governmental Fund Balance – Special Revenue to
 Net Assets of Governmental Activities
 June 30, 2012

Reconciliation to the Statements of Net Assets:

Fund balances – governmental funds		\$ 43,854,738
Amounts reported for governmental activities in the statement of net assets are different because:		
Liabilities that are not due and payable in the current period are not reported in the fund:		
Capital leases payable	(9,459)	
Accrued compensated absences	<u>(3,584,191)</u>	(3,593,650)
Assets are capitalized and depreciated in statement of net assets and charged to expenditures in the governmental fund:		
Capital assets, net of accumulated depreciation		<u>21,167,001</u>
Net assets – governmental activities		<u>\$ 61,428,089</u>

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

South Carolina Department of Employment and Workforce
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Fund – Special Revenue
Year ended June 30, 2012

Revenues:

Employer tax contingency assessments	\$ 9,004,206
Employer tax penalties and interest	3,270,786
Interest surcharge	38,331,065
User fees	4,740
Intergovernmental:	
Federal	125,587,973
State of South Carolina	6,678,731
Local	80,555
Parking	53,416
Total Revenues	183,011,472

Expenditures:

Employment and training administration	59,272,469
Contingency assessments	5,706,146
Penalties and interest	253,766
Workforce Investment Act	52,340,944
Trade Adjustment Assistance	9,333,283
Other federal programs	3,724,359
Other non-federal programs	128,734
Parking	72,558
Occupational Information Coordinating Committee	388,945
Capital outlay	963,581
Debt service:	
Principal	110,980
Interest on federal advance	28,618,009
Total Expenditures	160,913,774

Excess of Revenues Over Expenditures	22,097,698
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Other Financing Uses:

Indirect costs remitted to General Fund of the State	264,858
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Total Other Financing Uses	264,858
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Net Increase in Fund Balance	21,832,840
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Beginning Fund Balance	22,021,898
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Ending Fund Balance	\$ 43,854,738
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The accompanying notes are an integral part of these financial statements.

South Carolina Department of Employment and Workforce
 Reconciliation of the Statement of Revenues, Expenditures and Changes in Governmental Fund
 Balance – Special Revenue Fund to the Statement of Activities
 Year ended June 30, 2012

Reconciliation to the Statement of Activities:

Net increase in fund balance	\$ 21,832,840
Amounts reported for governmental activities in the statement of activities are different because:	
Costs of capital assets are reported as expenditures in the governmental funds and are reported as capital asset additions in the statement of net assets	963,581
Depreciation of capital assets is reported as an expense in the statement of activities	(2,005,149)
The carrying values of capital assets disposed of are reported as expenses in the statement of activities	(46,144)
Repayments of long-term debt are reported as expenditures in the governmental funds and are reported as a reduction of liabilities in the statement of net assets	
Capital leases payable	110,980
Net decrease in accrued compensated absences is reported as an increase of expenses in the statement of activities	<u>204,649</u>
Increase in net assets	<u><u>\$ 21,060,757</u></u>

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

South Carolina Department of Employment and Workforce
Statement of Net Assets
Proprietary Fund
June 30, 2012

Assets:

Current assets:

Cash and cash equivalents	\$ 256,422,471
Assessments receivable, net	125,178,418
Benefit overpayments receivable, net	13,163,467
Due from reimbursable employers, net	954,120
Intergovernmental receivables, net:	
Federal	12,433,843
State agencies	1,268,276
Local governments	2,191,508
Other states	1,064,650
Total assets	\$ 412,676,753

Liabilities:

Current liabilities:

Benefits payable	\$ 18,210,229
Tax withholdings payable	14,619
FUTA credit overage payable	61,692
Contributions payable	20,431,690
Intergovernmental payables:	
Federal	6,963,004
Other states	4,606,292
Interfund payable – Department	18,713,389
Advances from federal government	106,500,000
Total current liabilities	175,500,915

Advances from federal government, net of current portion	675,687,983
Total liabilities	851,188,898

Net Deficit Assets:

Unrestricted	(438,512,145)
Total liabilities and net assets	\$ 412,676,753

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

South Carolina Department of Employment and Workforce
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Fund
Year ended June 30, 2012

Operating Revenues:	
Assessments	\$ 384,480,481
Reimbursement of unemployment compensation benefits from employers	4,664,857
Benefit overpayment recoveries	9,864,345
Intergovernmental:	
Federal	643,582,602
State budget appropriation	139,669,463
State agencies	6,758,986
Other states	6,117,424
Local governments	13,667,575
Total operating revenues	<u>1,208,805,733</u>
 Operating Expenses:	
Unemployment compensation benefits	<u>1,059,341,778</u>
Total operating expenses	<u>1,059,341,778</u>
Operating income	<u>149,463,955</u>
 Non-operating revenue:	
Gain on forgiveness of debt	<u>119,325</u>
Total non-operating revenues	119,325
Changes in net assets	149,583,280
Total net deficit – beginning	<u>(588,095,425)</u>
Total net deficit – ending	<u>\$ (438,512,145)</u>

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

South Carolina Department of Employment and Workforce
Statement of Cash Flows
Proprietary Fund
Year ended June 30, 2012

Cash flows provided by operating activities:	
Cash received from assessments	\$ 410,484,086
Cash received from state budget appropriations	139,669,463
Cash received from employer reimbursements	5,219,297
Cash received from benefit overpayment recoveries	7,328,591
Cash received from federal, state and local agencies	663,508,020
Benefits paid	(1,035,388,331)
Refund overpayment of assessments	(10,619,627)
Net cash provided by operating activities	180,201,499
 Cash flows provided by non-capital financing activities:	
Payments to federal government net of FUTA credits applied	(184,760,935)
Net cash used in non-capital financing activities	(184,760,935)
Net decrease in cash	(4,559,436)
Cash and cash equivalents – beginning	260,981,907
Cash and cash equivalents – ending	\$ 256,422,471
 Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 149,463,955
Net changes in assets and liabilities:	
Assessments receivable	1,757,681
Benefit overpayments receivable	(2,535,754)
Due from reimbursable employers	554,440
Intergovernmental receivables:	
Local governments	1,268,219
State agencies	1,052,233
Other states	653,469
Federal	(8,839,808)
Benefits payable	14,431,582
Tax withholdings payable	(26,085)
FUTA credit overage payable	61,692
Contributions payable	11,452,115
Due to Department	13,626,297
Intergovernmental payable:	
Federal tax withholdings	(2,933,278)
Other states	214,741
Net cash provided by operating activities	\$ 180,201,499

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

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 1. Liquidity

Over the last decade, the Trust Fund generated substantial operating losses and was required to use all of its cash resources to fund the continued payment of unemployment insurance benefits. Revised tax legislation, effective January 1, 2011, significantly increased tax assessment revenues for the Trust Fund. Cash balances at June 30, 2012 consist primarily of funds received from employers and held in the State of South Carolina's ("State") account in the Federal Unemployment Compensation Fund for purposes of paying state unemployment insurance benefits and repaying principal on advances from the federal unemployment account. Due to the increasing unemployment rate, the resulting increased amount of unemployment benefits paid, and the increased length of time over which the benefits are paid, the Trust Fund was required to obtain advances from the Federal Unemployment Account ("FUA") of \$115,594,636 during the year ended June 30, 2011.

Increased tax collections, coupled with decreases in the number of individuals eligible for and claiming State unemployment insurance benefits, have enabled the Trust Fund to operate without obtaining additional advances from the federal government since April of 2011. The federal government has not established a maximum amount that the Trust Fund can borrow.

State supplemental funding provided via SC FY 12-13 Proviso 90.20 and Act 290 provided the Trust Fund with \$77 million earmarked for federal loan repayments (received in September 2012). The Trust Fund was required to recalculate business unemployment taxes for 2012 retroactive to January 1, 2012. The recalculation of rates resulted in overpayments from businesses for the first two calendar quarters of 2012. Any credits resulting from the lower rates will be applied to future quarters. Due to the timing of the appropriation and restrictions in federal law, no refunds are available from these credits in 2012. All credits must be used against future tax liability. At this time, there is no final estimate of the amount of credits that will be issued. However, management has estimated that it will be approximately \$40 million.

