

October 1, 1998

The Honorable David M. Beasley, Governor
and
Members of the Board of Governors
South Carolina Medical Malpractice Patients' Compensation Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Medical Malpractice Patients' Compensation Fund for the fiscal year ended June 30, 1998, was issued by Wilkes & Company, 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

TLW/trb

**SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND**

COLUMBIA, SOUTH CAROLINA

June 30, 1998

SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the South Carolina Medical Malpractice Patients' Compensation Fund as of and for the year ended June 30, 1998, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. 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 described in Note 1, the financial statements of the South Carolina Medical Malpractice Patients' Compensation Fund are intended to present the financial position, result of operations, and the cash flows of only that portion of the Funds of the State of South Carolina that is attributable to the transactions of the South Carolina Medical Malpractice Patients' Compensation Fund.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the South Carolina Medical Malpractice Patients' Compensation Fund as of June 30, 1998, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 14 to the financial statements, the Fund changed its method of accounting for unrealized gains in internal investment pools as required by the provisions of Governmental Accounting Board (GASB) Statement No. 31.

Columbia, South Carolina
September 22, 1998

FINANCIAL STATEMENTS

SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND

BALANCE SHEET
JUNE 30, 1998

ASSETS

Current Assets:

Cash and cash equivalents	\$ 19,511,100
Accounts receivable	248,300
Interest receivable	<u>143,379</u>

Total Current Assets 19,902,779

Fixed Assets:

Equipment	31,287
Accumulated depreciation	<u>(23,471)</u>

Total 7,816

Total Assets \$ 19,910,595

LIABILITIES AND FUND EQUITY

Current Liabilities:

Accounts payable	\$ 4,998
Accrued salaries and employer contributions	13,923
Accrued annual leave	27,629
Unearned fees	<u>4,050,000</u>

Total Current Liabilities 4,096,550

Noncurrent Liabilities:

Claims and awards:	
Reported	15,998,000
Incurred but not reported	<u>9,251,000</u>

Total Noncurrent Liabilities 25,249,000

Total Liabilities 29,345,550

Fund Equity:

Retained earnings (deficit)	<u>(9,434,955)</u>
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Total Liabilities and Fund Equity \$ 19,910,595

THE ACCOMPANYING NOTES
ARE AN INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA MEDICAL MALPRACTICE
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**STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN RETAINED EARNINGS
FOR THE YEAR ENDED JUNE 30, 1998**

Operating Revenues:

Members fee income (Net of refunds)	\$ 14,253,115
Interest earned	<u>972,555</u>
Total Operating Revenues	<u>15,225,670</u>

Operating Expenses:

Claims and awards	22,366,941
Administration	291,055
Depreciation	<u>2,793</u>
Total Operating Expenses	<u>22,660,789</u>

Net Income (Loss)	(7,435,119)
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Retained Earnings - July 1	<u>(1,999,836)</u>
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Retained Earnings (Deficit) - June 30	<u>\$ (9,434,955)</u>
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THE ACCOMPANYING NOTES
ARE AN INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA MEDICAL MALPRACTICE
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STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 1998

Cash Flows From Operating Activities:

Net income (Loss)*	\$ (7,435,119)
Adjustments to reconcile net income to net cash provided by operating activities:	
Interest classified as operating income	(972,555)
Depreciation	2,793
(Increase) decrease in assets:	
Accounts receivable	(248,300)
Increase (decrease) in liabilities:	
Accounts payable	1,109
Claims and awards liabilities	12,449,000
Accrued salaries and employer contributions	725
Accrued annual leave	5,271
Unearned fees	<u>1,350,000</u>
Total Adjustments	<u>12,588,043</u>
Net Cash Used by Operating Activities	<u>5,152,924</u>

Cash Flows From Capital and Related Financing
Activities:

Purchase of Equipment	<u>(2,273)</u>
Cash Used for Capital and Related Financing Activities	<u>(2,273)</u>

Cash Flows from Investing Activities:

Interest received	<u>994,487</u>
Cash Provided by Investing Activities	<u>994,487</u>
Net Increase (Decrease) in Cash and Cash Equivalents	6,145,138
Cash and Cash Equivalents, Beginning of Year	<u>13,365,962</u>
Cash and Cash Equivalents, End of Year	<u>\$ 19,511,100</u>

Supplementary Disclosures:

Cash flows from operating activities:	
Cash paid for claims and awards	<u>\$ 9,917,941</u>

* For purposes of this financial statement net income or loss and operating income or loss are the same.

