

**SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS**

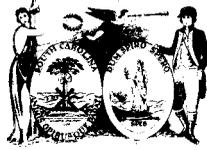
**AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION**

YEAR ENDED JUNE 30, 2003

WITH

REPORT OF INDEPENDENT AUDITORS

State of South Carolina



Office of the State Auditor

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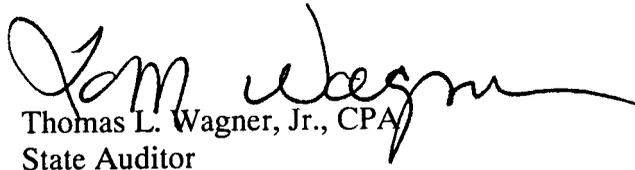
October 20, 2003

The Honorable Mark Sanford, Governor
and
Members of the South Carolina State Budget and Control Board
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Budget and Control Board Office – Employee Insurance Programs for the fiscal year ended June 30, 2003, was issued by DeLoach & Williamson, L.L.P., 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,


Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/trb

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

YEAR ENDED JUNE 30, 2003

WITH

REPORT OF INDEPENDENT AUDITORS

CONTENTS

Report of Independent Auditors	1
Management's Discussion and Analysis	3
Basic Financial Statements	
Statement of Net Assets	13
Statement of Activities	14
Statement of Revenue, Expenditures, and Changes in Fund Balances-Governmental Funds.....	15
Statement of Net Assets-Proprietary Fund	16
Statement of Revenue, Expenses, and Changes in Net Assets-Proprietary Fund.....	17
Statement of Cash Flows-Proprietary Fund.....	19
Notes to Financial Statements	21
Other Financial Information	
Statement of Expenditures - Budget and Actual-All Budgeted Funds	57
Independent Auditors' Report on Internal Control	
Independent Auditors' Report on Internal Control.....	58

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying financial statements of the governmental activities of the South Carolina State Budget and Control Board, Employee Insurance Programs (the "Fund") as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the management of the South Carolina State Budget and Control Board, Employee Insurance Programs. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in *Note 1*, the accompanying financial statements of the South Carolina State Budget and Control Board, Employee Insurance Programs are intended to present the financial position and results of operations of its governmental and proprietary fund types and cash flows of its proprietary fund type of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the funds of the South Carolina State Budget and Control Board, Employee Insurance Programs. They do not purport to, and do not, present fairly the financial position of the State of South Carolina as of June 30, 2003 and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in *Note 17*, the Fund has experienced a net reduction in equity of approximately \$163,114,259 over the past five years which has resulted in a significant equity deficit. See *Note 17* for additional information.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the South Carolina State Budget and Control Board, Employee Insurance Programs, as of June 30, 2003, and the results of operations and cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2003, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's discussion and analysis is not a part of the basic financial statements, but is supplementary information required by the *Governmental Accounting Standards Board (GASB)*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Robert S. Williamson, C.C.P.

September 26, 2003

Management Discussion & Analysis

This section of the South Carolina State Budget and Control Board, Employee Insurance Program (EIP) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of EIP's financial performance during the fiscal year ended June 30, 2003. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

Fiscal Year ending June 30, 2002 was the first year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. The financial statement presentation required by GASB Statement 34 provides a comprehensive perspective of EIP's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

Financial Highlights

- Proprietary Fund Activities reported a change in net assets of \$3,129,299 for the year ended June 30, 2002 and negative net assets of \$69,614,594 at year end. For the year ended June 30, 2003, Business-Type Activities reported a change in net assets of negative \$10,300,236 and total net assets at year end of negative \$79,914,830.
- Governmental Fund Activities (Senior Drug Program) was transferred to the Department of Health and Human Services effective July 1, 2002. For administrative purposes, EIP continued paying claims through February 18, 2003. As of June 30, 2002, the Senior Drug Program reported positive net assets of \$5,662,478. The Senior Drug Program has a zero net assets balance as of June 30, 2003.

Overview of Financial Statements

The Employee Insurance Program is an internal service fund proprietary type engaged primarily in governmental activities. EIP administered the Senior Drug Program, a Governmental Activity, through February 2003. Following is a condensed Statement of Net Assets and a condensed Statement of Revenue, Expenses, and Changes in Net Assets and a condensed Statement of Cash Flows.

The Statement of Net Assets presents the financial position of EIP at the end of the fiscal year and requires classification of assets and liabilities into current and noncurrent categories. The difference between total assets and total liabilities is reflected in the net assets section, which displays net assets in three categories: invested in capital assets (net of related debt), restricted, and unrestricted. Net assets are one indicator of the current financial condition of EIP, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. The primary contributing factor of the change in net assets as of June 30, 2003 is the increase of Incurred but Not Reported (IBNR) liability and year end claims payable.

The Statement of Revenues, Expenses, and Changes in Net Assets present revenues and expenses as operating and are detailed by classification.

The Statement of Cash Flows will aid readers in identifying the sources and uses of cash by the categories of operating, capital and related financing, non-capital financing, and investing activities.

Financial Analysis of EIP

This schedule is a condensed version of EIP's assets, liabilities, and net assets and is prepared from the Statement of Net Assets.

**Net Assets
as of June 30, 2003
(in millions)**

	June 30,	
	2003	2002
Current assets	\$ 92.8	\$ 73.6
Non-current assets	22.6	21.3
Total assets	115.4	94.9
Current liabilities	195.0	158.6
Non-current liabilities	0.3	0.2
Total liabilities	195.3	158.8
Net assets:		
Restricted-Senior's Drug Program	-	5.7
Investment in capital assets, net of related debt	-	-
Unrestricted	(79.9)	(69.6)
Total net assets	\$ (79.9)	\$ (63.9)

The following schedule is a summary of the EIP's operating results for the fiscal year.

Statement of Activities
(In millions)

	Year Ended June 30,	
	2003	2002
Governmental Activities:		
Program revenue	\$ 1,178.5	\$ 1,070.0
Expenses	(1,198.9)	(1,074.5)
Total governmental activities	(20.4)	(4.5)
General Revenue and Transfers:		
Appropriations	-	0.1
Earnings on investments	7.3	11.2
Miscellaneous	0.2	0.2
Transfers to other agencies	(3.1)	(0.8)
Total general revenue and transfers	4.4	10.7
Change in net assets	(16.0)	6.1
Net assets, beginning of year	(64.0)	(70.0)
Net assets, end of year	\$ (79.9)	\$ (64.0)

The EIP's net assets have been restated as of July 1, 2001 due to a change in the capitalization level of assets.

A condensed version of Statement of Cash Flows is presented as follows:

Condensed Statement of Cash Flows
(In millions)
(Business-Type Activities)

	Year Ended	
	June 30,	
	2003	2002
Cash Flows from Operating Activities	\$ 11.2	\$ 15.5
Cash Flows from Noncapital Financing Activities	(0.9)	(0.7)
Cash Flows from Investing Activities	6.1	1.9
Net increase in cash and cash equivalents	<u>16.4</u>	<u>16.7</u>
Cash and cash equivalents, beginning of year	<u>44.4</u>	<u>27.7</u>
Cash and cash equivalents, end of year	<u>\$ 60.8</u>	<u>\$ 44.4</u>

Overview of EIP:

The Employee Insurance Program (EIP) manages group health, dental, life, accidental death and dismemberment and disability programs as authorized in § 1-11-710 and § 1-11-720 of the South Carolina Code of Laws. Also managed by EIP is the long-term care program as authorized in § 1-11-740 of the South Carolina Code of Laws.

Following is a listing of benefits offered by EIP differentiated according to self-insured versus fully-insured status.

Self-Insured Programs

- State Health Plan (medical, prescription drug and behavioral health)
- MUSC Options (HMO)
- Companion (HMO)
- Companion (POS)
- CIGNA (HMO)
- CIGNA (POS)
- State Dental Plan
- Basic Long Term Disability

Fully-Insured Programs

- Dental Plus
- State Life
- Optional Life
- Dependent Life
- Long Term Care
- Supplemental Long Term Disability

Benefits are offered to eligible employees and retirees of State agencies, school districts, local governments and other enterprises. The State Health Plan is the significant driver of EIP's financial activity, accounting for over 90% of all revenue. Premium revenue is shared between the employer and the enrollee (employee or retiree). For 2003, this split was 76% employer/24% enrollee, compared to 82% employer/19% enrollee in 2002.

Following is a look at total enrollment in the State’s medical insurance programs and the enrollment in the State Health Plan (as of June 2003).

