

Financial Statements of
South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
for the years ended June 30, 2011 and 2010

State of South Carolina



Office of the State Auditor

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September 29, 2011

The Honorable Nikki R. Haley, Governor
and
Mr. Abraham Turner, Director
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 Unemployment Compensation Fund for the fiscal year ended June 30, 2011 was issued by Scott and Company, LLP, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

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

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

RHGjr/trb

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Independent Auditors' Report

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

We have audited the accompanying financial statements of the South Carolina Department of Employment and Workforce Unemployment Compensation Fund (the "Fund") as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the financial statements of the Fund are intended to present the financial position and results of operations of only that portion of the funds of the State of South Carolina financial reporting entity that is attributable to the transactions of the Fund. They do not purport to and do not present the financial position of the State of South Carolina as of June 30, 2011 and 2010, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America, and do not include any other agencies, divisions, or component units of the State of South Carolina.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Fund as of June 30, 2011 and 2010, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2011, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

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

Scott and Company LLP

Columbia, South Carolina
September 29, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the South Carolina Department of Employment and Workforce (the "Department") offers readers this narrative overview and analysis of the financial activities attributed to the South Carolina Department of Employment and Workforce's Unemployment Compensation Trust Fund (the "Fund") for the fiscal years ended June 30, 2011 and 2010. Please read this information in conjunction with the Fund's financial statements and accompanying notes.

Financial Highlights

- In recent years, the 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 Fund has been required to obtain advances from the Federal Unemployment Fund of \$115,594,636 and \$541,780,847 during the years ended June 30, 2011 and 2010, respectively.

Increased tax collections, coupled with decreases in the number of individuals eligible for and claiming state unemployment insurance ("UI") benefits, have enabled the 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, as needed, to fund its deficits for the foreseeable future. The federal government has not established a maximum amount that the Fund can borrow.

On August 10, 2010, the Fund received \$97,459,490 in UI modernization incentive funds from the U.S. Department of Labor. The funding stems from various changes made to South Carolina (the "State") unemployment insurance law that will make benefits available to more people, including part-time workers and those who quit work for compelling family reasons. The State qualified for the funds available under the American Recovery and Reinvestment Act ("ARRA"). These funds were used to pay State UI benefits and to reduce the need for requesting additional advances from the federal government. The Fund estimates that it will not require additional advances until February of 2012.

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

- The Fund was created per Section 41-33-10 of the South Carolina Employment Security Law. The Fund is made up of three separate accounts: (1) a clearing account which is used for the deposit of contributions, interest, penalties, contingency, service charges, recording fees, and payments in lieu of contributions received from employers in the State; (2) an unemployment trust fund account consisting of funds transferred from the clearing account and funds received from other states to be held to withdraw for unemployment benefit claims and to make required principal payments on federal unemployment account advances. This account also contains

money received from the federal government as reimbursements pursuant to Section 204 of the Federal-State Extended Compensation Act of 1970 and Reed Act funds received from the federal government; and (3) a benefit payment account which receives funds from the Fund to pay unemployment benefit claims.

- In March 2010, Section 41-29-10 of the South Carolina Code of Laws was amended by the General Assembly through Act 146 to replace the Commissioners with an Executive Director, appointed by the Governor for a four year term. The act also renamed the Department, moved it to the Governor's cabinet, moved the Workforce Investment Act ("WIA") and Trade Assistance Act ("TAA") programs back to the Department, and established an appellate panel charged with hearing higher level appeals for unemployment benefits. The State General Assembly elects the three-member appellate panelists to four year terms. Although the legislative restructuring affected the organization, governance, and operation of the Department as a whole, the character, operating regulations and responsibilities of the Fund were not changed.
- Liabilities exceeded assets as of June 30, 2011 by \$588,095,425 which is shown as a net deficit. The net deficit as of June 30, 2010 was \$(761,147,843).
- Total unemployment compensation benefits paid were \$2,171,063,209 and \$2,027,711,376 during the years ended June 30, 2011 and 2010, respectively.

