

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

DISTRICT OF COLUMBIA

UNEMPLOYMENT COMPENSATION FUND

**Financial Statements
(With Independent Auditors' Report Thereon)
Years Ended September 30, 2012, and 2011**



**CHARLES J. WILLOUGHBY
INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



February 28, 2013

The Honorable Vincent C. Gray
Mayor
District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Gray and Chairman Mendelson:

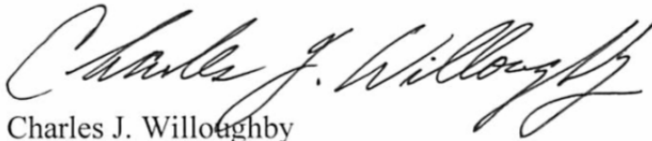
As part of our contract for the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2012, KPMG LLP (KPMG) submitted the enclosed final report on the District of Columbia Unemployment Compensation Fund (Fund) Financial Statements for years ended September 30, 2012, and 2011 (OIG No. 13-1-10BH).

KPMG opined that the financial statements present fairly, in all material respects, the respective financial position of the Fund, and respective changes in financial position and cash flows thereof for the years ended September 30, 2012, and 2011, in conformity with United States of America generally accepted accounting principles. In accordance with *Government Accounting Standards*, KPMG also issued its report on consideration of the Fund's internal control over financial reporting which identified no deficiencies in internal control considered to be material weaknesses. A material weakness is defined as follows: a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of an entity's financial statements will not be prevented, or detected and corrected on a timely basis. However, KPMG identified a deficiency considered to be a significant deficiency, as described in the accompanying schedule of findings and responses: SD2012-1. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Mayor Gray and Chairman Mendelson
Unemployment Compensation Fund Financial
Statements (with Independent Auditors' Report
Thereon) for FYs 2012 and 2011
OIG No. 13-1-10BH – Final Report
February 28, 2013
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If you have questions or need additional information, please contact Ronald W. King,
Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,



Charles J. Willoughby
Inspector General

CJW/ws

Enclosure

cc: See Distribution List

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Mayor Gray and Chairman Mendelson
Unemployment Compensation Fund Financial
Statements (with Independent Auditors' Report
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The Honorable Harold Rogers, Chairman, House Committee on Appropriations,
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Mr. Paul Geraty, CPA, Public Sector Audit Division KPMG LLP (1 copy)



**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

FINANCIAL STATEMENTS

September 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

**FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 and 2011
(in thousands)**

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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

The Mayor and the Council of the Government of the District of Columbia
Inspector General of the Government of the District of Columbia:

We have audited the accompanying statements of net assets of the Government of the District of Columbia's Unemployment Compensation Fund (the Fund) as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and statements of cash flows (here in after referred to as basic financial statements) for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express opinions on these basic 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 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 Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinions.

As discussed in Note 1, the basic financial statements of the Fund are intended to present the financial position and the changes in financial position and cash flows of the Fund. They do not purport to or present fairly the financial position of the Government of the District of Columbia as of September 30, 2012 and 2011, the changes in its financial position, or where applicable, its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the Fund as of September 30, 2012 and 2011, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 25, 2013 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 audit.



U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 4–10 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 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 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.

KPMG LLP

January 25, 2013

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS

SEPTEMBER 30, 2012 AND 2011
(in thousands)

This section of the annual financial report of the District of Columbia Unemployment Compensation Fund ("the Fund") presents our discussion and analysis of the financial performance of the fund during the fiscal year (FY) ended September 30, 2012 compared to fiscal year ended September 30, 2011. This discussion has been prepared by management and should be read in conjunction with the financial statements and note disclosures. The financial statements, disclosures and discussion and analysis are the responsibility of management.

Reporting Entity

The Fund was established by the Government of the District of Columbia (the District) to account for its unemployment compensation program. The Fund is administered by the District's Department of Employment Services. Substantially all administrative costs of the program are paid by a federal grant, which is recorded in the District's Fund.

Financial Statement Presentation

The Fund's basic financial statements consist of (a) statement of net assets; (b) statement of revenue, expenses, and changes in net assets, and (c) statement of cash flows.

■ Statement of Net Assets

The Statement of Net Assets represents the Fund's assets, liabilities, and net assets. Net assets are the difference between assets and liabilities. Over time, increases or decreases in the Fund's net assets may serve as a useful indicator of whether the Fund's financial position is improving or deteriorating.

■ Statement of Revenue, Expenses, and Changes in Net Assets

The Statement of Revenue, Expenses, and Changes in Net Assets represent information showing how the Fund's net assets have changed during the fiscal year. All changes in net assets are reported as soon as the event underlying the change occurs without respect to the timing of the related cash flows. Accordingly, the revenues and expenses reported in this statement for certain items will result in cash flow in future periods (e.g. accounts receivable and accrued liabilities).

