

## INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

Mr. Thomas L. Wagner, Jr., CPA  
State Auditor  
State of South Carolina  
Columbia, South Carolina

Dear Mr. Wagner:

We have audited the financial statements of the South Carolina State Budget and Control Board, Employee Insurance Programs (the "Fund") as of and for the year ended June 30, 2002, and have issued our report thereon dated September 25, 2002. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

The management of the Fund is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of combined financial statements in accordance with accounting principles generally accepted in the United States of America. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Fund for the year ended June 30, 2002, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. Accordingly, we do not express such an opinion or provide such assurance. With respect to the internal control, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention related to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

Our consideration of the internal control would not necessarily disclose all matters in the internal control components that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the combined financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted the following matter involving internal control and its operation that we consider to be a material weakness as defined above.

During 2001/2002, the Employee Insurance Programs Fund reported an increase in net assets of \$6,085,825. This income, along with losses in recent years, has resulted in liabilities exceeding assets of \$63,952,116 for the Fund at June 30, 2002. Additionally, Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended, stipulates that "a reserve equal to not less than an average of one and one-half months' claims must be maintained in the accounts and all funds in excess of the reserve must be used to reduce premium rates or expand benefits as funding permits." Under Proviso 63.15 the reserve requirement was changed. The Proviso reads "Notwithstanding any other provision of law, the State Health Plan is only required to seek a zero day reserve fund by the end of calendar year 2002. Although certain changes in the funding and coverages have taken place, there is no guarantee that the Fund will return to a surplus position or that cash will be adequate to cover claims and administrative costs. Additional funding sources, such as further rate increases, State appropriations, etc. may be necessary to provide for the costs of the continued existence of the Plan.

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This report is intended solely for the information of the State Auditor, management and others within the Organization and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

September 25, 2002