Overview/Discussion of the Financial Statements

Management's discussion and analysis serves as an introduction to the basic financial statements. These financial statements consist of (1) statements of net assets (deficit); (2) statements of revenues, expenses, and changes in Fund net assets (deficit); (3) statements of cash flow; and (4) notes to financial statements. The management discussion and analysis represents management's analysis of the Fund's financial condition.

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

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

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

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

Condensed Financial Data

Statements of Net Deficit

	<u>2011</u>	<u>2010</u>	<u>Change</u>
Assets	<u>\$ 411,146,669</u>	<u>\$ 169,957,368</u>	<u>\$ 241,189,301</u>
Current liabilities	<u>\$ 215,548,618</u>	<u>\$ 44,442,859</u>	<u>\$ 171,105,759</u>
Non-current liabilities	<u>783,693,476</u>	<u>886,662,352</u>	<u>(102,968,876)</u>
Total liabilities	<u>999,242,094</u>	<u>931,105,211</u>	<u>68,136,883</u>
Net deficit, unrestricted	<u>(588,095,425)</u>	<u>(761,147,843)</u>	<u>173,052,418</u>
Total liabilities and net deficit	<u>\$ 411,146,669</u>	<u>\$ 169,957,368</u>	<u>\$ 241,189,301</u>

Statements of Revenues, Expenses, and Changes in Fund Net Deficit

	<u>2011</u>	<u>2010</u>	<u>Change</u>
Operating Revenues			
Assessments	<u>\$ 502,622,038</u>	<u>\$ 282,915,570</u>	<u>\$ 219,706,468</u>
Federal grants	<u>1,753,813,746</u>	<u>1,235,188,534</u>	<u>518,625,212</u>
Other	<u>52,491,098</u>	<u>65,726,404</u>	<u>(13,235,306)</u>
Total operating revenues	<u>2,308,926,882</u>	<u>1,583,830,508</u>	<u>725,096,374</u>
Operating Expenses			
Unemployment compensation benefits	<u>2,171,063,209</u>	<u>2,027,711,376</u>	<u>143,351,833</u>
Operating income (loss)	<u>137,863,673</u>	<u>(443,880,868)</u>	<u>581,744,541</u>
Non-operating revenues			
Gain on forgiveness of debt	<u>35,188,745</u>	<u>-</u>	<u>35,188,745</u>
Changes in net assets	<u>173,052,418</u>	<u>(443,880,868)</u>	<u>616,933,286</u>
Total net deficit –beginning	<u>(761,147,843)</u>	<u>(317,266,975)</u>	<u>(443,880,868)</u>
Total net deficit – ending	<u>\$ (588,095,425)</u>	<u>\$ (761,147,843)</u>	<u>\$ 173,052,418</u>

Financial Analysis

Statements of Net Deficit:

Total assets increased by approximately \$241 million due primarily to the increase in the cash balance, which was the result of both a decrease in State-funded unemployment benefit claims paid during the 2011 fiscal year and the increased amounts assessed to employer accounts. Unemployment continued to increase, with claimants filing for a longer period of time, as required by the federal government. Many individuals exhausted regular State UI benefits during the year, and thereby began receiving benefit payments fully-funded by the federal government instead of being funded by the State.

Federal intergovernmental payable increased during the year, largely due to claimant refunds, cancelled payments, and other items being owed back to the federal government which, in total, offset any amounts due from the federal government. For the year ended June 30th 2010, a significant amount due from the federal government was reported. This balance was largely a result of the *Unemployment Compensation Extension Act of 2010*, passed by Congress in late July 2010. As a result of claimants continuing to file for various Emergency Unemployment Compensation (“EUC”) and Extended Benefits (“EB”) during the period between the original ending date of federal EUC and EB funding and extension passed on July 22, 2010, a large number of claims for benefit weeks ending prior to June 30, 2010 were paid subsequent to year end. The accrual of these benefit expenses required a corresponding accrual for reimbursable amounts receivable from the federal government.