■ Statement of Cash Flows

The Statement of Cash Flows represents information on sources and uses of cash for operations, noncapital financing, and investing activities.

Financial Highlight

The District's average unemployment rate for the FY ended September 30, 2012 was 9.53%, which was a 0.47% decreased compared to 10.0% in FY 2011. The Fund's net assets increased by \$7,986 or 3.6% in FY 2012 as compared to a \$11,352 or 4.87% decrease in FY 2011.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SEPTEMBER 30, 2012 AND 2011

(in thousands)

Overall Financial Analysis

Summary of Net Assets

	2012	2011	Change	2010	Change
Assets					
Cash Held with U.S. Treasury	\$309,802	\$313,190	(\$3,388)	\$322,826	(\$9,636)
Receivables	<u>18,012</u>	<u>17,511</u>	<u>501</u>	<u>23,646</u>	<u>(6,135)</u>
Total Assets	<u>\$327,814</u>	<u>\$330,701</u>	<u>(\$2,887)</u>	<u>\$346,472</u>	<u>(\$15,771)</u>
Liabilities					
Payables	\$63,767	\$75,656	(\$11,889)	\$79,531	(\$3,875)
Due to D.C. Government	<u>34,117</u>	<u>33,101</u>	<u>1,016</u>	<u>33,645</u>	<u>(\$544)</u>
Total Liabilities	<u>\$97,884</u>	<u>\$108,757</u>	<u>(\$10,873)</u>	<u>\$113,176</u>	<u>(\$4,419)</u>
Net Assets					
Restricted for Unemployment Compensation Benefits	\$229,930	\$221,944	\$7,986	\$233,296	(\$11,352)

- The Fund's largest asset is the cash held with U.S. Treasury, which represented 94.51 % of the Fund's total assets. The FY 2012 cash balance decreased by \$3,388 or 1.08% as a result of unemployment benefits payments exceeding the cash receipts from employer taxes and governmental agencies. The FY 2011 cash balance decreased by \$9,636 or 2.98% from FY 2010.
- For FY 2012, Receivables, net of allowance for doubtful accounts, increased by \$501 or 2.86%. The Fund's receivables consist of amounts owed from the Federal government and other states for unemployment benefits paid, employers for unpaid taxes, and claimants for unemployment benefit overpayments. In FY 2011, there was a net decrease in receivables of \$6,135 or 25.95% from FY 2010.
- The Fund's total liabilities for FY 2012 decreased by \$10,873 or 10.0% as compared to a decrease of \$4,419 or 4.0% in FY 2011. Amounts due to claimants for unemployment benefits comprise a major portion of the payables. For FY 2012, claimants Payable estimated at \$52,400 was decreased by \$8,741 or 14.3% from prior year as a result of fewer claims being filed from the prior year. For FY 2011, claimants' payable estimated at \$61,141 was decreased by \$ 5,811 or 8.68% from FY 2010.
- Due to D.C. Government represents amounts owed to the District for unemployment benefits and employer tax refunds paid on behalf of the Fund. For FY 2012, the Fund's payables to DC Government increased by \$1,016 or 3.07% as compared to FY 2011. In FY 2011, there was a decrease of \$544 or 2.0% from FY 2010 in payables to the DC Government. At September 30, 2012, the unspent Reed Funds totaled \$31,212 compared to \$32,244 at September 30, 2011. The Reed fund is received from the federal government through Reed Act Account to be used for paying the trust fund administrative costs other than benefit payments.
- For FY 2012, the Fund's current assets of \$327,814 were sufficient to cover current liabilities of \$97,884, a ratio of \$3.35 dollars in assets for every dollar in liabilities. For FY 2011, the total current assets and current liabilities of the fund were \$ 330,701 and \$108,757 respectively; a ratio of \$3.04 in assets for every dollar in liabilities.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SEPTEMBER 30, 2012 AND 2011

(in thousands)