	<u>Program</u>	<u>State Health Plan</u>
Total Insured Persons:	417,166	372,188
Subscribers:	235,553	207,735
Spouses:	65,149	60,198
Children:	116,464	104,255
Total Subscribers:	235,553	207,735
Employees:	178,074	151,433
Retirees:	53,305	52,274
Survivors:	2,749	2,718
COBRA:	1,425	1,310
Active Employees:	178,074	151,433
State Agencies:	65,067	53,700
School Districts:	79,240	71,188
Local Government:	27,521	22,450
Enterprises:	6,246	4,095

A short historical review of the State Health Plan’s financial experience on a Plan year basis (January through December) indicates five consecutive years of net losses, preceded by seven consecutive years of net gains. Even without rate increases in each of Plan years 1994, 1995 and 1996, Plan income exceeded expenses. For Plan years 1997 and 1998, contributions remained constant, with the expectation of operating losses. These losses were “planned” to spend down or reduce accumulated cash reserves, at the direction of State budget writers, because even with losses, cash reserves were expected to remain within statutory parameters. Beginning in Plan year 1999, claims expenses began to surge unexpectedly. This dramatic change in claims trend was not unique to the State Health Plan, but rather one that was experienced throughout the health insurance industry.

The State’s budget process calls for budget requirements for the upcoming calendar year to be estimated at the outset of the prior year. Because of this timing, 2000 contribution rates were estimated and 1999 rates already established based on 1998 claims data, not knowing that the surge was about to occur.

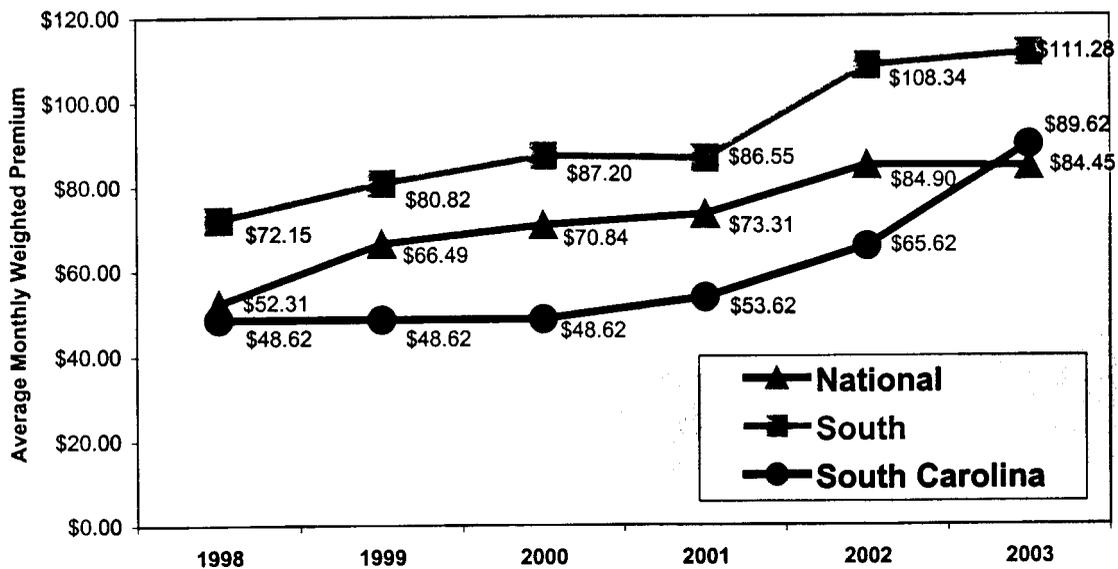
Losses continued for Plan years 1999 and 2000. And, while Plan years 2001 and 2002 saw modest gains, the State Health Plan reserve balance has been depleted in its entirety.

Following is a look at employer and enrollee contribution increases implemented since Plan year 1999.

	<u>Employer</u>	<u>Enrollee</u>	<u>Total</u>
1999	18.0%	-0-	14.0%
2000	10.0%	-0-	8.0%
2001	20.0%	10.3%	18.2%
2002	9.5%	22.4%	11.7%
2003	-0-	36.6%	6.8%

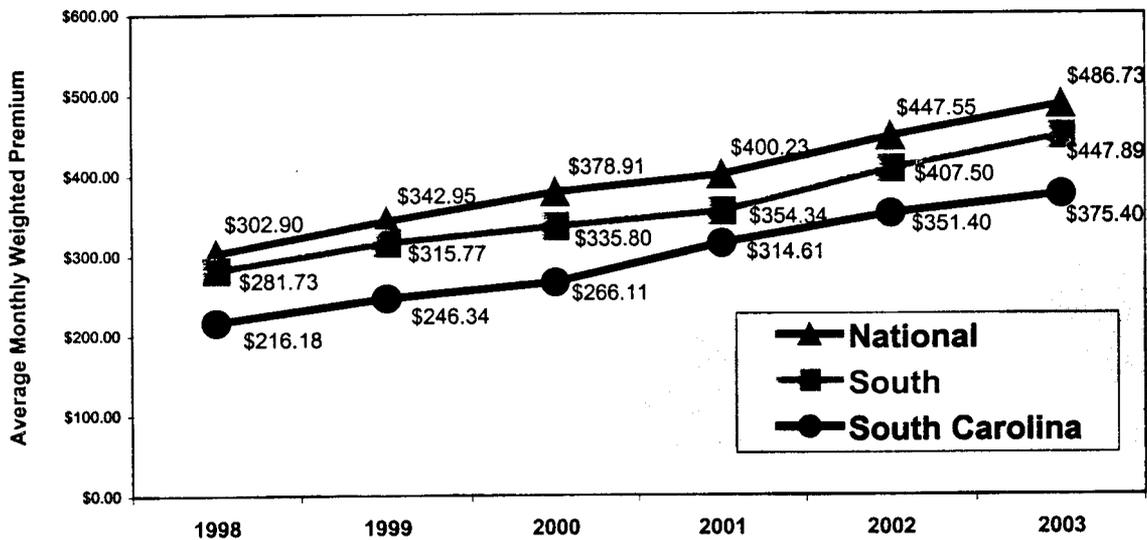
The employee premium paid by State Health Plan enrollees is now higher than the national average, but still well below the regional average. Below is a comparative graph of the State Health Plan average weighted employee premiums compared to regional and national averages.

Average Weighted Employee Premiums for State Health Plan Compared to Regional and National Averages



While rates have been rising, the combined employer and enrollee State Health Plan premium continues to be below both regional and national averages. Below is a comparative graph of the combined enrollee and employer average weighted premiums for the State Health Plan compared to regional and national averages.

Combined Employee and Employer Average Weighted Premiums for State Health Plan compared to Regional and National Averages



In addition to annual contribution increases, material provider reimbursement cuts and reductions in benefits were implemented for Plan years 2000 and 2001, respectively. Despite these measures, claims trend continues to rise. Analysis of Plan payout growth per person during the period 1994 through 1998 averaged 5.3%. In 1999, the payout growth reached 8.9%, for 2001 that growth was 11.5% and current growth estimate for 2002 is 10.2%. Prescription drugs are responsible for roughly half of the growth in expense from 1997 through 2001. With the exception of prescription drugs and physician office visits, payment per service episode has either declined or remained virtually static. Even so, payments for these services are increasing as well, because of service volume growth. The Plan is also experiencing accelerated claims growth in certain disease categories in comparison to others and prescription drug expense continues to balloon. Prescription drugs accounted for 23% of total claims expense in 2001 compared to 13% in 1997 and continues to accelerate, reaching 25% for 2002. The growth in prescription drugs is attributed to the substantial increase in users per enrollees, prescription per enrollee, and cost per prescription. A major factor driving this growth is the result of heavily marketed drugs by the pharmaceuticals. These marketed drugs account for the highest State Health Plan volume.

State Health Plan 2003 Initiatives:

No new employer funding was appropriated for Plan year 2003. This being the case, and in order to maintain a zero reserve balance during 2003, \$24 per subscriber per month in Plan "impact" was deemed necessary. Proviso 63.15 eliminated any reserve requirement for Plan years 2002 and 2003. This proviso stipulates "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 2003." After consulting with participants and stakeholder groups, it was determined that this impact be achieved entirely through an increase in enrollee contributions, without changes to the Plan of Benefits. Effective January 2003, the State Health Plan increased enrollee contributions an average of \$24 per subscriber per month.