Ending net deficit decreased by approximately \$173 million as compared to a \$444 million increase for the prior year, which is the result of the significant increase to assessments collected and federal grants received.

Revenues, Expenses, and Changes in Net Deficit:

Assessments increased by approximately \$220 million as compared to last year due to higher tax rates being assessed on employers as a result of the revised tax legislation passed by the legislature, effective January 1, 2011.

Total operating revenue increased by approximately \$725 million primarily due to an increase in federal grants relating to federally funded unemployment programs, and increased amounts of tax revenues received from employers.

Unemployment compensation benefits increased by approximately \$143 million due to increased unemployment and increases in the period of time over which benefits are paid as mandated by the federal government.

Operating income for 2011 was approximately \$138 million as compared to a \$444 million operating loss for the prior year due to the increase in assessments received.

Non-operating revenues increased by approximately \$35 million for the year 2011 as a result of the federal government’s forgiveness of certain debts due to the application of Federal Unemployment Tax Act (“FUTA”) credit tax reductions for employers subject to the provisions of the State’s unemployment application law.

Due to proper and adequate principal payments being made subsequent to the end of the 2011 fiscal year, such credit reductions should be avoided in future years. For the 2011 calendar year, the required loan payments to avoid FUTA credit reduction will be funded through increased tax assessments coupled with non-recurring revenues appropriated to the Fund by the State’s General Assembly.

South Carolina Department of Employment and Workforce
Unemployment Compensation Fund
Statements of Net Deficit
As of June 30,

	2011	2010
Assets:		
Current assets:		
Cash and cash equivalents	\$ 260,981,907	\$ 71,232,244
Assessments receivable, net	126,936,099	49,409,725
Benefit overpayments receivable, net	10,627,713	6,664,877
Due from reimbursable employers, net	1,508,560	1,576,638
Intergovernmental receivables, net		
Local governments	3,459,727	3,942,077
State agencies	2,320,509	4,270,715
Other states	1,718,119	2,405,088
Federal	3,594,035	30,456,004
Total assets	\$ 411,146,669	\$ 169,957,368
Liabilities:		
Current liabilities:		
Benefits payable	\$ 3,778,647	\$ 20,684,580
Tax withholdings payable	40,704	83,713
Contributions payable	8,979,575	6,808,134
Intergovernmental payables:		
Federal	9,896,282	3,900,273
Other states	4,391,551	4,743,719
Interfund payable – Department	5,087,092	8,222,440
Advances from federal government	183,374,767	-
Total current liabilities	215,548,618	44,442,859
Advances from federal government, net of current portion	783,693,476	886,662,352
Total liabilities	999,242,094	931,105,211
Net Deficit:		
Unrestricted	(588,095,425)	(761,147,843)
Total liabilities and net deficit	\$ 411,146,669	\$ 169,957,368

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

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

	2011	2010
Operating Revenues:		
Assessments	\$ 502,622,038	\$ 282,915,570
Reimbursement of unemployment compensation benefits from employers	5,946,656	6,396,890
Benefit overpayment recoveries	8,933,828	13,449,679
Intergovernmental:		
Federal	1,753,813,746	1,235,188,534
State agencies	10,042,141	9,510,740
Other states	8,548,524	16,994,946
Local governments	19,019,949	19,374,149
Total operating revenues	2,308,926,882	1,583,830,508
 Operating Expenses:		
Unemployment compensation benefits	2,171,063,209	2,027,711,376
Total operating expenses	2,171,063,209	2,027,711,376
 Operating income (loss)	137,863,673	(443,880,868)
 Non-operating revenue:		
Gain on forgiveness of debt	35,188,745	-
Total non-operating revenues	35,188,745	-
 Changes in net assets	173,052,418	(443,880,868)
 Total net deficit – beginning	(761,147,843)	(317,266,975)
 Total net deficit – ending	\$ (588,095,425)	\$ (761,147,843)