Summary of Revenues, Expenses, and Changes in Net Assets

	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>2010</u>	<u>Change</u>
Revenues:					
Employer Taxes	\$133,618	\$128,876	\$4,742	\$129,470	(\$594)
Governmental Contributions	27,945	35,329	(\$7,384)	36,998	(1,669)
Total Revenue	<u>\$161,563</u>	<u>\$164,205</u>	<u>(\$2,642)</u>	<u>\$166,468</u>	<u>(\$2,263)</u>
Expenses:					
Unemployment Benefits	\$344,913	\$409,920	(\$65,007)	\$480,976	(\$71,056)
Operating Loss	(\$183,350)	(\$245,715)	\$62,365	(\$314,508)	\$68,793
Non-operating Revenues:					
Interest Revenue	\$8,495	\$11,743	(\$3,248)	\$13,532	(\$1,789)
Federal Contributions	182,552	222,620	(\$40,068)	229,498	(6,878)
Other Revenue	289	0	289	0	0
Total Non-operating Revenues	<u>\$191,336</u>	<u>\$234,363</u>	<u>(\$43,027)</u>	<u>\$243,030</u>	<u>(\$8,667)</u>
Change in Net Assets	\$7,986	(\$11,352)	\$19,338	(\$71,478)	\$60,126
Total Net Assets - Beginning	221,944	233,296	(\$11,352)	304,774	(71,478)
Total Net Assets - Ending	<u>\$229,930</u>	<u>\$221,944</u>	<u>\$7,986</u>	<u>\$233,296</u>	<u>(\$11,352)</u>

Revenues

In FY 2012, the Fund's operating revenue totaled \$161,563 compared to \$164,205 in FY 2011. In FY 2010 the operating revenue was \$166,468. Operating revenues decreased by 1.61% from FY 2011 to FY 2012 and decreased by 1.36% from FY 2010 to FY 2011. This is due to a decrease in governmental contributions as the number of former employees filed for unemployment benefits changes. Federal and other governments reimburse the Fund 100% for benefits paid to their former employees. Operating revenue came primarily from employer taxes.

Revenues from all sources (operating and non-operating) totaled \$352,899 in FY 2012, \$398,568 for FY 2011 compared to \$409,498 in FY 2010. The following schedule shows sources of operating revenue for the Fund in FY 2012 and 2011:

Revenue Source	FY	FY 2011
Employer Taxes	\$ 133,618	\$ 128,876
Other States' Contributions	7,034	6,702
Federal Government Reimbursement	8,708	12,302
Reimbursement from the District Government	12,203	16,325
Total	\$ 161,563	\$ 164,205