Note 2. Summary of Significant Accounting Policies

Reporting Entity

The accounting policies of the Agency 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 Agency's accounting principles 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 Agency has determined it has no component units. The primary government is the State of South Carolina. The State has determined that the Agency 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.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Reporting Entity (continued)

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; and
- (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. An organization may also be considered a component unit if the omission of its financial statements from the primary entity's financial statements would be misleading to the user of the financial statements.

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 Agency 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. On April 3, 2010, the Governor of South Carolina signed into law Act 159 restructuring the Agency into a State cabinet agency under the Governor. The Agency merged with the Workforce Development division of the South Carolina Department of Commerce to become the South Carolina Department of Employment and Workforce. Act 159 designated the Department of Employment and Workforce as the entity responsible for the administration of the Workforce Investment Act ("WIA") and Trade Adjustment Assistance ("TAA") activities and for carrying out all functions necessary to comply with WIA and the Trade Act of 1974, as amended by the Trade and Globalization Adjustment Assistance Act of 2009. The administrative costs of the Agency are paid from grants primarily from the United States Department of Labor ("US DOL").

The Unemployment Insurance Program collects taxes from employers covered by the law, and pays out unemployment benefits to eligible unemployed citizens under both state and federal law.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Reporting Entity (continued)

The Employment Services Program operates as a free labor exchange where workers and jobs are brought together in local “SC Works” centers throughout the State. Workers of all skills, professions, and types, including veterans, migrant and seasonal farm workers, youth, older workers, and the disabled are placed in suitable jobs by the local State Employment Service/Job Service. Special emphasis is given to the job placement of unemployment insurance (“UI”) claimants. In addition, the Agency maintains a comprehensive Labor Market Information Program, which collects and disseminates employee statistics, job forecasts, wage information, demographics, and other information in cooperation with the US DOL’s Bureau of Labor Statistics.

The Agency is granted an annual appropriation for operating purposes as authorized by the South Carolina General Assembly. The appropriation, as enacted, becomes the legal operating budget for the Agency. The Appropriations Act authorizes expenditures from the General Fund of the State and authorizes expenditures of total funds.

Governmental Funds

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 and note disclosures of only those transactions of the State of South Carolina, the primary government, that are attributable to the Agency reporting entity defined above.

Governmental funds are used to account for the government's general government activities. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; and the differences between the assets and liabilities is the fund balance. All of the Agency’s governmental funds are accounted for in the special revenue fund.

The special revenue fund accounts for the various federal grants and other revenue which the Agency receives for administrative purposes and special projects. Federal grants received for unemployment compensation benefits are accounted for in the proprietary fund. The primary accounts included in the special revenue fund are as follows:

Employment and Training Administration (“ETA Administrative”) – The division of the US DOL which administers Employment Services and Unemployment Insurance includes administrative funds in the UI, Employment Service (“ES”), and ES Reimbursable Programs.

Administrative Contingency Assessment (“UI Contingency Assessment”) – The assessment was established by the Legislature in 1986 in response to federal budget cuts which would have forced office closing and reductions in staff. The contingency assessment portion of the tax is accounted for in the special revenue fund which is used primarily to fund administrative costs and employment services, whereas State unemployment taxes fund unemployment compensation benefits in the proprietary fund.

Special Administrative Account (“UI Penalties and Interest”) – Employers who do not submit required reports by their due dates are subject to a penalty and must pay interest on unpaid contributions. The monies are transferred to the Special Administrative Account each month.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Governmental Funds (continued)

Unemployment Compensation Modernization Incentive Payments (“Modernization”) – This is a special transfer of funds from the US DOL to the Agency’s account at the Federal Unemployment Trust Fund to be used for certain administrative purposes. Administrative purposes include the improvement of unemployment compensation benefit and tax operations, including responding to increased demand for unemployment compensation and staff-assisted reemployment services for unemployment compensation claimants.

South Carolina Occupational Information Coordinating Committee (“SCOICC”) – The SCOICC was established in 1977 as a consortium of agencies mandated by the Carl D. Perkins Vocational Education Act. The primary function of the SCOICC is to improve coordination, communication, and cooperation in the development and use of occupational information to meet the common occupational information and data needs of education programs and the employment and training programs at national, state, and local levels. These functions have primarily been delivered by the on-line Career Information System referred to as the South Carolina Occupational Information System (“SCOIS”). SCOIS also develops printed career development products for schools grade K-12. The SCOICC is charged with giving special attention to the career and educational needs of individuals involved in career decision making. The SCOIS system delivers up-to-date occupational, educational, employment and career guidance information to career decision makers and job seekers. The SCOICC is funded by an appropriation from the State of South Carolina to support its operations. All school districts in South Carolina have free access to the SCOIS Career System.

Workforce Investment Act (“WIA”) – WIA is a federal program administered in South Carolina through the Workforce Division of the Department of Employment and Workforce and through 12 Workforce Investment areas throughout the State. A statewide board appointed by the Governor and comprised of business owners, state government officials, educators and private citizens guides policy for all WIA-funded programs. WIA programs help businesses meet their need for skilled workers and provide individuals with access to training that helps them prepare for work.

Trade Adjustment Assistance (“TAA”) - TAA is a federal program of the US DOL that provides reemployment services to workers who have been adversely impacted by increased imports or by a shift in production or services to another country. The goal of the TAA program is to help workers become reemployed in a suitable job as quickly as possible.

Proprietary Funds

Proprietary funds distinguish operating revenues from non-operating items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund’s principle ongoing operations. The principle operating revenue of the Agency’s proprietary fund is from assessments to employers and reimbursement from the federal government for the payment of unemployment benefits. The Agency’s proprietary fund is used to account for the Trust Fund.

The Trust 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.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Proprietary Funds (continued)

The Trust Fund includes the following accounts:

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 Trust Fund balances, when applicable.

Unemployment Compensation for Federal Employees (“UCFE”) – This fund accounts for unemployment compensation paid to ex-federal employees and is funded by the federal government.

Unemployment Compensation for Ex-Servicemen (“UCX”) – This fund accounts for unemployment compensation paid to ex-servicemen and 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 fund 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”) – This program was implemented in fiscal year 2009 as a wage option available to older workers under the TAA program to eventually replace ATAA. It consists of monies paid to individuals age 50+ who have 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 originally 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. The date was extended again for new claims to be filed by December 24, 2011 with last week payable of January 2, 2013. It is funded by the federal government and partially funded with ARRA funds.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Proprietary Funds (continued)

Emergency Unemployment Compensation Tier II (“EUC 2”) – This is an expansion of the Emergency Unemployment Compensation Tier I for individuals who have no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2011, with payments on those claims ending on January 2, 2013. It is funded by the federal government.

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. The extension for new EUC claims is through December 31, 2011 with payments on those claims ending on January 2, 2013. 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 have no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2011 with payments on those claims ending on January 2, 2013. 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 have no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2011 with payments on those claims ending on January 2, 2013. It is funded by the federal government.

Government-wide and Fund Financial Statements

The financial statements of the Agency are presented in accordance with GAAP applicable to state and local governmental units. The GASB is the accepted standard setting body in the United States of America for establishing governmental accounting and financial reporting principles. The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Other items not properly included among program revenues are reported instead as general revenues.

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Measurement Focus, Basis of accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis method of accounting. Revenues are recorded when earned and expenses are recorded when liabilities are incurred, regardless of the timing of the cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis method of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Agency considers revenues to be available if they are collected within one year of the end of the current reporting period. Expenditures generally are recorded when liabilities are incurred, as under the accrual basis method of accounting.