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

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

	2011	2010
Cash flows used by operating activities:		
Cash received from assessments	\$ 424,942,221	\$ 277,077,463
Cash received from employers	6,014,734	6,645,141
Cash received from benefit overpayment recoveries	4,970,992	14,425,092
Cash received from federal, state and local agencies	1,821,405,854	1,268,511,624
Benefits paid	(2,180,196,869)	(2,041,676,029)
Refund overpayment of assessments	(2,981,905)	(3,064,089)
Net cash provided by (used in) operating activities	74,155,027	(478,080,798)
Cash flows provided by non-capital financing activities:		
Proceeds from advances from federal government	115,594,636	541,780,847
Net cash provided by non-capital financing activities	115,594,636	541,780,847
Net increase in cash	189,749,663	63,700,049
Cash and cash equivalents – beginning	71,232,244	7,532,195
Cash and cash equivalents – ending	\$ 260,981,907	\$ 71,232,244
Reconciliation of operating income (loss) to net cash		
Provided by (used in) operating activities:		
Operating income (loss)	\$ 137,863,673	\$ (443,880,868)
Net changes in assets and liabilities:		
Assessments receivable	(77,526,374)	(7,655,688)
Benefit overpayments receivable	(3,962,836)	975,413
Due from reimbursable employers	68,078	248,251
Intergovernmental receivables:		
Local governments	482,350	(232,692)
State agencies	1,950,206	(1,560,039)
Other states	686,969	2,058,289
Federal	26,861,969	(12,822,302)
Benefits payable	(16,905,933)	12,888,567
Tax withholdings payable	(43,009)	(22,739,048)
Contributions payable	2,171,441	(1,998,472)
Interfund payable – Department	(3,135,348)	(1,246,508)
Intergovernmental payable:		
Federal	5,996,009	-
Other states	(352,168)	(2,115,701)
Net cash provided by (used in) operating activities	\$ 74,155,027	\$ (478,080,798)

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

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

Note 1. Summary of Significant Accounting Policies

Liquidity

In recent years, the Fund generated substantial operating losses and has been required to use all of its cash resources to fund its operations. Revamped tax legislation, effective January 1, 2011, significantly increased tax assessment revenues for the Fund. Cash balances at June 30, 2011 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 principle on advances from the federal unemployment account. Due to the increasing unemployment rate and the resulting increased amount of unemployment benefits paid, and the increased length of time over which the benefits are paid, the Fund has been required to obtain advances from the Federal Unemployment Compensation Fund of \$115,594,636 and \$541,780,847 during the years ended June 30, 2011 and 2010, respectively.

Increased tax collections, coupled with decreases in the number of individuals eligible for and claiming State unemployment insurance benefits, have enabled the 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 Fund can borrow.

Legislative reforms to the State's unemployment insurance tax structure, effective on tax assessments for the first quarter of the 2011 calendar year, were specifically designed to assist in putting the Fund back on the path to solvency, including providing for timely repayment of federal unemployment account balances. These changes are addressed in Note 7.

Reporting Entity

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

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

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

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

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

Note 1. Summary of Significant Accounting Policies (continued)

Reporting Entity (continued)

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

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

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

The Employment Security Commission was created by Section 41-29-10 of the South Carolina Code of Laws to administer the South Carolina Employment Security Law which provides for the payment of unemployment insurance benefits, the collection of the unemployment tax from subject employers, and the operation of a statewide employment service. Section 41-29-10 was amended by the South Carolina General Assembly in 2011 through Act 146 to replace the Commissioners with an Executive Director. The act also renamed the agency the Department of Employment and Workforce (the “Department”), moved it to the Governor’s cabinet, moved the Workforce Investment Act (“WIA”) and Trade Assistance Act (“TAA”) programs back to the agency from another state agency, and established an appellate panel charged with hearing higher level appeals for unemployment benefits.