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

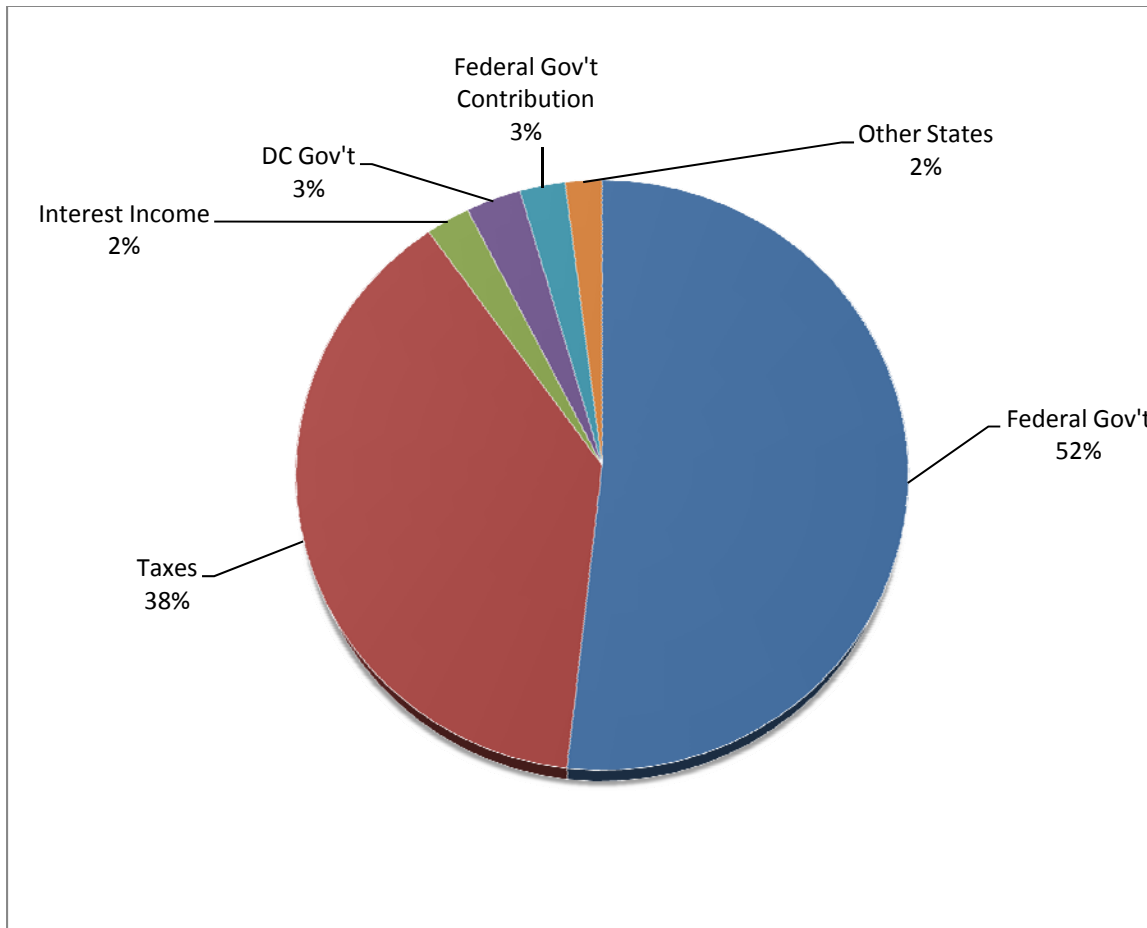
SEPTEMBER 30, 2012 AND 2011

(in thousands)

In FY 2012, the Fund's sources of non-operating revenue consist of interest income of \$8,495, extended benefits of \$182,538, Federal stimulus contribution of \$14 and other revenue of \$289. The non-operating revenue for FY 2011 was consisted of interest income of \$11,743, extended benefits of \$219,087, and stimulus contribution of \$3,533. Total non-operating revenue in FY 2012 was \$191,336 compared to \$234,363 in FY 2011. The net decrease in non-operating revenue is due to the fact that the Federal stimulus contribution lapsed, except for those claimants who were already in the program.

Figures 1 and 2 show the percentage of revenues received during FY 2012 and 2011 from the Fund's different sources. In both fiscal periods, the largest source of revenue was from the Federal government for temporary and extended unemployment compensation (TEUC) which represents 52% in 2012 and 55% in 2011 of total revenues.

Figure 1: Total Revenues (Operating and Non-Operating) for the year ended September 30, 2012



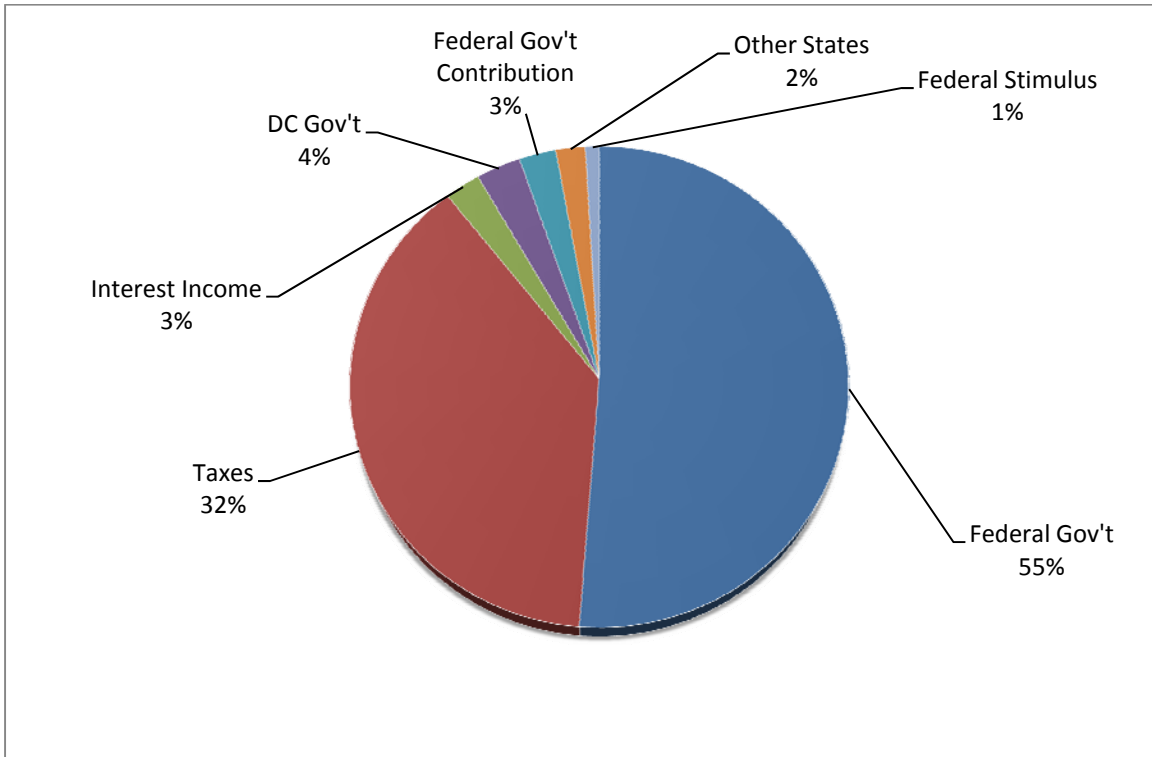
**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SEPTEMBER 30, 2012 AND 2011