State Health Plan 2004 Initiatives:

§ 1-11-710 (A) (2) of the South Carolina Code of Laws requires that the Budget and Control Board approve by August 15, the State Health Plan benefits and contributions for the upcoming year. No new employer funding was appropriated for Plan year 2004. Again, this being the case, and in order to maintain a zero reserve balance during 2004, \$65 per subscriber per month in Plan "impact" was needed. Proviso 63.12 eliminated any reserve requirement for the Plan in 2004. This proviso stipulates "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 2004." In contrast to 2003, responses from participants and stakeholders indicated financial viability be achieved not only through a contribution increase, but also through changes to the Plan of Benefits.

Effective January 2004, the State Health Plan will increase enrollee contributions an average of \$25 per subscriber per month. Premiums will increase \$19.04 for single and employee/child coverage and \$38.08 for employee/spouse and full family coverage.

A variety of Plan benefit changes will also be implemented January 2004. They include, increasing Plan annual deductibles to \$350 single/\$700 family for the Standard plan (from \$250 single/\$500 family) and \$500 single/\$1,000 family for the Economy plan (from \$350 single/\$700 family). Out-of-pocket maximums will increase to \$2,000 single/\$4,000 family for both plans (from \$1,500 single/\$3,000 family). Also, per-occurrence deductibles will increase to \$75 for outpatient hospital visits (from \$50) and \$125 for emergency room visits (from \$100). A new \$10 per-visit deductible will also be applied for all physician office visits beginning in 2004. Other benefit design changes include a 20% out-of-network fee and changes to the pharmacy benefit. A third tier drug co-payment will be added and drug co-payments will increase from \$7/generic and \$22/brand to a co-payment structure including \$10/generic, \$25/brand and \$40/nonpreferred brand. The prescription drug out-of-pocket maximum will increase from \$1,100 to \$2,500 and the State Health Plan will participate in Medco Health's Select Network, garnering a greater percentage of discounts off of prescription drug charges.

Also approved, but not in effect until July 1, 2004 is the application of experience rating for “optional” groups. These are groups, other than State agencies and school districts, who participate at their option as authorized under §1-11-720. Overall claims experience for these groups has been approximately 11% higher than mandatory State Health Plan participants. Premiums will be tiered and could reach as high as 50% above the State Health Plan rate for “non-optional” groups.

Senior Drug Program:

Effective July 1, 2002, the Senior Drug Program SilverCard was transferred from EIP to the Department of Health and Human Services as required under proviso 63.18. However, due to administrative consideration, EIP received funds from the Department of Health and Human Services to transfer to the Third Party Administrator (ASC) through February 18, 2003 for claims transactions incurred through December 31, 2002.

Capital Asset and Debt Administration

Due to a change in the capitalization threshold mandated by the Comptroller General’s Office of the State of South Carolina, a restatement of net assets was required as of July 1, 2001. As of June 30, 2003 and 2002, Equipment, Net of Accumulated Depreciation is \$75,132 and \$62,375, respectively. The EIP has no debt outstanding as of year-end.

Contact Information:

Questions related to the Management Discussion & Analysis and the accompanying financial statements should be directed to Phyllis Buie, Chief Financial Officer, at 734-0326.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF NET ASSETS

JUNE 30, 2003

	<u>Governmental Activities</u>
Assets	
Current assets:	
Cash and cash equivalents	\$ 60,783,594
Premiums receivable	636,336
Prescription Drug Rebate receivable	2,904,642
Accrued interest	334,564
Due from South Carolina Division of Retirement	28,163,671
Total current assets	<u>92,822,807</u>
Non-current assets:	
Investments	22,537,354
Capital assets, net of accumulated depreciation	75,132
Total non-current assets	<u>22,612,486</u>
Total assets	<u>115,435,293</u>
Liabilities	
Current liabilities:	
Accounts payable	238,940
Accrued payroll	302,146
Claims payable	60,386,984
Deferred premium revenue	6,289,767
Claims incurred but not reported	127,766,109
Accrued compensated absences	35,133
Total current liabilities	<u>195,019,079</u>
Long-term liabilities:	
Contingencies (<i>Note 13</i>)	
Accrued compensated absences	331,044
Total long-term liabilities	<u>331,044</u>
Total liabilities	<u>195,350,123</u>
Net assets	
Investment in capital assets	75,132
Unrestricted	<u>(79,989,962)</u>
Total net assets	<u>\$ (79,914,830)</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2003

	Expenses	Program Revenue Charges for Services	Net (Expense) Revenue and Changes in Net Assets Governmental Activities
Activities:			
Senior drug program	\$ 18,308,416	\$ 12,494,566	\$ (5,813,850)
Health	1,073,056,185	1,072,328,897	(727,288)
Dental	48,815,790	50,620,731	1,804,941
Life and disability	10,632,390	42,576,064	31,943,674
Administration	48,070,714	491,749	(47,578,965)
Total governmental activities	\$ 1,198,883,495	\$ 1,178,512,007	(20,371,488)
General revenue and transfers:			
Earnings on investments			7,318,521
Miscellaneous			189,847
Transfers to other agencies			(3,099,594)
Total general revenue and transfers			4,408,774
Change in net assets			(15,962,714)
Net assets at beginning of year			(63,952,116)
Net assets at end of year			\$ (79,914,830)

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENDITURES,
AND CHANGES IN FUND BALANCES

GOVERNMENTAL FUND

YEAR ENDED JUNE 30, 2003

	<u>Senior Drug Program</u>
Revenue:	
Investment earnings	\$ 7,116
Other	189,847
Total revenue	<u>196,963</u>
 Expenditures	
Administrative fees	66,606
Claims expense	5,595,873
Total expenditures	<u>5,662,479</u>
 Excess of expenditures over revenue	<u>(5,465,516)</u>
 Other financing sources (uses):	
Transfers to other funds	(196,962)
Total other financing sources (uses)	<u>(196,962)</u>
 Excess of expenditures and other financing uses over revenue and other financing sources	<u>(5,662,478)</u>
 Fund balance, beginning of year	<u>5,662,478</u>
Fund balance, end of year	<u>\$ -</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF NET ASSETS

PROPRIETARY FUND

JUNE 30, 2003

Assets

Current assets:

Cash and cash equivalents	\$ 60,783,594
Premiums receivable	636,336
Prescription Drug Rebate receivable	2,904,642
Accrued interest	334,564
Due from South Carolina Division of Retirement	28,163,671
Total current assets	<u>92,822,807</u>

Non-current assets:

Investments	22,537,354
Capital assets, net of accumulated depreciation	75,132
Total non-current assets	<u>22,612,486</u>

Total assets 115,435,293

Liabilities

Current liabilities:

Accounts payable	238,940
Accrued payroll	302,146
Claims payable	60,386,984
Deferred premium revenue	6,289,767
Claims incurred but not reported	127,766,109
Accrued compensated absences	35,133
Total current liabilities	<u>195,019,079</u>

Long term liabilities:

Contingencies (<i>Note 13</i>)	
Accrued compensated absences	331,044
Total long term liabilities	<u>331,044</u>

Total liabilities 195,350,123

Net assets

Investment in capital assets	75,132
Unrestricted	<u>(79,989,962)</u>
Total net assets	<u>\$ (79,914,830)</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

PROPRIETARY FUND

YEAR ENDED JUNE 30, 2003

Operating Revenue

Insurance premiums:	
Active employees:	
Health	\$ 742,795,418
Dental	46,839,288
Life	749,263
Long-term disability	12,456,613
Dependent/optional life	29,370,188
HMO-point of service	75,294,357
Retirees:	
Health	59,654,359
Dental	3,781,443
Retiree surcharge	181,308,429
HMO-point of service	846,100
Other premium revenues	13,583,284
Prescription drug rebates	11,341,516
Other	491,749
Total operating revenue	1,178,512,007

Operating Expenses:

Premiums	70,118,486
Claims:	
Health	703,442,400
Dental	46,666,918
Life	39,944
Long-term disability	9,440,537
HMO-point of service	55,862,621
Prescription drug	259,646,002
Salaries and benefits	3,800,349
Professional services	41,257,904

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

PROPRIETARY FUND

(CONTINUED)