The proprietary fund financial statements are reported using the accrual basis method of accounting. For the business-type activities, the Agency 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.

Non-exchange Transactions

Non-exchange transactions involving financial or capital resources are transactions in which the Agency either gives value to another party without directly receiving equal value in exchange or receives value from another party without directly giving equal value in exchange. The Agency mainly engages in voluntary non-exchange transactions. This type of transaction includes most federal grants and State capital improvement bond proceeds. Voluntary non-exchange transactions usually involve eligibility requirements that must be met before transactions are recognized. The eligibility requirements can include one or more of the following:

- a) The recipient has met the characteristics specified by the provider;
- b) The recipient has met the time requirements specified by the provider;
- c) The provider offers resources on a reimbursement basis and the recipient has incurred the allowable costs under the applicable program;
- d) The provider’s offer of resources is contingent upon a specified action of the recipient and that action has occurred.

Budget Policy

The Agency is granted an annual appropriation for operating purposes by the General Assembly. The appropriation as enacted becomes the legal operating budget for the Agency. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The Total Funds column in the Appropriation Act for each individual budgetary unit authorizes expenditures from all budgeted resources. A revenue budget is not adopted for individual budgetary units. The General Assembly enacts the budget through passage of line-item appropriations by program within budgetary unit within budgetary fund category, State General Fund, or other budgeted funds. Budgetary control is maintained at the line-item level of the budgetary entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Budget Policy (continued)

The Agency's budget is not presented for comparison purposes because GASB 34 requires only major special revenue funds of the State to present such information. Since the Agency is not a major special revenue fund of the State, budgetary comparison information is excluded from the basic financial statements.

Cash and Cash Equivalents

The amounts shown in the financial statements as "cash and cash equivalents" represent petty cash, 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 depository financial institutions.

Most State agencies, including the Agency, participate in the State's internal cash management pool. Because the internal 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 internal 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. For credit risk information pertaining to the internal cash management pool, see the deposits disclosure in Note 3.

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 Agency 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 primarily of the following:

Assessments Receivable

Assessments receivable includes employer tax contributions, contingency assessments and related penalties, and interest and collection charges, net of the allowance for uncollectibles.

Unemployment tax contributions are assessed each quarter based on covered wages during the quarter. Also, effective January 1, 1986, most covered employers are assessed a special contingency assessment at the rate of six one-hundredths of one percent upon all covered wages. This contingency assessment is due in the same time and manner as the unemployment tax contribution.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Receivables (continued)

Taxes and contingency assessments 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 Agency is required to notify employers of such tax delinquencies. If the delinquent amount is not paid within ten days thereafter, the Agency is directed to initiate a collection notification process consisting of follow-up notices, telephone calls, and ultimately the issuance of a warrant of execution upon real and personal property of the employer.

Various penalties and interest are levied on delinquent employer tax receivables for failure to timely file quarterly wage reports and timely make the required payments.

Receivables are written off by reducing the allowance account and the corresponding receivable.

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 and governmental employers to former employees, net of the allowance for uncollectibles.

Intergovernmental Receivables

The federal receivable amount represents reimbursements due under various federal grant programs in which the Agency participates. Revenues and related receivables are recognized at the time and to the extent that allowable expenditures are incurred under such programs.

The amounts due from the State in the proprietary fund represent unemployment benefit reimbursements due from other South Carolina state agencies. The benefit reimbursement receivable from other states and local governments is based on the prorata share of wages earned by the employees in those states and localities for which benefits are being paid by the Agency.

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. In 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 overpayments attributable to reimbursable employers or federal programs are due to such employers or the federal government. The Agency generally uses collection on overpayments to fund current benefit obligations. Refunds are made only when there are no current benefit obligations. Benefit overpayment receivables are recorded net of an allowance for uncollectibles.

Allowance for Uncollectibles

The allowance for uncollectibles is computed based upon an estimate of collections over the past five years with all receivables over 24 months old being allowed for as doubtful accounts. All receivables under ten years old, although allowed for as doubtful accounts, are left on the books as a receivable, and the Agency continues to pursue collection of them.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Capital Assets

Capital assets are recorded at cost at the date of acquisition or fair market value at the date of donation in the case of gifts. The Agency follows capitalization guidelines established by the State of South Carolina. All land is capitalized, regardless of cost. Qualifying improvements that rest in or on the land itself are recorded as depreciable land improvements. Major additions and renovations and other improvements that add to the usable space, prepare existing buildings for new uses, or extend the useful life of an existing building are capitalized.

The Agency capitalizes movable personal property with a unit value in excess of \$5,000 and a useful life in excess of two years and depreciable land improvements, buildings and improvements, and intangible assets costing in excess of \$5,000. Routine repairs and maintenance are charged to operating expenses in the year in which the expense was incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 20 to 50 years for buildings and improvements and land improvements and 3 to 25 years for software, machinery, equipment, furniture, and vehicles.

Benefits Payable

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

Compensated Absences

Generally all full-time equivalent State employees and certain part-time employees scheduled to work at least one-half of the Agency's work week are entitled to accrue and carry forward at calendar year-end up to maximums of 180 days sick leave and 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination.

The Agency calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in the statement of net assets.

Indirect Cost

The Agency recovers indirect costs from federal funding sources based on a negotiated indirect cost agreement approved by the U.S. Department of Labor, Office of Cost Determination. The indirect costs recovered from this agreement are used to offset the administrative costs of the Agency and services provided by other State agencies. During the period July 1, 2011 through June 30, 2012, the Agency recovered approximately \$9,166,715 of indirect costs from the indirect cost agreement. Of this amount, approximately \$264,858 was remitted to the State and approximately \$8,901,857 was retained by the Agency. Indirect cost recoveries are reported as federal revenues.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Interfund Transactions

Expenditures are initially recorded in the fund making the disbursement. However, if they are properly applicable to another fund, a reimbursement must be recorded. Reimbursements from one fund to another are treated as expenditures of the reimbursing fund and a reduction of the expenditures or expenses of the reimbursed fund. The primary transaction that falls into this category is indirect costs, which are allocated to the various funds through the Agency's cost allocation system.

Transfers from funds receiving revenues to funds through which the resources are to be expended are classified as operating transfers.

Prepaid Items

Payments made to vendors for services that will benefit periods beyond the fiscal year-end are recorded as prepaid items. Prepaid items benefiting more than one accounting period are accounted for under the consumption method and recognized as expenses/expenditures when used.

These services include maintenance contracts on data processing and office equipment, equipment rentals, professional services, software costs paid in advance, and insurance coverage.

Intergovernmental Payables – Other States

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

Contributions Payable

Contributions payable includes amounts received from employers in excess of current unemployment tax liabilities. The Agency retains the payments on account to cover future tax liabilities.

Operating and Nonoperating Revenues and Expenses

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

Net Assets / Fund Balances

The Agency records reservations for portions of its fund equity which are legally segregated for specific future uses or which do not represent available expendable resources and therefore are not available for expenditures in the governmental fund balance sheet. Unassigned fund balances indicate that portion of fund equity which is available for appropriations in future periods. If restricted and unrestricted assets are available for the same purpose, then restricted assets will be used before unrestricted assets.

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Net Assets / Fund Balances (continued)

Net assets are categorized as follows:

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 asset use 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."

The Agency has adopted GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (required implementation date of June 2011). This Statement establishes criteria for classifying governmental fund balances into specifically defined classifications. Classifications are hierarchical and are based primarily on the extent to which the Agency is bound to honor constraints on the specific purposes for which amounts in the funds may be spent. Application of the Statement requires the Agency to classify and report amounts in the appropriate fund balance classifications. The Agency's accounting and finance policies are used to interpret the nature and/or requirements of the funds and their corresponding assignment of restricted, committed, assigned, or unassigned. Fund balances are classified as follows:

Non-spendable – Amounts that cannot be spent either because they are not in a spendable form, such as inventory or prepaid insurance, or because they are legally or contractually required to be maintained intact, such as a trust.