(in thousands)

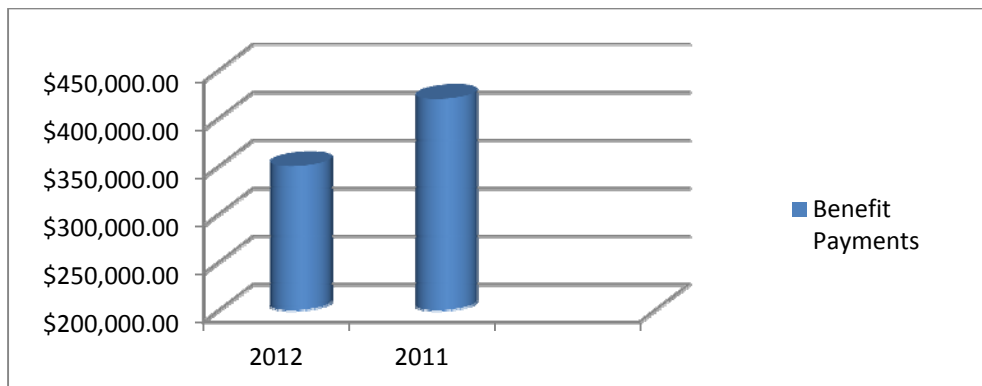
Figure 2: Total Revenues (Operating and Non-Operating) for the year ended September 30, 2011



Expenses

The Fund's only operating expense is unemployment benefit payments. Figure 3 shows the comparison of benefits payments in FY 2012 and FY 2011.

Figure 3: Total Operating Expenses for the years ended September 30, 2012 and 2011



**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SEPTEMBER 30, 2012 AND 2011
(in thousands)

In FY 2012, the Fund's unemployment benefits (payments) decreased by \$65,007 or 15.86% as compared to a decrease of \$71,056 or 14.77% in FY 2011. The drop in benefit payments was attributed to a reduction in the number of weeks eligible to be paid from 99 to 63 weeks in FY 2011 and FY 2012, a 36% decline, which was triggered by the decreases in the monthly unemployment rate throughout FY 2012.

Figure 4: Shows District's unemployment rate by Month for the Year Ended September 30, 2012

FY 2012 Average Unemployment Rate					9.53%
Current Year	Month	Labor Force	Number of Employed	Number of Unemployed	Unemployment Rate (%)
2011	Oct	343,911	308,525	35,386	10.3
2011	Nov	344,622	309,541	35,081	10.2
2011	Dec	345,328	310,557	34,771	10.1
2012	Jan	346,567	312,157	34,410	9.9
2012	Feb	347,810	313,554	34,256	9.8
2012	Mar	348,625	314,489	34,136	9.8
2012	Apr	349,685	316,431	33,254	9.5
2012	May	352,149	319,283	32,866	9.3
2012	Jun	354,112	321,954	32,158	9.1
2012	Jul	353,809	322,148	31,661	8.9
2012	Aug	354,020	322,847	31,173	8.8
2012	Sep	357,296	326,388	30,908	8.7

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SEPTEMBER 30, 2012 AND 2011
(in thousands)

Figure 5: Shows District's unemployment rate by Month for the Year Ended September 30, 2011

FY 2011 Average Unemployment Rate					10.0%
Current Year	Month	Labor Force	Employment	Number of Unemployed	Unemployment Rate (%)
2010	Oct	331,197	299,071	32,126	9.7
2010	Nov	331,030	299,052	31,978	9.7
2010	Dec	331,150	299,272	31,878	9.6
2011	Jan	332,378	300,571	31,807	9.6
2011	Feb	334,289	302,678	31,611	9.5
2011	Mar	334,366	302,566	31,800	9.5
2011	Apr	334,694	302,547	32,147	9.6
2011	May	334,641	301,770	32,871	9.8
2011	Jun	332,680	298,171	34,509	10.4
2011	Jul	331,143	295,315	35,828	10.8
2011	Aug	330,368	293,710	36,658	11.1
2011	Sep	332,237	295,171	37,066	11.2

Contact Information

This financial report is designed to provide a general overview of the Fund's finances. Questions concerning any information provided in this report, or requests for additional financial information, should be addressed to the Office of the Chief Financial Officer; Government of the District of Columbia; 1350 Pennsylvania Avenue, NW; Washington, D.C., 20004.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2012 AND 2011
(in thousands)