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

The Department is part of the primary government of the State of South Carolina. The funds of the Department, including the Fund, are included in the Comprehensive Annual Financial Report of the State of South Carolina. The South Carolina General Assembly elects the three-members of the appellate panelist for four-year terms, while the Governor appoints the Executive Director for a four-year term.

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

The Fund accounts for all financial transactions related to employer tax contributions, employer reimbursements in lieu of tax contributions, and federal and other funds used for the payment of unemployment compensation benefits. Interest income earned on excess funds on deposit with the U.S. Treasury is retained in the Fund for the payment of unemployment compensation benefits as long as the fund is not indebted to the federal government for unemployment compensation advances. The Fund includes the following:

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

Note 1. Summary of Significant Accounting Policies (continued)

Reporting Entity (continued)

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

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

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

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

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

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

Reemployment Trade Adjustment Assistance (“RTAA”) - Program implemented in fiscal year 2009 as a wage option available to older workers under the TAA program to eventually replace ATAA. Consists of monies paid to individuals age 50+ who had lost their jobs due to imports but are now working again at a lower salary. They are paid 50% of the difference in their old and new salary. It is funded by the federal government.

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

Emergency Unemployment Compensation Tier I (“EUC 08”) - The Emergency Unemployment Compensation (“EUC”) program, created in June 2008 and expanded in November 2008, provides up to 20 weeks of benefits to eligible jobless workers in all states and up to 13 additional weeks of benefits in states with high unemployment. It was set to expire on March 31, 2009. The ARRA extended the date for new EUC claims to December 31, 2009, with payments on those claims ending on May 31, 2010. The Unemployment Compensation Extension Act of 2010 extended the date for new EUC claims to November 30, 2010, with payments on those claims ending April 30, 2011. The date was extended again for new claims to be filed by December 24, 2011 with last week payable of June 9, 2012. It is funded by the federal government and partially funded with ARRA funds.

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

Note 1. Summary of Significant Accounting Policies (continued)

Reporting Entity (continued)

Emergency Unemployment Compensation Tier II (“EUC 2”) – This is an expansion of the Emergency Unemployment Compensation Tier I for individuals who had no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2011, with payments on those claims ending on June 9, 2012. 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. It is funded by the federal government.

Emergency Unemployment Compensation Tier III (“EUC 3”) - This is an additional 13 week expansion of the EUC for individuals who had no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2011 with payments on those claims ending on June 9, 2012. It is funded by the federal government.

Emergency Unemployment Compensation Tier IV (“EUC 4”) - This is an additional 6 week expansion of the EUC for individuals who had no rights to regular, extended, or additional benefits under State law. The extension for new EUC claims is through December 31, 2010 with payments on those claims ending on June 9, 2011. It is funded by the federal government.

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

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

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

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

Unrestricted net assets – This component of net assets consists of net assets or deficits that do not meet the definition of “restricted net assets” or “invested in capital assets, net of related debt.” Since the Fund has a net deficit, this deficit is included in unrestricted net deficit at June 30, 2011 and 2010.

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

Note 1. Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

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

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

Most State agencies, including the Fund, participate in the State's internal cash management pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Information pertaining to carrying amounts, fair value, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

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

Some State Treasurer accounts are not included in the State's internal cash management pool because of restrictions on the use of the funds. For those accounts, cash equivalents include investments in short-term highly liquid securities having an initial maturity of three months or less at the time of acquisition. At year-end, the Fund held no short-term investments.

Receivables - Receivables consist of the following:

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

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

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

Note 1. Summary of Significant Accounting Policies (continued)

Receivables (continued)

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

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

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

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

Payables – Payables consist of the following:

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

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

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

Operating and Nonoperating Revenues and Expenses

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

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

Reclassifications – Certain 2010 amounts have been reclassified to conform to the 2011 presentation. These include a reclassification of \$3,900,273 from intergovernmental receivables – federal to intergovernmental payables – federal for the year ended June 30, 2010.