Telephone and utilities	80,433
Supplies	718,512
Other services	1,473,534
Printing and publication	309,842
Postage and shipping	348,639
Depreciation	14,895
Total operating expenses	<u>1,193,221,016</u>
Operating (loss)	(14,709,009)
Non-operating revenue:	
Income from deposits and investments	<u>7,311,405</u>
Income (loss) before transfers	(7,397,604)
Interfund-transfers	196,962
Transfers to other state agencies	<u>(3,099,594)</u>
Change in net assets	(10,300,236)
Net assets, beginning of year	<u>(69,614,594)</u>
Net assets, end of year	<u><u>\$ (79,914,830)</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF CASH FLOWS

PROPRIETARY FUND

YEAR ENDED JUNE 30, 2003

Cash Flows from Operating Activities	
Insurance premiums from customers	\$ 1,161,690,872
Other receipts	10,049,312
Payments to employees	(2,965,512)
Payments to suppliers	(1,157,587,196)
Net cash provided by operating activities	<u>11,187,476</u>
 Cash Flows from Noncapital Financing Activities	
Transfers from other funds	196,962
Transfers from other state agencies	1,000,000
Transfers to other state agencies	(2,099,594)
Net cash used in noncapital financing activities	<u>(902,632)</u>
 Cash Flows from Capital and Related Financing Activities	
Purchase of fixed assets	(27,652)
Net cash used in capital and related financing activities	<u>(27,652)</u>
 Cash Flows from Investing Activities	
Purchases of investments	(3,244,023)
Proceeds from sales and maturity of investments	3,261,844
Interest received-deposits and investments	6,060,969
Net cash provided by investing activities	<u>6,078,790</u>
Net increase in cash and cash equivalents	16,335,982
Cash and cash equivalents, beginning of year	<u>44,447,612</u>
Cash and cash equivalents, end of year	<u>\$ 60,783,594</u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF CASH FLOWS

PROPRIETARY FUND

(CONTINUED)

Reconciliation of loss to net cash provided by operating activities		\$ (14,709,009)
Operating loss		(14,709,009)
Adjustments to reconcile operating loss to net cash provided by operating operating activities:		
Depreciation expense		14,895
Premiums redirected to State General Fund		(2,000,000)
Change in assets-(increase) decrease:		
Premiums receivable		(226,943)
Due from South Carolina Division of Retirement		(6,985,747)
Prescription drug rebate receivable		(1,783,954)
Change in liabilities-increase (decrease):		
Accounts payable, accrued payroll and compensated absences		(430,477)
Deferred premium revenue		4,224,821
Claims payable and incurred but not reported		33,083,890
Net cash provided by operating activities	\$	<u>11,187,476</u>
 Supplemental Information		
Premiums redirected to State General Fund	\$	<u>2,000,000</u>
Unrealized gains on investments	\$	<u>1,310,544</u>
Increase in investments for amortization/accretion	\$	<u>122,790</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

1. Basis of Presentation and Summary of Significant Accounting Policies

The financial statements of all funds of the South Carolina State Budget and Control Board, Employee Insurance Programs (the "Fund") were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Fund's accounting policies are described below.

Reporting Entity

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by accounting principles generally accepted in the United States of America, 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. In turn component units may have component units.

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 dependent on the primary entity that holds one or more of the following powers:

- (1) Determine its budget without another government's having the authority to approve and modify that budget.
- (2) Levy taxes or set rates or charges without approval by another government.
- (3) Issue bond debt without approval by another government.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Reporting Entity (Continued)

Based on these criteria, the Fund has determined that it has no component units. This financial reporting entity includes only the Fund, a primary entity.

The South Carolina State Budget and Control Board (the “Board”), Employee Insurance Programs, Employee Insurance Program Fund and Seniors’ Prescription Drug Program are funds of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. All funds of the Employee Insurance Program, which includes the Employee Insurance Program Fund and the Seniors’ Prescription Drug Program Fund, are included in this report and no other offices or funds of the South Carolina State Budget and Control Board or any other part of the State of South Carolina primary government are included. Effective July 1, 2002, the Seniors’ Prescription Drug Program was transferred under the control of the South Carolina Department of Health and Human Services (*Note 12*).

All of the divisions of the Board reporting entity are under the control of the Executive Director of the State Budget and Control Board. The Board is composed of the Governor; the State Treasurer; the Comptroller General; the Chairman of the Senate Finance Committee; and the Chairman of the House Ways and Means Committee; all of whom serve in an ex-officio capacity.

The South Carolina State Budget and Control Board, formerly the Budget Commission, was established and created by Reorganization Plan No. 2 adopted by the General Assembly in 1950 pursuant to the terms and provisions of Act 621, Acts of 1948. Under the Act, ten state agencies were abolished as separate entities and their functions and duties were brought under the supervision of the Budget and Control Board. The funds of the Budget and Control Board are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Fund operates as a unit under the Board and its Executive Director. The laws of the State and the policies and procedures specified by the State for State agencies are applicable to the Fund’s activities. The accompanying financial statements present the financial position and results of operations solely of the Fund and do not include any other agencies or any component units of the State of South Carolina.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

The group health, dental, life, accidental death and dismemberment and disability programs managed by the Fund are authorized in Sections 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended. The long-term care program managed by the Fund is authorized in Section 1-11-740 of the South Carolina Code of Laws of 1976, as amended.

The Employee Insurance Program provides health insurance to eligible employees and retirees of State agencies and its political subdivisions who elect coverage. Coverage elections include the State's self-insured health plan, two point of service plans, or three health maintenance organization (HMO) plans including the Medical University of South Carolina (MUSC) managed plan which are self-insured. Premiums are paid through payroll deductions. The Long-Term Disability Plan is a self-insured group long-term disability plan available to eligible active employees enrolled in a State health plan. The State Life Plan is fully insured. All dental coverage is through the State's self-insured plan which is available to eligible employees and retirees. Health and dental premiums are paid from State funds and through payroll deductions for eligible employees. Dental Plus is a fully insured plan. Premiums for participating retirees are paid by the Agencies and other eligible employers through the retirement system (employer share) and directly from the employee (employee share). State agencies and other eligible employers pay the premiums for the following insured plans which are available to eligible full-time employees enrolled in a State health plan: (1) basic group life, and (2) basic long-term disability plan. The dependent/optional life program is available to eligible employees. Premiums for the dependent/optional life program are paid through payroll deduction. Premiums and the retiree surcharge (see *Note 6*) for the self-insured health and dental plans are actuarially determined and approved by the South Carolina State Budget and Control Board. Long-term care insurance is also available to eligible employees. Premiums for long-term care insurance are paid through payroll deductions. The long-term care plan is fully insured. Details on eligibility requirements and coverage for all plans are contained in the *Insurance Benefits Guide*. Premium rates for all plans are reviewed on a calendar year basis annually and adjusted as considered necessary after actuarial calculation. Interest income is considered in the premium rate setting process.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

The State as the predominant participant retains the risk of loss for the self-insured health, dental and basic long-term disability coverages.

The South Carolina Seniors' Prescription Drug Program is authorized in Section 44-130-30 and 44-130-40 of the South Carolina Code of Laws of 1976, as amended.

Beginning January 1, 2001, the South Carolina Seniors' Prescription Drug Program (the "Program") was created by the South Carolina Seniors' Prescription Drug Program Act passed by the General Assembly.

This program was administered by the State Budget and Control Board through its Employee Insurance Programs. Effective July 1, 2002, this program was transferred to the South Carolina Department of Health and Human Services for administration (*Note 12*).

Basis of Presentation

The financial statements present all funds of the South Carolina State Budget and Control Board, Employee Insurance Programs:

Government-wide Statements: The statement of net assets and the statement of activities display information about the reporting entity. These statements include the financial activities of the South Carolina State Budget and Control Board, Employee Insurance Programs. Eliminations have been made to minimize the double-counting of internal activities. Governmental activities generally are financed through appropriations, taxes, intergovernmental revenues, and other nonexchange transactions.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

The statement of activities presents a comparison between direct expenses and program revenue for each function of the governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Indirect expense allocations that have been made in the funds have been reversed for the statement of activities. Program revenue include (a) fees, fines, and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the accounting funds. Separate statements for each fund category—*governmental and proprietary*—are presented. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds. The Fund has no nonmajor funds. Major fund reporting requirements do not apply to internal service funds.