	<u>2012</u>	<u>2011</u>
Current Assets:		
Cash Held With U.S. Treasury (note 2)	\$309,802	\$313,190
Accounts Receivable, Net (note 3)	17,688	17,014
Due From Federal Government (note 4)	<u>324</u>	<u>497</u>
Total Current Assets	<u>\$327,814</u>	<u>\$330,701</u>
Current Liabilities:		
Accounts Payable (note 5)	\$11,367	\$14,515
Claimants Payable (note 6)	52,400	61,141
Due To D.C. Government (note 7)	<u>34,117</u>	<u>33,101</u>
Total Current Liabilities	<u>\$97,884</u>	<u>\$108,757</u>
Net Assets:		
Restricted for Unemployment Compensation Benefits	<u>\$229,930</u>	<u>\$221,944</u>

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

GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED SEPTEMBER 30, 2012 AND 2011
(in thousands)

	<u>2012</u>	<u>2011</u>
Operating Revenues:		
Employer Taxes	\$133,618	\$128,876
Other States' Reimbursements	7,034	6,702
Federal Reimbursements	8,708	12,302
District Reimbursements	<u>12,203</u>	<u>16,325</u>
Total Operating Revenues	<u>\$161,563</u>	<u>\$164,205</u>
Operating Expenses:		
Unemployment Benefits	<u>\$344,913</u>	<u>\$409,920</u>
Total Operating Expenses	<u>\$344,913</u>	<u>\$409,920</u>
Operating Loss	(\$183,350)	(\$245,715)
Non-operating Revenues:		
Federal Extended Benefit Contributions	\$182,538	\$219,087
Interest Revenues	\$8,495	\$11,743
Federal Stimulus Contributions	14	3,533
Other Revenue	<u>289</u>	<u>0</u>
Total Non-Operating Revenues	<u>\$191,336</u>	<u>\$234,363</u>
Change in Net Assets	\$7,986	(\$11,352)
Total Net Assets - Beginning	<u>\$221,944</u>	<u>\$233,296</u>
Total Net Assets - Ending	<u><u>\$229,930</u></u>	<u><u>\$221,944</u></u>

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

GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 2012 AND 2011
(in thousands)

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities:		
Cash Receipts from Employers	\$132,944	\$128,876
Cash Receipts from Federal Government	8,881	12,302
Cash Receipts from District Government	12,203	16,325
Cash Receipts from Other States	7,034	6,702
Cash Payments to Claimants	<u>(\$355,497)</u>	<u>(\$408,204)</u>
Net Cash Used in Operating Activities	<u>(\$194,435)</u>	<u>(\$243,999)</u>
 Cash Flows from Investing Activities:		
Interest Income Received	<u>8,495</u>	<u>11,743</u>
Net Cash Provided by Investing Activities	<u>\$8,495</u>	<u>\$11,743</u>
 Cash Flows from Noncapital Financing Activities:		
Federal Extended Benefit Contributions	\$182,538	\$219,087
Federal Stimulus Contributions	<u>14</u>	<u>3,533</u>
Net Cash Provided by Noncapital Financing Activities	<u>\$182,552</u>	<u>\$222,620</u>
 Net Decrease in Cash	(\$3,388)	(\$9,636)
 Cash, Beginning of Year	<u>\$313,190</u>	<u>\$322,826</u>
 Cash, Ending of Year	<u><u>\$309,802</u></u>	<u><u>\$313,190</u></u>
 Reconciliation of Operating Loss to Net Cash Used in Operating Activities:		
Operating Loss	(\$183,350)	(\$245,715)
Other Revenue	289	0
Increase in Assets:		
Receivables	(674)	6,135
Due from Federal Gov't	173	0
Increase in Liabilities:		
Payables	<u>(10,873)</u>	<u>(4,419)</u>
Net Cash Used in Operating Activities	<u><u>(\$194,435)</u></u>	<u><u>(\$243,999)</u></u>

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

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2012 AND 2011
(in thousands)

NOTE 1 NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities: Pursuant to Federal law, the Government of the District of Columbia (the District) maintains an Unemployment Compensation Fund (the Fund). The Fund pays up to 26 weeks of regular statutory benefits to eligible unemployed former employees of the District of Columbia or the Federal government. The Fund currently pays extended benefits to eligible claimants who have exhausted their regular 26 weeks of benefits under a federal reimbursement program.

The Fund Operating Revenue consists of employer taxes and reimbursements from governmental agencies for regular unemployment benefits paid to former employees.

Included in the Non-operating Revenue is the Emergency Unemployment Compensation benefit (EUC), which is a 100% federally funded program that provides benefits to individuals who have exhausted regular state benefits. The EUC program was created on June 30, 2008 and has been modified several times and extended to January 1, 2014. The extended benefits payments beyond the 26 weeks base period have to be authorized by the Federal Government. When this happens, the states are reimbursed by the Federal Government to cover the benefits. Also, included in the Non-operating Revenue is the interest generated by the Fund.