Restricted – Amounts that can be spent only for specific purposes because of Agency ordinances, state or federal laws, or externally imposed conditions by grantors or creditors, such as, the surcharge adopted to pay the Trust Fund's debt.

Committed – Amounts constrained to specific purposes by the Agency itself, using the highest level of decision-making authority. To be reported as committed, amounts cannot be used for any other purpose unless the Agency takes the same highest level action to remove or change the constraint.

Assigned – Amounts the Agency intends to use for a specific purpose. Intent can be expressed by an official or body to which the Agency delegates the authority.

Unassigned – All amounts not included in other spendable classifications.

The Agency permits funds to be expended in the following order: committed, assigned, and unassigned.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 2. Summary of Significant Accounting Policies (continued)

Net Assets / Fund Balances (continued)

At June 30, 2012, three of the Agency's restricted balances are as follows:

Debt service – The Trust Fund has received advances of approximately \$967 million from the federal government as of June 30, 2012. By law, the Trust Fund is a proprietary fund and only permitted to pay unemployment benefits. Therefore debt service of the interest due on the advances must be accounted for in the governmental funds of the Agency. At June 30, 2012, approximately \$17.8 million is restricted for debt service of the interest.

Reed Act – The Agency has no funds available under the Reed Act in the proprietary funds. During 2010, due to the Trust Fund becoming insolvent, all funds remaining were used to pay benefits. These funds are granted to the Trust Fund from the federal government from federal unemployment tax collections to be used for unemployment benefits if they are needed. Upon appropriation by the State legislature and after approval of the Governor, these funds can be used for other purposes. Of these funds, \$13,827,461 was 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 Trust Fund to the Special Revenue Fund upon Legislative appropriation. During fiscal year 2012, \$0 was spent from the previously appropriated funds and \$47,779 is shown as a restricted fund balance.

SCOICC – Pursuant to 2005 Appropriation Act Proviso 51.2, all user fees collected by the South Carolina Occupational Information Coordinating Committee through the Agency may be retained to use for operating the South Carolina Occupational Information System. All user fees not expended in the prior fiscal year were brought forward for use in the current fiscal year.

As provided by 2012 Appropriation Act Proviso 67.1, all user fees not expended in fiscal year 2011 may be carried forward to fiscal year 2012 for use in the SCOICC program. As of June 30, 2012, \$177,729 was carried forward and is reported as a restricted fund balance.

Use of Estimates

The preparation of financial statements in conformance with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. The most significant estimates are the allowance for doubtful accounts and the useful lives of capital assets.

Note 3. Deposits

The amount shown as cash and cash equivalents in the statement of net assets at June 30, 2012 is composed of the following:

Cash on hand	\$ 1,500
Deposits held by State Treasurer	24,866,038
Deposits held by U.S. Treasury	237,726,585
Other deposits	11,651,889
Totals	<u>\$ 274,246,012</u>

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 3. Deposits (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. As of June 30, 2012, all State Treasurer bank balances were fully insured or collateralized with securities held by the State or its agent in the State's name.

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are 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 Trust Fund. However, individual states are not due any interest while carrying federal unemployment account advances on their books.

Other Deposits

Custodial credit risk for deposits is the risk that in the event of a depository financial institution's failure, the Agency's deposits may not be returned or the Agency 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 to be fully insured or collateralized. All deposits of the Agency 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 Agency's name.

The Agency does not invest in foreign securities or have transactions with foreign currency and, as a result, does not have a policy for foreign currency risk.

Note 4. Interfund Receivables/Payables

The amounts shown on the financial statements as being interfund receivables/payables represent amounts which were collected for penalties and interest and contingency assessments in tax remittances from employers and unemployment compensation modernization funds as of June 30, 2012 are as follows:

Interest surcharge	\$ 13,997,056
Special administration funds	4,384,956
Penalty, interest, service charges and fees	196,823
Contingency assessments	108,821
Reed Act	25,733
Total	<u>\$ 18,713,389</u>

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 5. Receivables

The receivable balances at June 30, 2012 and the related amounts for allowances for uncollectibles are as follows:

	Receivables	Allowances for Uncollectibles	Net Receivables
Special revenue fund:			
Assessments receivable:			
Contingency	\$ 2,845,585	\$ (315,006)	\$ 2,530,579
Penalty, interest, service charge and fees	5,237,889	(3,054,996)	2,182,893
Interest surcharge	8,548,885	(897,633)	7,651,252
Intergovernmental receivables:			
Federal	31,576,217	—	31,576,217
State agencies	634,420	—	634,420
Totals	\$ 48,842,996	\$ (4,267,635)	\$ 44,575,361
	Receivables	Allowances for Uncollectibles	Net Receivables
Proprietary fund:			
Assessments receivable			
Due from reimbursable employers	\$ 134,589,408	\$ (9,410,990)	\$ 125,178,418
	954,120	—	954,120
Intergovernmental receivables			
Local governments	2,191,508	—	2,191,508
State agencies	1,268,276	—	1,268,276
Other states	1,064,650	—	1,064,650
Federal	12,433,843	—	12,433,843
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	13,833,069	(6,451,643)	7,381,426
Federal employees (UCFE)	137,512	(101,599)	35,913
Ex-servicemen (UCX)	122,415	(64,803)	57,612
Trade readjustment compensation (TRA)	65,796	(32,764)	33,032
Emergency Unemployment Compensation (EUC)	13,224,355	(7,568,871)	5,655,484
Totals	\$ 179,884,952	\$ (23,630,670)	\$ 156,254,282

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 6. Capital Assets

A summary of capital assets activity for the year ended June 30, 2012 is as follows:

	Balances June 30, 2011	Increases	Decreases	Balances June 30, 2012
Capital assets not being depreciated:				
Land and land improvements	\$ 3,419,379	\$ —	\$ (42,131)	\$ 3,377,248
Construction in progress	1,498,080	125,691	(1,498,080)	125,691
Total capital assets not being depreciated	4,917,459	125,691	(1,540,211)	3,502,939
Other capital assets:				
Buildings and improvements	30,593,198	—	—	30,593,198
Equipment and furniture	4,238,441	565,425	(652,750)	4,151,116
Vehicles	318,922	57,305	(31,508)	344,719
Intangible assets	5,886,824	1,713,240	—	7,600,064
Total other capital assets	41,037,385	2,335,970	(684,258)	42,689,097
Less accumulated depreciation for:				
Buildings and improvements	(15,107,435)	(752,169)	—	(15,859,604)
Equipment and furniture	(2,935,110)	(605,196)	648,737	(2,891,569)
Vehicles	(300,047)	(13,540)	31,508	(282,079)
Intangible assets	(5,357,539)	(634,244)	—	(5,991,783)
Total accumulated depreciation	(23,700,131)	(2,005,149)	680,245	(25,025,035)
Other capital assets, net	17,337,254	330,821	(4,013)	17,664,062
Total capital assets, net	\$ 22,254,713	\$ 456,512	\$ (1,544,224)	\$ 21,167,001

Depreciation expense was approximately \$2,005,000. Total outstanding commitments on projects were approximately \$599,000.