Measurement Focus and Basis of Accounting

Government-wide and Proprietary Fund Financial Statements. The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus. The government-wide and proprietary fund financial statements are reported using the accrual basis of accounting. Revenue are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the Fund gives (or receives) value without directly receiving (or giving) equal value in exchange, include state appropriations, grants, entitlements, and donations. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. The Fund establishes claims liabilities when the information available prior to the issuance of the financial statements indicates it is probable a liability has been incurred by the date of the financial statements and the amount can be reasonably estimated.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Governmental Fund Financial Statements. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenue is recognized when measurable and available. The Fund considers all revenue reported in the governmental funds to be available if the revenue are collected within one year after year-end. Interest is considered to be susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Under the terms of grant agreements, certain programs are funded by a combination of specific cost-reimbursement grants, and general revenues. Thus, when program expenses are incurred, there are both restricted and unrestricted net assets available to finance the program. It is the Fund's policy to first apply restricted resources to such programs, followed by unrestricted resources.

The accounting policies of the Fund conform to accounting principles generally accepted in the United States of America applicable to governmental and proprietary activities as prescribed by GASB. Accordingly, the Fund applies all applicable GASB pronouncements and its predecessors those applicable standards issued by the Financial Accounting Standards Board on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Fund considers all highly liquid securities with a maturity of three months or less at the time of purchase to be cash equivalents. Most State agencies participate in the internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. Because the State's internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the 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. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 4*.

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. Deposits in the general deposit account are recorded and reported at cost. However, the Fund reports its deposits in the special deposit accounts at fair value. Investments in the pool are recorded and reported at fair value. Interest earned by the agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total income receivable of the pool.

The amounts shown in the financial statements as "cash and cash equivalents" represent cash on deposit with the State Treasurer as a part of the State's internal cash management pool, and cash invested in various short-term instruments by the State Treasurer and held in separate agency accounts.

Investments

Investments, in accordance with Governmental Accounting Standards Board (GASB) Statement Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Investment income consists of interest earned during the year, amortization of premiums and accretion of discounts, realized gains/losses on securities, and unrealized gains and losses resulting from changes in fair value. Earnings are posted to the agency's account at the end of each month. Securities and securities transactions are reflected in the financial statements on a trade-date basis. Realized gains/losses on securities are calculated independently from the calculation of change in fair value therefore realized gains/losses reported in the current period may include amounts previously reported as change in fair value (unrealized gains/losses).

Premium Revenue

Premiums billed to employers, employees and retirees (premiums receivable) for insurance coverage are recorded as revenue when earned on a monthly basis. The retiree surcharge on employees is recognized as the liability is incurred by the various State agencies and school districts.

Deferred Premium Revenue

Premiums billed in advance of coverage, payments received in advance of coverage, or in excess of amounts billed and premiums collected but unearned are recorded as deferred premium revenue.

Capital Assets

Capital assets are capitalized at cost if purchased. Capital assets contributed by other State agencies or funds are recorded at the State's original acquisition cost less accumulated depreciation from the purchase date. Assets donated by other parties are valued at fair market value at the date of gift. The capitalization dollar threshold limit for capital assets is \$5,000. The Fund has one class of capital assets, equipment, which is depreciated on a straight-line basis over the estimated useful lives of 2-10 years. A full year of depreciation is taken the year the asset is placed in service and no depreciation is taken in the year of disposal.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Claims Liabilities Including Claims Incurred but not Reported (IBNR)

Losses are recorded at estimated amounts at the time they are reported and include a provision for expenses associated with claim settlements. Insurance claims are expensed as incurred over the period of coverage. The Fund establishes an unpaid claim liability for claims in the process of review, and for IBNR claims. The liability for IBNR claims is actuarially estimated based on the most current historical claims experience of previous payments, changes in number of members and participants, inflation, award trends, and estimates of health care trend (cost, utilization and intensity of services) changes. Estimates of liabilities for incurred claims are continually reviewed and revised as changes in these factors occur and revisions are reflected in the current year's operating statement in the applicable claims expense. Amounts for allocated and unallocated claims adjustment expenses have been included in the calculation of IBNR.

Claim costs for basic group life and long-term disability coverages are actuarially calculated using the one-year term cost method; the cost of coverage is the present value of all benefit payments that will be made on expected claims incurred during the year following the valuation date. Claim liabilities are equal to the present value, as of the valuation date, of all future payments to be made for disabilities and deaths up to that date. Actuarial assumptions include an interest rate of 6.25% for 2003 compounded annually.

Claims Payable

Claims payable represents claims related to health claims, dental claims and Long-Term Disability claims payable at June 30. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Fund.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for unused sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances. The Fund calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in the Fund.

Net Assets

Net assets are recorded in three categories:

Investment in capital assets, net of related debt consists of capital assets net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets which do not meet the definition of restricted net assets or investment in capital assets, net of related debt.

The Fund applies expenses that can use both restricted and unrestricted resources against restricted resources then unrestricted resources.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Budget Policy

The General Assembly enacts a budget for the Fund. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The Budgetary column includes all budgeted resources, including the State General Fund as well as most federal fund and department-generated sources. A revenue budget is not adopted for individual budgetary units.

The accompanying other financial information include a Statement of Expenditures-Budget and Actual-All Budgeted Funds. The Budgetary column on that statement corresponds to the difference between Total Funds and General Funds columns in the Appropriations Act.

The current Appropriations Act states that the General Assembly intends to appropriate all monies to operate state government for the current fiscal year. Any unexpended state General Fund appropriations lapse to the General Fund of the State on July 31 unless specific authorization is given to carryover the funds to the ensuing fiscal year. Appropriations carried forward for a specific purpose are reported as restricted net assets. Proviso 63.18 of the 2002/2003 Appropriations Act authorizes the South Carolina Seniors' Prescription Drug Program to carry forward unspent State General Fund appropriations.

During the fiscal year close-out period through July, departments and agencies may continue to charge vendor, interagency, and interfund payments applicable to the current year to this fiscal year's appropriation.

State law does not precisely define the budgetary process of accounting. The budget is prepared mostly on the cash basis with several exceptions. Departments and agencies charge certain vendor and interfund payments against the preceding fiscal year's appropriations through July 20. State law does not require the use of encumbrance accounting. Because the legally prescribed budgetary basis differs materially from GAAP, actual amounts in the accompanying budgetary comparison statements are presented on the budgetary basis. A reconciliation of the differences between the budgetary basis is presented in *Note 2*.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

1. Basis of Presentation and Summary of Significant Accounting Policies (Continued)

The state maintains budgetary control at the line-item level of expenditure within each program of each department or agency. All general fund expenditures are budgeted. The Fund processes its disbursement vouchers through a central budgetary accounting system maintained by the Comptroller General's Office. Disbursement vouchers can only be processed if there is enough cash and appropriations exist. The level of legal control is reported in a publication of the State Comptroller General's Office titled *A Detailed Report of Appropriations and Expenditures*.

Use of Estimates

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

Classification of Revenue

The Fund has established the following criteria for reporting operating revenue or nonoperating revenue:

Operating revenue generally results from exchange transactions to provide the services authorized by State Statute. These revenue include (1) premiums for insurance coverage, (2) administrative fees, and (3) other receipts arising from services provided.

Nonoperating revenue includes activities that have the characteristics of nonexchange transactions. These revenue include appropriations, investment income, and contract revenue not classified as operating revenue or restricted by the provider to be used exclusively for capital purposes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Budgetary Reporting Basis

Financial statements prepared on the legally enacted basis differ from GAAP basis statements. All of the Fund's Special Revenue Fund resources are included in the total funds authorized by the General Assembly. The Statement of Expenditures-Budget and Actual-All Budgeted Funds presented on page 57 present all funds for which a legal budget was enacted.

Adjustments of the GAAP basis of accounting to the budgetary basis of accounting consist principally of reclassifications from financial statement fund types to budgetary fund categories, reversals of payroll accruals and the related fringe benefits, and removals of unbudgeted accounts and funds, if any. Acquisitions of fixed assets by donation are unbudgeted and capital lease and installment purchase transactions are budgeted in the year of payment.

The following schedule reconciles the differences:

	Financial Statement Fund Type Special Revenue	Adjustment	Budgetary Category
Administrative fees	\$ 66,606	\$ (66,606)	\$ -
Claims expense	5,595,873	(5,595,873)	-
Other budgeted expenses	-	5,662,479	5,662,479
Total expenditures	\$ 5,662,479	\$ -	\$ 5,662,479

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

3. Other Budgeted Funds

Proviso 63.18 of the 2002/2003 General Appropriations Act cites the authority for the Fund to carry forward unspent appropriations from fiscal year 2002 to expenditure in fiscal year 2003.