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

Note 2. Deposits

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

	2011	2010
Deposits held by State Treasurer	\$ 3,295,405	\$ 7,049,273
Deposits held by U.S. Treasury	244,275,981	59,403,469
Other deposits	13,410,521	4,779,502
Total	\$ 260,981,907	\$ 71,232,244

Deposits held by State Treasurer – The deposits of the Fund held by the State Treasurer are under the control of the State Treasurer who, by law, has sole authority for investing State funds. State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days.

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are required to be insured or registered or are investments for which the securities are held by the State or its agent in the State's name. The State's investment policy by law authorizes investments that vary by fund, but generally include 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, certain corporate bonds, and commercial paper.

Custodial credit risk for investments is the risk that in the event of a failure of the counterparty to a transaction, the State will not be able to recover the value of investments or collateral securities that are in possession of an outside party. All of the State Treasurer's investments are fully insured or collateralized.

More information pertaining to carrying amounts, fair value, credit and other risks as required by GASB 40, *Deposits and Investments – Risk Disclosures*, of the State Treasurer's investments are disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

Deposits held by U.S. Treasury - Under the provisions of Section 904(e) of the Social Security Act, the Secretary of the Treasury is authorized to credit to the account of each state agency, on a quarterly basis, a proportionate part of the earnings of the Fund. States are not due any interest while carrying federal unemployment advances on their books.

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

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

Note 3. Payable to Department

The amount shown on the financial statements as being payable to Department represents amounts which were collected for penalties and interest and contingency assessments in tax remittances from employers and special administration funds. Special administration funds are funds received from the federal government that are payable to the Department to support its administration of the Fund. Interest surcharge amounts are collected from employer and transferred into a special administrative account to fund accrued interest payments on the federal unemployment account advances. Amounts due to the Department as of June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Penalty and interest loan	\$ -	\$ 629,708
Contingency assessments	103,441	2,478,929
Penalty and interest	167,099	212,502
Special administration funds	4,396,500	4,901,301
Interest surcharge	394,319	-
Reed Act	25,733	-
	<u>\$ 5,087,092</u>	<u>\$ 8,222,440</u>
Total		

Note 4. Reed Act Funds

The Fund has no funds available under the Reed Act as of June 30, 2011 and 2010. During 2009, due to the Fund becoming insolvent, all funds remaining were used to pay benefits. These funds were granted to the Fund from the federal government from federal unemployment tax collections to be used for unemployment benefits should they become needed. Upon appropriation by the State legislature and after approval of the Governor, these funds could be used for other purposes. Of these funds, \$13,827,461 were appropriated by the General Assembly in prior fiscal years to partially fund the purchase of new software and information technology equipment, land acquisition, and office expansion. The \$13,827,461 was shown as a transfer from the Fund to the Department upon Legislative appropriation prior to the fiscal year ended June 30, 2009. During the fiscal year ended June 30, 2011, \$25,733 in unexpended prior-year project funds was transferred to the Fund's Reed Act account. These funds are shown as payable to the Department at June 30, 2011, and will be properly transferred and/or otherwise utilized upon receiving final guidance on the appropriate treatment from the United States Department of Labor.