The Fund is administered by the Director of the District's Department of Employment Services. Substantially all administrative costs of the program are paid by a Federal grant, which is recorded in the District's General Fund. These financial statements present only assets, liabilities, revenues, and expenses of the Fund and are not intended to present the financial position and results of operations of the Government of the District of Columbia taken as a whole.

Basis of Presentation: The Fund's financial statements are presented in accordance with U.S. generally accepted accounting principles (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB).

Basis of Accounting: The accompanying financial statements are prepared on the accrual basis of accounting. Under this accounting method, all revenues are recognized when earned and expenses are recognized as incurred in the production of that revenue.

The Fund has elected, as allowed in paragraph 7 of GASB *Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, not to follow Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principle Board Opinions, and Accounting Research Bulletins of the Committee of Accounting Procedure issued subsequent to November 30, 1989. The Fund applies all applicable FASB pronouncements issued on or prior to November 30, 1989 in accounting for and reporting its operations, unless these pronouncements conflict with GASB pronouncements.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2012 AND 2011
(in thousands)

Measurement Focus: The financial statements are accounted for on a flow of economic resources measurement focus, wherein all assets and liabilities are included in the Statement of Net Assets. The related Statement of Revenue, Expenses, and Changes in Net Assets present increases (revenues) and decreases (expenses) in net assets.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 CASH HELD WITH U.S. TREASURY

The Fund's cash is held at the U.S. Department of Treasury (the Treasury) in a trust fund in the District's name. Pursuant to the Social Security Act, the funds held at the Treasury earn interest quarterly based on the interest rates of the Treasury's Certificates of Indebtedness. Interest earned in 2012 and 2011 was \$8,495 and \$11,743, respectively. At September 30, 2012, cash held at the Treasury was \$309,802 compared to \$313,190 at September 30, 2011.

NOTE 3 ACCOUNTS RECEIVABLE, NET

The Fund's accounts receivables consists of the following at September 30, 2012 and 2011 (in thousands):

	<u>2012</u>	<u>2011</u>
Employer Receivables	\$ 9,901	\$ 10,504
Claimant Receivables	18,432	13,803
Due from Other Funds/States	<u>4,229</u>	<u>4,216</u>
Total Receivables	\$32,562	\$28,523
Less: Allowance for Doubtful Accounts	<u>(14,874)</u>	<u>(11,509)</u>
Accounts Receivable, Net	<u>\$ 17,688</u>	<u>\$ 17,014</u>

Employer contributions are recognized as revenues in the accounting period in which they become due and measurable. Any contributions not received within the accounting period are recognized as Employer Receivables. Claimants receivable are benefits paid to claimants who ultimately are proven to be ineligible to receive all or a portion of those benefits. The Fund recognizes a receivable from these claimants when the benefits overpayment is identified. Due from other funds at September 30, 2012 is the amount owed to the Fund from the District. Aging of the receivables is used to estimate and establish an allowance for doubtful accounts. Employer tax receivables over two years old are recorded as Allowance for Doubtful Accounts as well as claimants' receivable over 450 days old.

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
UNEMPLOYMENT COMPENSATION FUND**

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2012 AND 2011
(in thousands)

NOTE 4 DUE FROM FEDERAL GOVERNMENT

At September 30, 2012 the amount due from the federal government for extended benefits is \$324 as compared to \$497 in FY 2011.

NOTE 5 ACCOUNTS PAYABLE

At September 30, 2012 and 2011, the Fund had payables to employers for taxes overpaid, various States for unemployment benefits paid to former District employees, and others for Fund related activities.

	2012	2011
Employer Tax Refund Payable	\$4,258	\$3,666
Income Tax Payable	244	1,737
Due to Other States	3,690	6,127
Others	3,175	2,985
Total Accounts Payable	\$11,367	\$14,515

NOTE 6 CLAIMANTS PAYABLE

Claimants Payables are estimated amounts due to claimants for the remaining periods of eligibility that are payable the following FY. The Claimant Payables as of September 30, 2012 and 2011 were \$52,400 and \$61,141, respectively.

NOTE 7 DUE TO D.C. GOVERNMENT

The amounts reported as “Due to DC Government” consist of Reed Act funds obligated for administrative costs, and interest and penalties assessed and collected from employers for late tax payments but not yet paid to the District. The amounts payable to the District as of September 30, 2012 and 2011 are \$34,117 and \$33,101, respectively.