Annual fiscal year 2002 appropriations of \$5,662,479 for Seniors' Prescription Drug Program, were approved for carry forward to fiscal year 2003 for expenditure for the same purpose.

4. Investments and Deposits

As prescribed by Statute, the State Treasurer is the custodian and investment manager of all investments and deposits of the Fund.

Investments

In accordance with State Law, the Fund may invest in a variety of instruments including obligations of the United States and its agencies and securities fully guaranteed by the United States, certain corporate obligations, certain shares of Federal savings and loan associations and State chartered savings and loan associations, and collateralized repurchase agreements. All investments are required to be insured or registered, or held by the State or its agent in the name of the State Treasurer as custodian.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

The Fund's investments are categorized to give an indication of the level of risk assumed by the entity at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment transaction fails. There are three categories of credit risk.

- (1) Insured or registered in the agency's name, or securities held by the agency or its agent in the agency's name.
- (2) Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the agency's name.
- (3) Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the agency's name.

At June 30, 2003, all of the Fund's long-term investments were in Category (1).

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agents in the State's name. Information pertaining to the reported amounts, fair values, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

The following table presents the amortized cost and fair values of the investments of the Fund at June 30, 2003.

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
U. S. Government agencies securities	\$ 1,109,626	\$ 19,494	\$ -	\$ 1,129,120
Collateralized mortgage-backed obligations	4,418,981	267,257	(46,112)	4,640,126
Other Governmental guaranteed investments	250,000	5,938	-	255,938
Repurchase agreement	3,405,000	-	-	3,405,000
Corporate bonds	11,403,768	1,042,878	(153,039)	12,293,607
Financial paper	3,771,412	447,151	-	4,218,563
Total	\$ 24,358,787	\$ 1,782,718	\$ (199,151)	\$ 25,942,354

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

At June 30, 2003, the amortized cost of the above investments was comprised of the following:

	<u>Par Value</u>	<u>Unamortized Premiums</u>	<u>Unaccreted Discounts</u>	<u>Amortized Cost</u>
U. S. Government agencies	\$ 1,110,000	\$ -	\$ (374)	\$ 1,109,626
Collateralized mortgage-backed obligations	4,349,499	134,207	(64,725)	4,418,981
Other Government guaranteed investments	250,000	-	-	250,000
Repurchase agreement	3,405,000	-	-	3,405,000
Corporate bonds	11,548,590	113,680	(258,502)	11,403,768
Financial paper	3,800,000	18,409	(46,997)	3,771,412
	<u>\$ 24,463,089</u>	<u>\$ 266,296</u>	<u>\$ (370,598)</u>	<u>\$ 24,358,787</u>

The accounts classified as investments in the financial statements comprise investments held for the Fund and the State of South Carolina which are legally restricted and earnings thereon become revenue of the specific fund from which the investment was made. These investments are specific, identifiable investment securities, some of which may be included in one of the State Treasurer's investment pools.

The investment types listed above include all investment types in which monies were held as long-term investments throughout the fiscal year. For all investment classifications reported above, the balances therein fluctuated minimally in excess of the year-end balances throughout the year ended June 30, 2003. As discussed in *Note 1*, GASB Statement Number 31 required investments reported at fair value. Therefore, gains and losses recognized due to market fluctuations are recognized as income on deposits and investments. The Fund held no short-term investments at June 30, 2003. Short-term investments held during the fiscal year 2003 consisted of U.S. Government agency and government-insured securities whose amortized cost approximates fair value at June 30, 2003.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

The investment types listed above include all investment types in which monies were held throughout the year ended June 30, 2003. Due to higher cash flows at certain times during the year, the Fund's investment in repurchase agreements and short-term investments fluctuated significantly. The maximum amounts held in these classifications during the year ended June 30, 2003, were as follows:

Short-term investments	\$ 659,600
Repurchase agreements	\$ 7,870,000

Deposits

All deposits with financial institutions are required to be insured or collateralized with securities held by the State or its agent in the State Treasurer's name as custodian. At June 30, 2003, the Fund had no deposits with financial institutions. The Fund had cash and pooled investments of \$8,728,375 and \$48,650,219, respectively, held by the State Treasurer as of June 30, 2003.

Fair market value for cash and cash equivalents reported approximate the carrying value.

During the year, the following amounts (which apply to all investments) were included in investment earnings:

	2003
Interest earned	\$ 5,973,325
Discount accretion	161,231
Premium amortization	(38,441)
Realized gains (losses)	(88,138)
Change in unrealized gains (losses)	1,310,544
Investment earnings	\$ 7,318,521

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

The following schedule reconciles investments and deposits as reported in the statement of net assets to disclosures included in this note.

	Statements	Note Disclosure
Held by the State Treasurer:		
Cash and cash equivalents	\$ 60,783,594	\$ 8,728,375
Pooled investments	-	48,650,219
Specifically identified investments	22,537,354	25,942,354
Total	\$ 83,320,948	\$ 83,320,948

5. Premiums Receivable

Premiums receivable at June 30, 2003, consist of the following:

Local government	\$ 268,260
State government (<i>Note 12</i>)	259,874
Other	108,202
	\$ 636,336

As of June 30, 2003, all of the receivables are deemed by management to be collectible. Therefore, no allowance for doubtful accounts has been recognized. In addition, the Fund has applied no discounts to its receivables as of June 30, 2003.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

6. Due to or from South Carolina Division of Retirement

At June 30, 2003, a total of \$28,163,671 consisting of \$27,276,203 from South Carolina Retirement System and \$887,468 from Police Officers Retirement System were due from the South Carolina Retirement Systems. In accordance with provisions of the Appropriations Act for each year, an additional employer contribution surcharge on covered payroll was added to the contribution rate applicable to entities covered by the State Health Insurance Plan. Accordingly, these amounts represent revenues collected on behalf of the Fund of a percentage of covered compensation from all State agencies and public school systems to be used for health and dental insurance benefits of State retirees. The percentage in effect was 3.15% from July 1, 2002 to June 30, 2003.

7. Capital Assets

The following are summaries of changes in capital assets for the year.

	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003
Furniture and equipment	\$ 222,519	\$ 27,652	\$ -	\$ 250,171
Accumulated depreciation	(160,144)	(14,895)	-	(175,039)
Capital assets, net	\$ 62,375	\$ 12,757	\$ -	\$ 75,132

Depreciation expense for the year ended June 30, 2003 was \$14,895.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. Lease Obligations

The Fund leases office space from a party outside of State government and is accounted for as an operating lease. The office space lease expires June 1, 2005. Rental expense under this lease for the year ended June 30, 2003 was \$389,119.

The Fund has also entered into an operating lease from a party outside of State government which will expire in 2006 for office equipment which contains a cancellation provision and is subject to annual appropriation. In the normal course of business, operating leases are generally renewed or replaced by other leases. Operating leases are generally payable on a monthly basis. For the year ended June 30, 2003, expenses under these leases were approximately \$14,525.

The following schedule summarizes the Fund's obligations under noncancelable operating leases having remaining terms in excess of one year as of June 30, 2003:

<u>Fiscal Year</u> <u>Ending June 30,</u>	<u>Total</u>
2004	\$ 327,264
2005	<u>327,264</u>
Total	<u>\$ 654,528</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Pension Plans

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the South Carolina Retirement Division, Post Fund Box 11960, Columbia, South Carolina 29211-1960. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

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

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 15 years credited service (five years effective January 1, 2001). Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service (this requirement does not apply if the disability is the result of a job-related injury). A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Pension Plans (Continued)

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (TERI) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. For the year ended June 30, 2003, the employer contribution rate was 7.55 percent (before a surcharge to fund retiree health and dental insurance coverage). The Fund's actual contributions to the SCRS was approximately \$308,000, respectively, and equaled the required contributions of 7.55 percent (excluding the surcharge) for each year. Also, the Fund paid employer group-life insurance contributions at the rate of .15 percent of compensation for the year ended June 30, 2003.

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

Article X, Section 16 of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of compensation).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Pension Plans (Continued)

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

At retirement, employees participating in the SCRS receive additional service credit (at a rate of 20 days equals one month of services) for up to 90 days for accumulated unused sick leave.

10. Post-Employment and Other Employee Benefits

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the Fund are eligible to receive these benefits. The State provides post employment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

These benefits are provided through annual appropriations by the General Assembly to the Fund for its active employees and to the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable sources of the Fund for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Currently, approximately 20,100 State retirees meet these eligibility requirements.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. Post-Employment and Other Employee Benefits (Continued)

The Fund recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$260,000, for the year ended June 30, 2003. As discussed in *Note 12*, the Fund paid approximately \$92,000 for the year ended June 30, 2003, applicable to the surcharge included with the employer contributions for retirement benefits (3.15% for 2003).