Note 7. Long-Term Liabilities

A summary of changes in long-term liabilities for the year ended June 30, 2012 is as follows:

Governmental	Balance, July 1, 2011	Additions	Reductions	Balance, June 30, 2012	Due within one year
Capital lease payable	\$ 120,439	\$ —	\$ (110,980)	\$ 9,459	\$ 9,459
Accrued compensated absences and related benefits	3,788,840	2,255,987	(2,460,636)	3,584,191	2,672,817
	<u>\$ 3,909,279</u>	<u>\$ 2,255,987</u>	<u>\$ (2,571,616)</u>	<u>\$ 3,593,650</u>	<u>\$ 2,682,276</u>

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 7. Long-Term Liabilities (continued)

Business-type	Balance, July 1, 2011	Additions	Reductions	Balance, June 30, 2012	Due within one year
Advances from federal government	\$967,068,243	\$ —	\$(184,880,260)	\$782,187,983	\$106,500,000
	<u>\$967,068,243</u>	<u>\$ —</u>	<u>\$(184,880,260)</u>	<u>\$782,187,983</u>	<u>\$106,500,000</u>

Note 8. Leases

During 2012, the Agency paid monthly payments of \$14,066 including principal and interest at 4.18% maturing in fiscal year 2013 for two capital leases for printers. Monthly executory costs of \$4,574 are included in the \$14,066 but do not reduce the principal balance. The carrying amount of the printers totaled approximately \$51,000 as of June 30, 2012. The current year's amortization expense of approximately \$94,000 on the capitalized lease assets is included in depreciation expense. Total payments on the capital leases for the year ended June 30, 2012 were \$122,088 consisting of principal of \$110,980 and interest of \$11,108.

The Agency has entered into operating leases for office space and office equipment. All of the leases are non-cancelable leases with no purchase options and their terms are greater than one year. Payments are due on a monthly basis. Ending payment dates range from fiscal years 2013 through 2015. Certain operating leases provide for renewal options for periods from one to five years at their fair rental value at the time of renewal. In the normal course of business, operating leases are generally renewed or replaced by other leases. The Agency is responsible for maintenance on most leased property. Rental expenditures for office space and equipment were approximately \$1,356,000 for the year ended June 30, 2012.

The following is a schedule by years of future minimum rental payments required under the capital lease and the noncancellable operating lease agreements with remaining terms at June 30, 2012 in excess of one year. The future minimum rental payments for the capital leases exclude the monthly executory costs.

	Year Ended June 30,	Capital Leases	Operating Leases
	2013	\$ 9,492	\$ 39,687
	2014	—	23,982
	2015	—	9,993
Total minimum lease payments		9,492	<u>\$ 73,662</u>
Less: interest		(33)	
Present value of minimum lease payments		<u>\$ 9,459</u>	

Note 9. Pension Plans

The majority of employees of the Agency are covered by a retirement plan through the South Carolina Retirement System ("SCRS"), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally, all full-time equivalent State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustments, death, and group-life insurance benefits to eligible employees and retirees.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 9. Pension Plans (continued)

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (“CAFR”) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the Retirement Division, 202 Arbor Lake Drive, Columbia, South Carolina 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years of credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989 for the SCRS is 1.82 percent of an employee’s average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years of service and qualify for a survivor’s benefit upon completion of 15 years of credited service (five years effective January 1, 2002).

Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years of credited service (this requirement does not apply if the disability is a result of a job related injury). A group life insurance benefit equal to an employee’s annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (“TERI”) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years.

Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits.

Effective July 1, 2007, employees participating in the SCRS were required to contribute 6.50% of all compensation. Effective July 1, 2011, the employer contribution rate became 13.685%, which included a 4.30% surcharge to fund retiree health and dental insurance coverage. The Agency’s actual contributions to the SCRS for the years ended June 30, 2012, 2011, and 2010 were approximately \$5,082,000, \$5,149,200, and \$5,351,400, respectively, and equaled the required contributions of 9.385% (excluding the surcharge) for 2010 and 2011 and 10.45% (excluding the surcharge) for 2012. Also, the Agency paid employer group life insurance contributions of approximately \$56,000, \$59,000, and \$63,000, at the rate of .15% of compensation for the current fiscal years ended June 30, 2012, 2011, and 2010 respectively.

The South Carolina Police Officers Retirement System (“PORS”) is a cost-sharing multiple employer defined benefit public employee retirement system. Generally, all full-time employees whose principal duties are the preservation of public order or the protection or prevention and control of property destruction by fire are required to participate in and contribute to PORS as a condition of employment. This plan provides annuity benefits as well as disability and group life insurance benefits to eligible employees and retirees. In addition, participating employers in the PORS contribute to the accidental death fund which provides annuity benefits to beneficiaries of police officers and firemen killed in the actual performance of their duties. These benefits are independent of any other retirement benefits available to the beneficiary.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 9. Pension Plans (continued)

Since July 1, 1988, employees participating in the PORS have been required to contribute 6.50% of all compensation. Effective July 1, 2011, the employer contribution rate became 15.663% which, as for the SCRS, included the 4.30% surcharge. The Agency's actual contributions to the PORS for the years ended June 30, 2012, 2011 and 2010, were approximately \$25,000, \$23,000, and \$21,000, respectively, and equaled the required contributions of 11.363% (excluding the surcharge) for 2010 and 2011 and 11.90% for 2012 (excluding the surcharge). Also, the Agency paid employer group life insurance contributions of approximately \$300 and accidental death insurance contributions of approximately \$300 in the current fiscal year for PORS participants. The rate for each of these insurance benefits is 0.20% of compensation.

New State employees may elect to participate in the Optional Retirement Program ("ORP"), a defined contribution plan. The ORP was established in 1987 under Title 9, Chapter 17, of the South Carolina Code of Laws. The ORP provides retirement benefits through contributions to a 401(a) with one of four approved vendors. The State assumes no liability for this plan other than for payment of contributions to designated companies. To elect participation in the ORP, eligible employees must elect membership within their first 30 days of employment. Under State law, contributions to the ORP are required at the same rates as for the SCRS, 10.45% plus the retiree surcharge of 4.55% from the employer in fiscal year 2012.

For the fiscal year, total contributions requirements to the ORP were approximately \$70,000 (excluding the surcharge) from the Agency as employer and approximately \$90,000 from its employees as plan members.

Employer contributions in the amount of 8.685% were remitted to the Retirement Division of the State Budget and Control Board. Also, the Agency paid employer group life insurance contributions of approximately \$2,070 in the current fiscal year at the rate of 0.15% of compensation. The balance was remitted directly to the respective annuity policy providers. The obligation for payment of benefits resides with the insurance companies.

The amounts paid by the Agency for pension, group-life benefits, and accidental death benefits are reported as employer contribution expenditures within the applicable functional expenditure categories to which the related salaries are charged.

Article X, Section 16, of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit, and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS (and PORS) are actuarially determined.

The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of compensation).

The SCRS does not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Agency's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Agency's liability under the pension plans is limited to the amounts appropriated in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Agency recognizes no contingent liability for unfunded costs associated with participation in the plans.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 9. Pension Plans (continued)

At retirement, employees participating in the SCRS or PORS may receive additional service credit for up to 90 days for accumulated unused sick leave.

Note 10. Post-Employment Benefits Other than Pensions

Plan Description

In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State provides post-employment health and dental and long-term disability benefits to retired State and school district employees and their covered dependents. The Agency contributes to the Retiree Medical Plan (“RMP”) and the Long-Term Disability Plan (“LTDP”), cost-sharing multiple employer defined benefit postemployment healthcare, and long-term disability plans administered by the Employee Insurance Program (“EIP”), a part of the State Budget and Control Board (“SBCB”).

Generally, retirees are eligible for the health and dental benefits if they have established at least ten years of retirement service credit. For new hires beginning employment May 2, 2008 and after, retirees are eligible for benefits if they have established 25 years of service for 100% employer funding and 15 through 24 years of service for 50% employer funding.

Benefits become effective when the former employee retires under a State retirement system. Basic Long-Term Disability (“BLTD”) benefits are provided to active state, public school district, and participating local government employees approved for disability.

Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the EIP and participating retirees to the SBCB, except for the portion funded through the pension surcharge and provided from the other applicable sources of the EIP, for its active employees who are not funded by State General Fund appropriations. Employers participating in the RMP are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 4.55% of annual covered payroll for 2012 and 4.30% of annual covered payroll for 2011. The EIP sets the employer contribution rate based on a pay-as-you-go basis. The Agency paid approximately \$1,740,000 and \$1,666,000 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2012 and 2011, respectively. BLTD benefits are funded through a person’s premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to EIP was \$3.23 for the fiscal years ended June 30, 2012 and 2011. The Agency recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of approximately \$4,543,000 and \$4,443,000 for the years ended June 30, 2012 and 2011, respectively.