NOTE 8 COMMITMENTS AND CONTINGENCIES

At September 30, 2012, there are matters of ongoing withholding tax issues with IRS involving the Unemployment Compensation Trust Fund for the amount of \$171. However, this amount is accrued in case the decision is unfavorable.



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

The Mayor and the Council of the Government of the District of Columbia
Inspector General of the Government of the District of Columbia:

We have audited the basic financial statements of the Government of the District of Columbia's Unemployment Compensation Fund (the Fund) as of and for the year ended September 30, 2012 and 2011, and have issued our report thereon dated January 25, 2013. 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

Management of the Fund is responsible for establishing and maintaining effective 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 basic 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 over financial reporting 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 over financial reporting, 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.

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. However, we identified certain deficiencies in internal control over financial reporting that we consider to be a significant deficiency and that is described in the accompanying schedule of findings and responses: SD2012-1. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 audits, 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*

We noted certain matters that we reported to management of the Fund in a separate letter dated January 25, 2013.

The Fund's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Fund's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, the Mayor, members of the Council and the Inspector General of the Government of the District of Columbia, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 25, 2013

Schedule of Findings and Responses

SD2012-1 Weaknesses in the Fund's General Information Technology Controls

Background:

General Information Technology Controls (GITCs) provide the foundation for a well-controlled technology environment that supports the consistent processing and reporting of operational and financial data in accordance with management's directives. Our audit included an assessment of selected GITCs in four (4) key control areas: Access to Programs and Data, Program Changes, Program Development, and Computer Operations. Our fiscal year 2012 audit, the following findings were identified.

Conditions:

1. Failure to institute well-designed program change policies that establish procedural and documentation requirements for authorizing, developing, testing, and approving changes to key financial applications and related infrastructure software¹ in the production environment.
2. Inconsistent adherence to established program change management procedures, including instances in which changes made to the system were not approved, tested or documented appropriately per the established procedures.
3. Failure to consistently restrict developer access to the production environments of key financial applications in accordance with segregation of duties considerations or, if not feasible, implement independent monitoring controls to help ensure changes applied to the production environment are authorized.

Criteria:

1. The Federal Information Security Management Act (FISMA), passed as part of the Electronic Government Act of 2002, mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST). The following NIST criteria were considered:
 - a. NIST SP 800-12, An Introduction to Computer Security: The NIST Handbook, October 1995;
 - b. NIST SP 800-53, Revision 3, Recommended Security Controls for Federal Information Systems and Organizations, August 2009;
 - c. NIST SP 800-64, Security Considerations in the System Development Life Cycle, October 2008; and
 - d. NIST SP 800-14, Generally Accepted Principles and Practices for Securing Information Technology, September 1996.

¹ Infrastructure changes refer to software changes and updates applied to underlying operating systems and databases supporting the key financial applications.

- e. The Information Systems Audit Control Association (ISACA) Control Objectives for Information and related Technology (COBIT®) 4.1, 2007.

Cause/Effect:

The findings highlighted above include weaknesses in both the design and operating effectiveness of controls considered relevant to the access to programs and data, program changes, program development, and computer operations areas. Although management has made progress remediating previous findings, additional improvements in formalizing key GITC processes and creating an effective monitoring function are needed. The existence of these conditions increases the risk that unauthorized changes applied to key financial applications and the data they process adversely affect application processing and data integrity and, as a result, may impact the financial statements. Additionally, the existence of these findings impacts the reliability of key application reports and the ability to rely upon automated, configurable controls embedded within key financial applications.

Recommendation:

Related to Program Change controls, we recommend that Fund management:

- a. Develop and implement change management processes and controls that establish one or more of the following:
 - i. Organizational and logical segregation of program development roles from production system and database administration roles among different individuals; and
 - ii. Implementation of one or more independently operated monitoring controls over the activities of the developers (and other individuals) with administrative access that require the documentation of monitoring activities as well as follow up on any suspicious behavior within the system. Documentation of these monitoring controls should be maintained and include sign-off of the review as well as notations as to the appropriateness of the actions taken by the developers within the database. Further, any suspicious activity, such as modifications to functionality or data without corresponding change request approvals, should be followed-up upon, as necessary.
 - iii. Additionally, management should continue to document the performance of User Acceptance Testing (UAT).
- b. Configure settings or implement monitoring tools to log changes made to application functionality, including all configuration changes.

Fund Management Response:

System administrator used his discretion due to the nature of system change. The policy will however be re-enforced to ensure that all program changes go through appropriate testing, documentation and authorization whenever such is required.

Users who had access to datasets in question had their roles transitioned to a different group and hence, no longer needed such access. Others served as back administrators. Affected users' accesses were removed as part of our October system access review exercise.