Information regarding the cost of insurance benefits applicable to Fund retirees is not available. By State law, the Fund has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from Systems' earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS benefits.

11. Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Fund have elected to participate. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401 (k), and 403 (b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Deferred Compensation Plans (Continued)

The State authorized deferred compensation matching contributions for fiscal year 2000-2001. The contributions are funded from various funding sources based on the same percentages used for employees' salaries. The State appropriated funds from unspent fiscal year 1999-2000 appropriations for the portion of contributions paid from State General Funds to 401(k) accounts of eligible state employees. The 401(k) match is limited to \$300. To be eligible, an employee must be a permanent full-time state employee or temporary grant employee who is actively contributing to a 401(k), 457 or 403(b) account on the date of distribution. Permanent full-time employees making less than \$20,000 as of July 1, 2000, are not required to contribute in order to receive the match.

This Fund made no contributions for the fiscal year ending June 30, 2003.

12. Transactions with State Entities

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

Services received at no cost include payroll processing, disbursement processing and maintenance of certain accounting records from the Comptroller General; check preparation, banking and investment functions from the State Treasurer; and legal services from the Attorney General.

The following services are provided for a fee to various State agencies and within the South Carolina State Budget and Control Board. The fees are recorded as revenues in the financial statements for the Fund.

Insurance coverage for state agencies and local governments:

- Health
- Dental
- Basic group-life and disability
- State Life and Long-Term Disability

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

The following details the insurance premiums charged by the Fund to other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2003:

SC State Senate - Clerical	\$ 363,481
SC State Senate - Senators	194,592
House of Representatives - Clerical	288,647
House of Representatives - Senators	434,460
Legislative Council	93,844
Legislative Printing and Information	95,655
Legislative Audit Council	56,892
SC Education Oversight Committee	25,123
Judicial Department	1,891,255
Sentencing Guidelines Committee	7,992
SC Administrative Law Judge Division	68,724
Governor's Office - Executive Control of State	49,917
State Law Enforcement Division	1,795,946
Governor's Office - Executive Policy & Programs	783,575
Governor's Office - Mansion & Grounds	43,423
Lt Governor's Office	23,015
Secretary of State	93,021
Comptroller General's Office	264,707
State Treasurer	226,370
Attorney General	452,832
SC Commission on Prosecution Coordination	169,014
SC Commission of Appellate Defense	51,394
Commission on Indigent Defense	19,440
Adjutant General's Office	785,262
State Election Commission	48,265
SC Budget & Control Board	4,110,168
SC Budget & Control Board - State Auditor	187,043
SC Budget & Control Board - Division of Retirement	1,090
Commission on Higher Education	170,413
Higher Education Tuition Grants Commission	14,295

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

The Citadel	2,154,503
Clemson University	14,747,760
College of Charleston	3,945,460
Coastal Carolina University	2,227,408
Francis Marion University	1,479,411
Lander University	1,164,900
SC State University	2,720,880
University of South Carolina	19,967,483
Winthrop University	2,546,447
Medical University of South Carolina	13,495,695
State Board for Technical & Comprehensive Education	373,730
Trident Technical College	1,948,597
Northeastern Technical College	311,384
Florence-Darlington Technical College	919,072
Greenville Technical College	2,165,756
Horry-Georgetown Technical College	1,002,083
Midlands Technical College	1,982,991
Orangeburg - Calhoun Technical College	646,644
Piedmont Technical College	1,021,488
Spartanburg Technical College	817,885
Central Carolina Technical College	652,366
Tri County Technical College	962,895
York Technical College	945,707
Aiken Technical College	479,226
Technical College of Low Country	479,499
Denmark Technical College	327,024
Williamsburg Technical College	212,395
Department of Education	3,852,983
SC Educational Television Commission	1,066,967
Wil Lou Gray Opp School	198,172
Vocational Rehabilitation	3,807,381
SC School for the Deaf & Blind	1,398,842
Department of Archives & History	269,744
SC State Library	151,031
SC Arts Commission	113,676

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

SC Museum Commission	144,120
Health & Human Services Financial	4,041,139
Health & Human Services-Silver Card	12,494,566
Department of Health & Environmental Control	17,002,965
Department of Mental Health	17,492,076
SC Department of Disabilities & Special Needs	8,647,856
SC Department of Alcohol & Other Drug Abuse Services	278,454
SC Department of Public Safety	9,474,549
Department of Social Services	15,113,769
John DeLa Howe School	372,205
SC Commission for the Blind	463,444
SC State Housing Finance & Development Authority	398,118
SC Human Affairs Commission	150,406
State Commission for Minority Affairs	14,973
SC Department of Corrections	20,046,088
SC Department of Probation, Parole & Pardon Services	2,767,569
SC Department of Juvenile Justice	4,912,748
Forestry Commission	1,569,604
Department of Agriculture	515,584
Department of Natural Resources	3,206,216
Sea Grant Consortium	40,049
Department of Parks, Recreation & Tourism	1,913,220
SC Department of Commerce	503,641
SC Jobs-Economic Development Authority	5,784
Business Carolina, Inc	53,587
Patriots Point Development Authority	244,311
Public Service Commission	312,793
SC Workers' Compensation Commission	217,435
State Accident Fund	275,629
Patients Compensation Fund	11,112
Second Injury Fund	82,497
SC Department of Insurance	334,907
State Board of Financial Institutions	124,103
SC Department of Consumer Affairs	125,045
Department of Labor, Licensing, & Regulation	1,356,730

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

Department of Revenue and Taxation	1,887,140
State Ethics Commission	26,648
Employment Security Commission	4,003,127
Procurement Review Panel	3,648
Department of Transportation	18,005,502
Office of State Infrastructure Bank	2,936
Aid to Subdivisions	295,391
South Carolina Education Lottery	396,609
COBRA and Retirees of State Agencies	55,031
	<u>\$ 252,750,664</u>

The Fund had financial transactions with various State agencies during the fiscal year. Significant payments were made to Divisions (Funds) of the State Budget and Control Board for retirement and insurance plans contributions, vehicle rental, surplus property disposal fees, Fund supplies, printing, and telephone, interagency mail, data processing services, purchasing, record maintenance, internal audit, personnel services, unemployment, and workers' compensation coverage for employees. The identifiable amounts of 2003 expenses applicable to related party transactions are as follows:

South Carolina Retirement Division	\$ 311,146
State Accident Fund	6,627
South Carolina Employment Security Commission	2,866
South Carolina Budget and Control Board	236,392
	<u>\$ 557,031</u>

In addition, transfer to (from) other state agencies include the following:

South Carolina General Fund	\$ 4,099,594
South Carolina Lottery Commission	(1,000,000)
	<u>\$ 3,099,594</u>

Included in the transfer to the South Carolina General Fund are \$2,000,000 of premiums that were redirected to the General Fund in accordance with Proviso 72.98.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

A significant portion of the Fund's total insurance premium revenue is for insurance premiums charged to other state agencies and divisions of the South Carolina State Budget and Control Board. Premiums owed from these entities at June 30, 2003 were:

SC State Senate - Clerical	\$ 1,765
SC State Senate - Senators	90
Legislative Council	101
Judicial Department	47,286
SC Administrative Law Judge Division	1
Governor's Office - Executive Control of State	1
State Law Enforcement Division	277
Governor's Office - Executive Policy & Programs	34,290
Governor's Office - Mansion & Grounds	2,654
Lt Governor's Office	1
Comptroller General's Office	176
State Treasurer	144
Attorney General	324
SC Commission of Appellate Defense	96
Commission on Indigent Defense	475
State Election Commission	2,979
SC Budget & Control Board	249
SC Budget & Control Board	8
SC Budget & Control Board	572
SC Budget & Control Board	80
SC Budget & Control Board - State Auditor	104
SC Budget & Control Board - Division of Retirement	1,095
Commission on Higher Education	2,655
State Board for Technical & Comprehensive Education	583
Midlands Technical College	20
Central Carolina Technical College	900
Aiken Technical College	599
Denmark Technical College	2,107
Williamsburg Technical College	1,599
SC Educational Television Commission	159
Vocational Rehabilitation	2,474
Department of Archives & History	60
SC Arts Commission	13
SC Museum Commission	920