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

Note 5. Receivables

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

	2011		
	Receivables at June 30, 2011	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	<u>\$ 139,401,750</u>	<u>\$ 12,465,651</u>	<u>\$ 126,936,099</u>
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	10,016,293	3,632,023	6,384,270
Federal employees (UCFE)	78,289	70,212	8,077
Ex-servicemen (UCX)	64,254	55,720	8,534
Trade readjustment (TRA)	78,445	37,508	40,937
Emergency Unemployment Compensation (EUC)	<u>9,270,228</u>	<u>5,084,333</u>	<u>4,185,895</u>
Totals	<u>\$ 19,507,509</u>	<u>\$ 8,879,796</u>	<u>\$ 10,627,713</u>
Due from reimbursable employers (UI)	<u>\$ 1,631,050</u>	<u>\$ 122,490</u>	<u>\$ 1,508,560</u>
Intergovernmental receivables (UI):			
Local governments	<u>\$ 3,497,110</u>	<u>\$ 37,383</u>	<u>\$ 3,459,727</u>
State agencies	<u>\$ 2,320,509</u>	<u>\$ -</u>	<u>\$ 2,320,509</u>
Other states	<u>\$ 1,718,119</u>	<u>\$ -</u>	<u>\$ 1,718,119</u>
Federal	<u>\$ 3,594,035</u>	<u>\$ -</u>	<u>\$ 3,594,035</u>
	2010		
	Receivables at June 30, 2010	Allowance for Uncollectibles	Net Receivables
Assessments receivable (UI)	<u>\$ 57,358,179</u>	<u>\$ 7,948,454</u>	<u>\$ 49,409,725</u>
Benefit overpayments receivable:			
Basic unemployment compensation (UI)	9,386,239	3,333,083	6,053,156
Federal employees (UCFE)	42,371	26,546	15,825
Ex-servicemen (UCX)	73,791	41,809	31,982
Trade readjustment (TRA)	109,510	35,013	74,497
Emergency Unemployment Compensation (EUC)	<u>5,301,065</u>	<u>4,811,648</u>	<u>489,417</u>
Totals	<u>\$ 14,912,976</u>	<u>\$ 8,248,099</u>	<u>\$ 6,664,877</u>
Due from reimbursable employers (UI)	<u>\$ 1,680,234</u>	<u>\$ 103,596</u>	<u>\$ 1,576,638</u>
Intergovernmental receivables (UI):			
Local governments	<u>\$ 3,979,460</u>	<u>\$ 37,383</u>	<u>\$ 3,942,077</u>
State agencies	<u>\$ 4,270,715</u>	<u>\$ -</u>	<u>\$ 4,270,715</u>
Other states	<u>\$ 2,405,088</u>	<u>\$ -</u>	<u>\$ 2,405,088</u>
Federal	<u>\$ 30,456,004</u>	<u>\$ -</u>	<u>\$ 30,456,004</u>

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

Note 6. Information on Business-Type Activities

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

	<u>2011</u>	<u>2010</u>
Charges for services	\$ 2,308,926,882	\$ 1,583,830,508
Non-operating revenue	35,188,745	-
Less: expenses	<u>(2,171,063,209)</u>	<u>(2,027,711,376)</u>
Net program expense	<u>173,052,418</u>	<u>(443,880,868)</u>
Change in net assets	<u>173,052,418</u>	<u>(443,880,868)</u>
Net (deficit) assets-beginning of year	<u>(761,147,843)</u>	<u>(317,266,975)</u>
Net (deficit) assets-end of year	<u><u>\$ (588,095,425)</u></u>	<u><u>\$ (761,147,843)</u></u>

Note 7. Advances from Federal Government

On December 26, 2008, the Fund began to obtain advances from the federal government in order to pay unemployment benefits due 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, 2011 and 2010, the outstanding balance of these advances was approximately \$967 million and \$887 million, respectively. Principal payments are required to begin on September 30, 2011 with interest accruing at an interest rate of approximately 4 percent beginning on January 1, 2011. Of the \$967 million total amount payable, approximately \$784 million is reported as a non-current liability, and \$183 million is reported as being due within one year.

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 year ended June 30, 2011, a total of \$35,188,745 was applied to reduce the balance of federal unemployment account advances to the Fund as a result of the reduced FUTA credits. This amount is has been reported as non-operating revenue in the Statements of Revenues, Expenses and Changes in Fund Net Deficit. Non-recurring revenues appropriated to SCDEW by the general assembly will be utilized to make principle payments on the federal advances in amounts sufficient to avoid the FUTA credit reduction for state employers for the 2011 tax year.