Effective May 1, 2008 the State established two trust funds through Act 195 for the purpose of funding and accounting for the employer costs of retiree health and dental insurance benefits and long-term disability insurance benefits. The South Carolina Retiree Health Insurance Trust Fund is primarily funded through the payroll surcharge. Other sources of funding include additional State appropriated dollars, accumulated EIP reserves, and income generated from investments. The Long Term Disability Insurance Trust Fund is primarily funded through investment income and employer contributions.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 10. Post-Employment Benefits Other than Pensions (continued)

Funding Policies (continued)

One may obtain complete financial statements for the benefit plans and the trust funds from Employee Insurance Program, 1201 Main Street, Suite 360, Columbia, SC 29201.

Note 11. Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Agency have elected to participate. The multiple employer plans, created under Internal Revenue Code Section 457, 401(k) and 403(b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina.

Compensation deferred under the plans is placed in trust for the contributing employee. The State has no liability for losses under these plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

Note 12. Risk Management

The Agency is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks except for automobile collision and losses on building contents.

Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage that was in place in the prior year. Settled claims have not exceeded any of its coverages in any of the prior three years. The Agency pays insurance premiums to certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits except for deductibles.

State management believes it is more economical to manage certain risks internally and to set aside assets for claim settlement. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
2. Claims of covered public employees for health and dental insurance benefits (Office of Insurance Services); and
3. Claims of covered public employees for long-term disability and group life insurance benefits (Office of Insurance Services).

Employees elect health coverage through either a health maintenance organization or through the State's self-insured plan. All of the other coverages listed above are through the applicable State self-insured plan except dependent and optional life premiums, which are remitted to commercial carriers.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 12. Risk Management (continued)

The Agency and other entities pay premiums to the State's Insurance Reserve Fund (“IRF”) which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following assets, activities, and/or events:

1. Theft of, damage to, or destruction of assets;
2. Real property;
3. Motor vehicles liability; and
4. Torts.

The IRF is a self-insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of certain property and equipment and auto liability. The IRF's rates are determined actuarially.

State agencies and other entities are the primary participants in the State's Health and Disability Insurance Fund and IRF.

The Agency obtains coverage through a commercial insurer for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation, up to a maximum of \$100,000 per employee. Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks.

The Agency has recorded insurance premium expenditures in the applicable program expenditure categories of the special revenue fund.

In management's opinion, claim losses in excess of insurance coverage for insured risks are unlikely, and if incurred, would be insignificant to the Agency's financial position. Furthermore, there is no evidence of asset impairment or other information to indicate that a loss expenditure and liability should be recorded at year-end for such risks. Therefore, no loss accrual has been recorded.

Note 13. Transactions with State Agencies

The Agency has significant transactions with the State of South Carolina and various State agencies.

The Agency was required to remit \$264,858 of indirect cost recoveries to the General Fund of the State in payment of services received from State agencies including maintenance of certain accounting records and payroll and disbursement processing from the Comptroller General; check preparation and banking from the State Treasurer; legal services from the Attorney General; and records storage from the Department of Archives and History.

Other services received at no cost from the various divisions of the SBCB include retirement plan administration, insurance plan administration, procurement services, grant services, personnel management, assistance in the preparation of the state budget, and approval of certain budget amendments and other centralized functions.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 13. Transactions with State Agencies (continued)

The Agency had financial transactions with various State agencies during the fiscal year. Payments were made to divisions of the SBCB for retirement and insurance plan contributions, unemployment insurance, insurance coverage, office supplies, telephone, and interagency mail. Payments were also made during the year to the State Accident Fund for worker's compensation insurance. The amounts of expenditures applicable to related party transactions with State agencies in the governmental fund – special revenue are as follows for the year ended June 30, 2012:

Budget and Control Board	\$1,988,528
Comptroller General	523,254
University of South Carolina	276,591
State Accident Fund	257,199
Legislative Audit Council	167,292
Department of Revenue and Taxation	138,704
Department of Commerce	61,048
Winthrop University	57,543
Francis Marion University	37,228
Clemson University	31,694
Technical and Computer Education Board	2,431
Department of Education	432
Other	33,529
	<u>\$ 3,575,473</u>

In the governmental fund - special revenue, the Agency received \$343,959 from State appropriations during the year for expenditures of the SCOICC. In the proprietary fund, the Agency recorded revenues of approximately \$6,759,000 for reimbursements of benefits paid to State employees and was due approximately \$1,268,000 for these benefits at year-end.

Note 14. 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 to 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, 2012 and 2011, the outstanding balance of these advances was approximately \$782 million and \$967 million, respectively. Principal payments began on September 30, 2011 with interest accruing at an interest rate of approximately 4 percent beginning on January 1, 2011. Of the \$782 million total amount payable, approximately \$675 million is reported as a non-current liability, and \$107 million is reported as being due within one year.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 14. Advances from Federal Government (continued)

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. For the fiscal years ended June 30, 2012 and 2011, a total of \$119,325 and \$35,188,745, respectively, was applied to reduce the balance of federal unemployment account advances to the Fund as a result of the reduced FUTA credits. This amount has been reported as non-operating revenue in the Statements of Revenues, Expenses and Changes in Fund Net Deficit.

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 Trust Fund back on the path to solvency. State unemployment tax rates are now structured to raise revenues that more accurately address the demands on the Trust Fund and the changing economic environment in which the Trust Fund operates. While the Trust 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.

Increased tax collections coupled with decreases in the number of individuals eligible for and claiming state UI benefits have enabled the Trust Fund to operate without obtaining additional advances from the federal government since May of 2011. Management plans to continue to borrow from the federal government, if needed, to fund its deficits for the foreseeable future; however, management estimated that no additional advances will be required under the new tax system. The federal government has not established a maximum amount that the Trust Fund can borrow. The amount due within one year consists of an amount to be paid in November of 2012 based on the U.S. Department of Labor's estimate of potential FUTA credit reduction for 2012. Federal regulations specify that interest on federal unemployment account advances may not be paid, either directly or indirectly, from the Trust Fund; therefore, no accrued interest is reported in the financial statements of the Trust Fund. The Department paid interest of approximately \$25 million from the Department's interest surcharge administrative fund subsequent to June 30, 2012, and paid approximately \$29 million during the year then ended.

Note 15. Contingencies

Federal Grants – The various programs administered by the Agency for fiscal years June 30, 2012 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 federal grantors have not been determined, but the Agency believes that any such amounts in the aggregate would not have a material adverse effect on the financial position of the Agency. Also, see information on subsequent events in Note 16 regarding new legislation and loss of administrative funding.

South Carolina Department of Employment and Workforce

Notes to Financial Statements

Note 15. Contingencies (continued)

Litigation – The Agency is a party to various legal proceedings arising principally in the normal course of operations. The outcome of any litigation has an element of uncertainty. Because, in the opinions of management and legal counsels, the risk of loss in excess of insurance coverage for any litigation is remote, the outcome of any litigation and claims is not expected to have a material adverse effect on the financial position of the Agency. Therefore, an estimated liability has not been recorded.

Note 16. Subsequent Events

Participation in the TERI program after July 1, 2012 has been redefined by legislation. TERI program elements such as eligibility, employment status and rights, employee contributions, deferred annuity, incidental death benefits, unused leave and distributions have been affected. The TERI program will end on June 30, 2018, regardless of when participants enter the program. Refer to Note 9 regarding the current TERI program.

The employee contribution rate will increase to 7.0 percent effective July 1, 2012, 7.5 percent effective July 1, 2013, and to 8.0 percent effective July 1, 2014. Effective July 1, 2012 the employer contribution rate for SCRS and PORS will increase to 10.6% and 11.90% respectively for SCRS and PORS. Effective July 1, 2013 the PORS employer contribution rate will increase from 11.90 percent to 12.44 percent. Other changes to these elements take effect in different stages between July 1, 2012 and January 1, 2014.