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

Health & Human Services Financial	4,232
Department of Health & Environmental Control	660
Department of Mental Health	8,874
SC Department of Disabilities & Special Needs	39
SC Department of Alcohol & Other Drug Abuse Services	1,036
Department of Social Services	54,343
SC Commission for the Blind	508
SC State Housing Finance & Development Authority	296
SC Department of Corrections	64,330
SC Department of Probation, Parole & Pardon Services	1,190
Department of Natural Resources	57
Sea Grant Consortium	56
Department of Parks, Recreation & Tourism	2,766
SC Department of Commerce	8
Patriots Point Development Authority	343
Public Service Commission	262
State Accident Fund	11
Second Injury Fund	28
SC Department of Insurance	16
State Board of Financial Institutions	124
SC Department of Consumer Affairs	6,997
Department of Labor, Licensing, & Regulation	227
Department of Revenue and Taxation	1,354
State Ethics Commission	154
Employment Security Commission	3,902
Procurement Review Panel	39
Department of Transportation	327
South Carolina Education Lottery	2,838
	<hr/>
	\$ 259,874
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SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

The following services are received from other Divisions (Funds) of the South Carolina State Budget and Control Board at no charge:

Division of Operations

Record storage

Division of Retirement

Collection of health and dental premiums from retirees

Retirement plan administration

Collection of retiree insurance surcharge from employers

The Fund acted as a Plan Administrator for the Senior Drug Prescription Program through February 2003. The duties as Plan Administrator consisted of procuring and contracting for claims servicing, processing the payment to the Third Party Administrator of claims, and receiving payment from the South Carolina Department of Health and Human Services. As Plan Administrator, the Fund, through its Special Revenue Fund, reimbursed the Third Party Administrator for \$5,595,873 in claims incurred, paid the salaries of employees of \$66,606 and provided the remaining resources of \$196,962 to the proprietary fund resulting in no assets, liabilities, or net assets for the Special Revenue Fund as of June 30, 2003. The Fund continued serving as Plan Administrator recognizing the revenue and claims expenses as a function of the internal service fund through the end of the current fiscal year.

The Fund acted as fiduciary for premiums collected from state agencies for State Life and Long-Term Disability. During the year ended June 30, 2003, \$2,542,818 was collected from state agencies and disbursed to the State Life and Long-Term Disability carrier.

Additionally, refer to *Note 6* for a description of the amounts due from South Carolina Division of Retirement.

The Fund offers a managed care program to MUSC's employees living in Charleston, Dorchester, Colleton or Berkeley counties. Refer to *Note 1* for a complete description.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

13. Contingencies

By the nature of its operations and responsibilities as an insurer, the Fund has been named in a number of lawsuits, many of which are pending. A provision has been made in the financial statements for the payment of routine claims. Management is not aware of any other claims that, in their opinion, would have a material effect on the financial statements and, therefore, no liability has been recorded.

14. Risk Management/Reinsurance

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks except for certain types of risks for which it is self-insured (these risks are further described herein). Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage in the prior year. Settled claims have not exceeded this coverage in any of the past three years.

The Fund pays insurance premiums to itself and certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits.

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

1. Claims of State employees for unemployment compensation benefits (Employment Security Commission);
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Employee Insurance Programs); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Employee Insurance Programs).
5. Claims of covered property damage, theft, collision (automobile), liability, and general tort (Insurance Reserve Fund).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

14. Risk Management/Reinsurance (Continued)

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

State agencies and other entities are the primary participants in the Fund.

The Fund obtains coverage of up to \$750,000 per loss through a commercial carrier for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation.

The Fund has recorded insurance premium expense regarding its internal operations in the applicable administrative expense categories.

The Fund has not transferred the portion of the risk of loss related to insurance policy deductibles and limits. The Fund has not reported an estimated claims loss expense, and the related liability at June 30, 2003, based on the requirements of GASB 10 because information at June 30 did not indicate that an asset had been impaired or a liability had been incurred. GASB 10 states that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30 and the amount of loss is reasonably estimable.

The Fund self-insures health and dental insurance for all participating governmental employees, including those of the Fund. Additionally, effective January 1, 1999, the Fund began offering a self-insured HMO point of service plan to certain employees in the service area of MUSC. The Fund also purchases HMO products through Companion and Cigna which are self-insured. The Fund also offers Dental Plus and State Life products which are fully insured. The Fund purchases coverage for basic group life, dependent life, optional supplemental life, group optional life and basic disability from commercial carriers. The Long-Term Disability program is also self-insured.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

15. Reconciliation of Claims Liabilities by Fund

The schedule below presents the changes in claims liabilities for the past two years for the Fund.

	(in thousands)	
	2003	2002
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 155,069	\$ 141,029
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	853,222	736,051
Increases (decreases) in provision for insured events of prior fiscal years	222,263	180,677
Total incurred claims and claim adjustment expenses	1,075,485	916,728
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	751,055	644,567
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	291,346	258,121
Total payments	1,042,401	902,688
Total unpaid claims and claim adjustment expenses at end of the fiscal year	\$ 188,153	\$ 155,069
The above totals are comprised of the following:		
Claims payable	\$ 60,387	\$ 55,670
Claims incurred but not reported	127,766	99,399
Total	\$ 188,153	\$ 155,069

The HMO self-insured managed care plan liability at June 30, 2003 and 2002 was \$3,601,178 and \$2,698,021, respectively, and is included in the claims liability listed above.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

16. Changes in Long-Term Liabilities

Changes in long-term obligations for the year ended June 30, 2003, were as follows:

	Beginning Balance July 1, 2002	Increases	Decreases	Ending Balance June 30, 2003	Due Within One Year
Compensated absences payable	\$ 332,124	\$ 52,198	\$ (18,145)	\$ 366,177	\$ 35,133

17. Discussion of Fund Deficit in FY 2002-2003

During 2002-2003 fiscal year, the Employee Insurance Programs reported a decrease in net assets of \$15,962,714. This loss combined with losses in recent years, resulted in liabilities exceeding assets of \$79,914,830. Changes in funding and coverage resulted in an increase in equity in 2000-2001 and 2001-2002 reducing the deficit by approximately \$13,000,000. Seeking similar results in 2002-2003, additional changes in funding and coverage were initiated. However, the economic trends of the cost of the coverage offered by the Fund, health, dental, life, and disability, once again exceeded the measures initiated by the Fund. While additional transfers of the burden of costs have been initiated for the 2003-2004 fiscal years, there is no guarantee that they will be able to protect the Fund from future operating losses. To guarantee the continuation of the coverage offered by the Fund, the deficit position must be reversed through sustained increases in equity. To provide for these increases, additional funding sources, State Appropriations, or other increases in fees and charges may be required.

OTHER FINANCIAL INFORMATION

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS FUND

STATEMENT OF EXPENDITURES-BUDGET AND ACTUAL
ALL BUDGETED FUNDS

YEAR ENDED JUNE 30, 2003

	Budgetary Special Revenue Fund		
	Legal Basis Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Other budgeted expenses:			
Special items:			
Tobacco Settlement	\$ 6,043,481	\$ 5,662,479	\$ 381,002
	\$ 6,043,481	\$ 5,662,479	\$ 381,002

See accompanying notes.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

DeLOACH & **W**ILLIAMSON, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
1401 MAIN STREET, SUITE 660
COLUMBIA, SOUTH CAROLINA 29201

PHONE: (803) 771-8855
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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, 2003, and have issued our report thereon dated September 26, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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 grants, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting 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 over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions identified are as follows:

The decrease net assets of \$15,962,714 for the 2002-2003 fiscal years brings the deficit in net assets to \$79,924,830. Changes in funding and coverage have occurred for the past two fiscal years with additional changes approved for the 2003-2004 fiscal year. In 2000-2001 and 2001-2002, these changes were moderately successful in reducing the deficit by \$13,000,000. However, these actions were not sufficient to countermand the increased costs of coverage experienced in the 2002-2003 fiscal year. Furthermore, there is no guarantee that these type measures at the level enacted will remedy the deficit in net assets at any point in the near future. To guarantee the continuation of the coverage offered by the Fund, the deficit position must be reversed by sustained constant increases in equity. To provide for these increases and continue the Fund's programs additional funding sources, State appropriations, or other increases in fees and charges may be required.

We recommend that the management of the Fund review this situation and take steps to return the Fund to profitable operations.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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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.

Rebeck & Williamson, L.L.P.

September 26, 2003