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

Note 7. Advances from Federal Government (continued)

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

Increased tax collections coupled with decreases in the number of individuals eligible for and claiming state UI benefits have enabled the Fund to operate without obtaining additional advances from the federal government since April of 2010. Management plans to continue to borrow from the federal government, as needed, to fund its deficits for the foreseeable future; however, it is estimated that no additional advances will be required until the first quarter of the 2012 calendar year. The federal government has not established a maximum amount that the Fund can borrow. The amount due within one year consists of a payment due by September 30, 2011 in an amount equal to total advances taken during the 2011 calendar year, and an amount to be paid in November of 2011 based on the U.S. Department of Labor's estimate of potential FUTA credit reduction for 2011. Federal regulations specify that interest on federal unemployment account advances may not be paid, either directly or indirectly, from the Fund; therefore, no accrued interest is reported in the financial statements of the Fund. The Department estimates that accrued interest of approximately \$27 million will be paid from the Department's interest surcharge administration fund by September 30, 2011.

A summary of changes in long-term liabilities for the year ended June 30, 2011 is as follows:

	Balance, July 1, 2010	Additions	Reductions	Balance, June 30, 2011	Due within one year
Advances from federal government	<u>\$886,662,352</u>	<u>\$115,594,636</u>	<u>\$35,188,745</u>	<u>\$967,068,243</u>	<u>\$183,374,767</u>

See Note 9 for a description of subsequent events relating to the change in the tax structure and federal advances.

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

Note 8. Contingencies

Federal Grants – The various programs administered by the Fund for fiscal years June 30, 2011 and years prior to that are subject to audit by the federal grantor agencies. At the present time, amounts, if any, which may be due to federal grantors have not been determined but the Fund believes that any such amounts in the aggregate would not have a material adverse effect on the financial position of the Fund. Furthermore, there is no evidence to indicate that a liability should be recorded at year-end.

Tax Withholdings – During fiscal year 2009 the Fund remitted late certain federal and State of South Carolina tax withholdings, and did not remit certain withholding taxes until after June 30, 2009. The amounts paid are reflected as reductions in tax withholdings payable in the accompanying statement of net assets. The Department paid penalties and interest to the South Carolina Department of Revenue during 2010 of approximately \$280,000 as a result of the 2009 failure to timely deposit state tax withholdings. All federal penalties and interest amounts assessed by the Internal Revenue Service penalties on the 2009 untimely tax deposits have been forgiven as a result of a request for abatement submitted by the agency.

Note 9. Subsequent Events

The balance of advances from federal government is \$851,315,717 at September 29, 2011, which is net of a principal payment made in September 2011 of \$115,174,767 and FUTA credit reductions of \$577,759 applied against the balance of advances from federal government subsequent to year-end. The Fund has not taken any additional advances from the federal government since May 2011.

Due to a budget proviso recently enacted, which provides the Fund with \$146 million earmarked for federal loan repayments (expected to be received by the agency in September 2011), the agency was required to recalculate business unemployment taxes for 2011 retroactive to January 1, 2011. The recalculation of rates will result in overpayments from businesses for the first two calendar quarters of 2011. Any credits resulting from the lower rates can be applied to future quarters automatically. If the business is interested in receiving a refund for any overpayments made in the 2nd quarter of 2011, they can begin requesting these refunds October 1, 2011. It is estimated that approximately \$23 million will be available to South Carolina businesses as refunds. Any overpayments associated with the 1st quarter are required to be kept on the books with the agency as credit to be applied to future tax liability, and the estimate of this amount is approximately \$67 million.

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



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

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

We have audited the financial statements of the South Carolina Department of Employment and Workforce Unemployment Compensation Fund (the "Fund") as of and for the years ended June 30, 2011 and 2010, and have issued our report thereon dated September 29, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is reasonable possibility that a material misstatement of the Fund's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

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

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

Scott and Company LLP

Columbia, South Carolina
September 29, 2011