The balance of advances from the federal government was \$782,187,983 at June 30, 2012. A principal payment of \$106,500,000 was made in August 2012 bringing the balance down to \$675,680,422, net of \$7561 of FUTA credits, at the date of the audit report. The Trust Fund has not taken any additional advances from the federal government since May 2011.

The State of South Carolina’s 2012-2013 Appropriations Act, enacted August 3, 2012, provided \$77 million for SUTA tax relief, as follows:

Section 67 of the budget	\$ 30,790,650
Proviso 90.20 of the budget	3,009,350
Section 1 of the capital reserve bill	43,200,000
	<u>\$ 77,000,000</u>

The Agency was required to recalculate 2012 unemployment taxes retroactive to January 1, 2012, which resulted in overpayments for the first and second calendar quarters of 2012. Credits from these overpayments are available to businesses as credits, but due to the timing of the funding are not available for refund. Although final numbers are not yet available, it is estimated that approximately \$40 million in credits will be issued that can be used to offset future tax liability to the Agency. The remaining \$37 million in appropriation will offset the lesser amount of collections due to the lower tax rates applied to the third and fourth quarters of 2012.

Administrative funding from the USDOL for staff and operating costs under the UI and EUC programs has continued to decline as the economy has improved over the last three fiscal years. The Agency will be forced to reduce its expenditures as a result of this, and other reductions in federal funding from USDOL, to avoid the liquidation of non-federal cash reserves, and to maintain long-term solvency as the nation recovers from the recession.

**South Carolina Department of Employment and Workforce
Schedule of Expenditures of Federal Awards**

Year Ended June 30, 2012

Federal Grantor/Program Title	Federal CFDA Number	Total Federal Expenditures	Passed Through to Sub- Recipients
Direct Programs:			
U.S. Department of Labor			
Labor Force Statistics	17.002	\$ 969,681	\$ —
Employment Service*	17.207	11,133,438	60,933
Unemployment Insurance	17.225	692,386,782	—
Trade Adjustment Assistance – Workers	17.245	9,333,284	—
Workforce Investment Act – Adult **	17.258	14,898,597	14,372,632
ARRA – Workforce Investment Act – Adult**	17.258	97,973	97,973
Workforce Investment Act – Youth**	17.259	17,073,334	15,287,869
ARRA – Workforce Investment Act – Youth**	17.259	487,641	487,641
Workforce Investment Act – Dislocated Workers**	17.278	19,152,030	17,690,247
ARRA - Workforce Investment Act – Dislocated Workers**	17.278	575,641	575,641
Work Opportunity Tax Credit	17.271	137,530	—
Workforce Data Quality	17.261	111,348	—
Work Incentives Grant	17.266	8,508	—
Labor Certification for Alien Workers	17.272	89,916	—
Disabled Veterans Outreach Program (DVOP)*	17.801	1,239,158	—
Local Veterans Employment Representative (LVER)*	17.804	1,479,719	—
Totals		<u>\$ 769,174,580</u>	<u>\$ 48,572,936</u>

* - part of Employment Services federal awards cluster

** - part of Workforce Investment Act federal awards cluster

**South Carolina Department of Employment and Workforce
Notes to Schedule of Expenditures of Federal Awards**

Year Ended June 30, 2012

NOTE 1 – BASIS OF PRESENTATION

The accompanying Schedule of Federal Awards (“Schedule”) presents the activity of all federal awards programs of the Agency for the year ended June 30, 2012. The information in the Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Expenditures for federal financial assistance awarded directly from federal agencies, as well as those passed through other government agencies, are included on the Schedule.

Loan Program – Federal Unemployment Account Advance (CFDA 17.225)

This loan is funded by the federal government through the Federal Unemployment Trust Fund and is used by the Agency to pay unemployment benefits. Loans made during fiscal year 2012 were \$0 and the loan balance at June 30, 2012 was \$782,187,983.

NOTE 2 – BASIS OF ACCOUNTING

The accompanying Schedule is presented using the full accrual basis of accounting, which is described in the notes to the Agency’s basic financial statements.

**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***

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
South Carolina Office of the State Auditor
Columbia, South Carolina

We have audited the financial statements of the governmental activities, the business-type activities, and each major fund of the South Carolina Department of Employment and Workforce (the “Agency”) as of and for the year ended June 30, 2012, which collectively comprise the Agency’s basic financial statements and have issued our report thereon dated May 24, 2013. 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

Management of the Agency is responsible for establishing and maintaining effective internal control. In planning and performing our audit, we considered the Agency’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 Agency’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Agency’s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described as item 2012-1 in the accompanying schedule of findings and questioned costs to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described as item 2012-2 to 2012-3 in the accompanying schedule of findings and questioned costs to be significant deficiencies.

Compliance and Other Matters

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

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

This report is intended solely for the information of the State Auditor, the Governor of the State of South Carolina, management of the Agency, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Scott and Company LLC

Columbia, South Carolina
May 24, 2013

**Independent Auditor's Report on Compliance with Requirements
That Could Have a Direct and Material Effect on Each Major Program and on Internal Control
Over Compliance in Accordance with *OMB Circular A-133***

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
South Carolina Office of the State Auditor
Columbia, South Carolina

Compliance

We have audited the compliance of South Carolina Department of Employment and Workforce (the "Agency") with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Agency's major federal programs for the year ended June 30, 2012. The Agency's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Agency's management. Our responsibility is to express an opinion on the Agency's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and *OMB Circular A-133* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Agency's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Agency's compliance with those requirements.

In our opinion, the Agency complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

Internal Control Over Compliance

Management of the Agency is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal programs. In planning and performing our audit, we considered the Agency's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with *OMB Circular A-133*, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance 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 compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses as defined in the preceding paragraph.

The purpose of this report is intended solely to describe the scope of our testing of compliance with the types of compliance requirements applicable to each of the Agency's major programs and our testing of internal control over compliance and the results of our testing, and to provide an opinion on the Agency's compliance but not to provide an opinion on the effectiveness of the Agency's internal control over compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Agency's compliance with requirements applicable to each major program and its internal control over compliance. Accordingly, this report is not suitable for any other purpose.

Scott and Company LLC

Columbia, South Carolina

**South Carolina Department of Employment and Workforce
Schedule of Findings and Questioned Costs**

Year Ended June 30, 2012

Section I—Summary of Auditor’s Results

Financial Statements:

We have issued an unqualified opinion dated May 24, 2013 on the basic financial statements of the South Carolina Department of Employment and Workforce.

Internal control over financial reporting:

- Material weaknesses identified? YES
- Significant deficiencies identified that are not considered to be material weaknesses? YES
- Noncompliance material to financial statements noted? NO

Federal Awards:

We have issued an unqualified opinion dated May 24, 2013 on the South Carolina Department of Employment and Workforce’s compliance for major programs.

Internal control over major programs:

- Material weaknesses identified? NO
- Significant deficiencies identified that are not considered to be material weaknesses? NO
- Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? NO

Identification of Major Programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
17.225	Unemployment Insurance
17.245	Trade Adjustment Act
17.258 *	Workforce Investment Act – Adult
17.258 *	ARRA - Workforce Investment Act – Adult
17.259 *	Workforce Investment Act – Youth
17.259 *	ARRA - Workforce Investment Act – Youth
17.278 *	Workforce Investment Act – Dislocated Workers
17.278 *	ARRA - Workforce Investment Act – Dislocated Workers

* - part of Workforce Investment Act federal awards cluster

Dollar threshold used to be distinguished between Type A and Type B Programs: \$2,307,524

Auditee qualified as low-risk auditee? NO

**South Carolina Department of Employment and Workforce
Schedule of Findings and Questioned Costs**

Year Ended June 30, 2012

Section II- Financial Statement Findings

Significant Deficiencies Considered to be Material Weaknesses:

2012-1: Audit Adjustments to the Financial Statements

Condition:

During our audit we proposed adjustments to expenditures and accounts payable and revenues and accounts receivable that were considered to be material to the financial statements. In addition, reconciled cash balances did not agree to the trial balance when we received the cash reconciliations from the Agency.

Cause:

Accounts payable and accounts receivable were understated due to fiscal year 2012 transactions being coded to the general ledger in fiscal year 2013. This issue was caused by the Request for Disbursement documentation submitted to DEW by local areas not containing a breakout of amounts requested for prior year expenses, versus amounts requested for current year expenses.

The reconciled cash balance was materially different than the trial balance amount of cash. This was due to cash adjustments manually posted by the State's accounting system in prior years related to payroll, that were not reflective of expenses recorded in the Agency's payroll ledgers.

Effect:

Accounts payable and expenditures, accounts receivable and revenues were understated for the year ended June 30, 2012. Because reconciled cash balances did not agree to the trial balance amounts, there were significant delays to our auditing the cash balances while the Agency researched the differences between the trial balance amounts and the supporting reconciliation.

Criteria:

As part of the annual closing of the financial statements, the cut-off of expense and revenue recognition must be kept on the basis of accounting prescribed by generally accepted accounting principles. In addition, balance sheet account reconciliation such as cash reconciliations should agree to the trial balance before they are given to the auditor.

Recommendation:

Procedures should be strengthened to assure that accounts payable and accounts receivable are adjusted at year-end for the proper cut-off of revenues and expenditures. Cash accounts should be reconciled monthly and agree to the general ledger to ensure accuracy and to examine any reconciling items so that the year-end trial balance agrees to the June 30 cash reconciliation.

Significant Deficiencies Not Considered to be Material Weaknesses:

2012-2: Business Continuity Plan

Condition:

The Agency has not adopted a business continuity plan.

Cause:

The Agency has not had the resources available to focus on preparing a business continuity plan.

Effect:

The Agency's business could be significantly interrupted or destroyed without a business continuity plan in place in case of emergency.

Criteria:

Proper business practices and internal controls indicate that all entities develop a business continuity plan to deal with unusual circumstances.

Recommendation:

The Agency should adopt a business continuity plan for emergency situations. The plan should be tested annually to ensure the organization recovers its business functions timely under unusual conditions and should include an IT disaster recovery plan that is also tested annually. Business continuity planning and testing should be an ongoing objective in the Agency's risk assessment process and should be appropriately documented. This plan could be part of the Agency's overall risk assessment program.

2012-3: Access to Program and Data (Logical Security)

Condition:

Although certain application data owners perform a periodic review of user access rights for certain applications, other application data owners have not yet established a plan of periodic review of user access rights for all in-scope applications to ensure all users (including terminated employees and transfers) have appropriate access rights.

Cause:

The IT department does not have an adequate review process for all in-scope applications regarding user access rights.

Effect:

Unauthorized users may have access to applications to disclose, modify, and damage data. All access rights may be inappropriately restricted without periodical recertification.

Criteria:

General computer controls indicate that a formal recertification process that reviews user access listing to all in-scope applications.

Recommendation:

The IT department needs to work with various application owners to ensure that application owners or their representative performs periodic review of user access rights for all in-scope applications, in order to be certain that all users (including terminated employees and transfers) have appropriate access rights. This joint effort and objective should be a part of entity's strategic planning and risk assessment process.

**South Carolina Department of Employment and Workforce
Schedule of Findings and Questioned Costs**

Year Ended June 30, 2012

Section III- Federal Award Findings and Questioned Costs:

Significant Deficiencies Not Considered to be Material Weaknesses:

None.

Summary Schedule of Prior Audit Findings:

During the current year audit, we reviewed the status of corrective action taken on the findings as reported in our prior year's reports on internal control and compliance of the Agency dated April 30, 2012, resulting from the audit of the financial statements and OMB Circular A-133 audit reports for the year ended June 30, 2011. We found that adequate corrective action was taken for all of the management letter comments, findings, and questioned costs except for items 2011-2 and 2011-4, which are repeated above as comments 2012-2 and 2012-3, respectively.

PO Box 995
1550 Gadsden Street
Columbia, SC 29202
www.dew.sc.gov



Nikki R. Haley
Governor

May 24, 2013

**South Carolina Department of Employment and Workforce
Corrective Action Plan**

The South Carolina Department of Employment and Workforce respectfully submits the following Corrective Action Plan for the audit of the year ended June 30, 2012 performed by the independent accounting firm:

Scott and Company LLC
1441 Main Street, Suite 800
Columbia, South Carolina 29201

Audit period: July 1, 2011 to June 30, 2012

Schedule of Findings and Responses

2012-1: Audit Adjustments to the Financial Statements

Condition:

During our audit we proposed adjustments to expenditures and accounts payable and revenues and accounts receivable that were considered to be material to the financial statements. In addition, reconciled cash balances did not agree to the trial balance when we received the cash reconciliations from the Agency.

Management's Response:

The understatement of accounts payable was caused by a discrepancy between the Request for Disbursement (RFD) form and the attached documentation submitted by the local areas. The expenses submitted to DEW from the local areas for reimbursement are one month behind compared to the actual date on the RFD form. A training session will be scheduled with the local areas in order to ensure appropriate documentation is sent with the RFD's. DEW will also ensure the date on the RFD form coincides with each local area's monthly expenditures, to ensure proper accrual of expenditures and completeness of liabilities reported in the financial statements.

The cash reconciliation did not agree to the trial balance when submitted to the auditors due to a payroll related issue from prior years. When DEW went live on SCEIS for payroll, manual entries were required but not recorded to clear the payroll cash. The payroll was cleared on the

agency's book of record for federal accounting/reporting purposes (FARS) resulting in a lower cash balance compared to SCEIS. This was a one-time occurrence, and payroll cash is currently posted in SCEIS and FARS monthly.

Significant Deficiencies Not Considered to be Material Weaknesses:

2012-2: Business Continuity Plan

Condition:

The Agency has not adopted a business continuity plan.

Management's Response:

DEW agrees with the audit findings regarding business continuity and is in process of adopting a Business Continuity Plan (BCP).

A Business Impact Analysis (BIA) has been conducted by a reputable vendor in that industry space. The purpose of the BIA was to gather key information and input from each business unit that would be necessary to develop a BCP that will include a Disaster Recovery Plan (DRP) capable of providing the systems required by each division/department in a timely and cost-effective manner.

The next step in this process is to gain agency consensus and approval to fund the operational expenses of a BCP. DEW intends to procure contractual services to write and help implement the final phases of the project providing DEW a viable BCP and a DRP going forward.

2012-3: Access to Program and Data (Logical Security)

Condition:

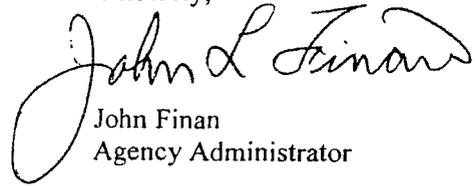
Although certain application data owners perform a periodic review of user access rights for certain applications, other application data owners have not yet established a plan of periodic review of user access rights for all in-scope applications to ensure all users (including terminated employees and transfers) have appropriate access rights.

Management's Response:

The IT Office of Information Security will finalize and publish a user permissions audit plan with corresponding procedures. The plan will require data owners to review user access rights to all applications to ensure that only appropriate access rights are granted. Audits of user access rights will be performed quarterly, at a minimum.

If there are any questions, or if additional information is needed, please contact Don Grant, CPA, Chief Financial Officer, at (803) 737-0367.

Sincerely,

A handwritten signature in cursive script that reads "John L. Finan". The signature is written in black ink and is positioned to the left of the typed name and title.

John Finan
Agency Administrator