THE ACCOMPANYING NOTES ARE AN
INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA MEDICAL MALPRACTICE
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NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by generally accepted accounting principles, the financial reporting entity includes both the primary government and all 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. The Organization is identified herein as the primary entity.

The primary 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 bonded debt without approval by another government.

Based on the application of the above criteria, no component units are included in the reporting entity.

The South Carolina Medical Malpractice Patients' Compensation Fund was established by Section 38-79-420 of the Code of Laws of South Carolina on July 1, 1976. The South Carolina Medical Malpractice Patients' Compensation Fund is part of the primary government of the State of South Carolina and is included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Board of Governors, whose members are appointed by the Governor, is the governing body of the South Carolina Medical Malpractice Patients' Compensation Fund.

SOUTH CAROLINA MEDICAL MALPRACTICE
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The coverage is available to any public or private health care provider in the state. The Fund is responsible for payment of that portion of any covered medical malpractice claim, settlement, or judgment which is in excess of \$100,000 per incident or in excess of \$300,000 in the aggregate for one year. Although the reporting entity operates somewhat autonomously it lacks full corporate powers. The accompanying financial statements present the financial position, results of operations, and cash flows solely of the South Carolina Medical Malpractice Patients' Compensation Fund and do not include any other component units of the State of South Carolina.

Fund Accounting

The government uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management.

A fund is a separate fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with related liabilities and residual equities or balances and changes therein, which are segregated to carry on specific activities or attain certain objectives in accordance with applicable regulations, restrictions, or limitations. All financial transactions in the financial statements have been reported by fund.

Proprietary Funds - are used to account for activities similar, to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Generally, when services from such activities are primarily provided to outside parties, the funds are classified as enterprise funds. All activities and accounts are classified in an enterprise fund of the proprietary fund category.

Enterprise Fund - accounts for activities that are self-sustaining, primarily through user charges, or are used when management wants to control or measure costs of services.

The South Carolina Medical Malpractice Patients' Compensation Fund was created by act of the General Assembly for the purpose of providing funds for payment of that portion of any medical malpractice claim, settlement or judgment against a health care provider which is in excess of \$100,000 per incident or in excess of \$300,000 in the aggregate for one year. The Fund is liable only for payment of claims against "licensed health care providers" which includes physicians and surgeons, directors, officers and trustees of hospitals; nurses; oral surgeons; dentists; pharmacists; chiropractors; hospitals; nursing homes; or any similar category of licensed health care providers. All providers licensed in South Carolina are eligible to participate in the Fund upon remitting the annual assessment fees in amounts as determined by the governing board of the Fund.

SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

Basis of Accounting

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of those funds are included on the balance sheet. Proprietary fund-type operating statements present increases and decreases in net total assets.

The financial statements are presented on the accrual basis of accounting for measuring financial position and results of operations. Proprietary fund type revenues and expenses are recognized on the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for generally accepted accounting principles applicable to governmental proprietary activities. The Fund applies all applicable Government Accounting Standards Board (GASB) pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with (GASB) pronouncements. In accordance with GASB Statement 20, the Fund has elected not to implement FASB Statements 103 and after. As discussed later, the Fund uses FASB 60, guidance to record unpaid claims liabilities.

Budget Policy

The South Carolina Medical Malpractice Patients' Compensation Fund is granted an annual appropriation for administrative operating purposes by the General Assembly. The appropriation as enacted becomes the legal operating budget for the Fund for its budgeted activities. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and expenditures of total funds. None of the funding of the South Carolina Medical Malpractice Patients' Compensation Fund is provided from State General Fund appropriations. The General Assembly enacts the budget through passage of line-item appropriations by program within budgetary unit. Budgetary control is maintained at the line-item level of the budgetary entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist.

Transfers of funds may be approved by the State Budget and Control Board under its authority or by the agency as set forth in Appropriation Act Proviso 72.9 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

SOUTH CAROLINA MEDICAL MALPRACTICE
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NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

During the fiscal year-end closeout period in July, agencies may continue to charge vendor, interagency, and interfund payments for the fiscal year to that fiscal year's appropriation. For the Fund, any unexpended funds as of June 30, automatically carry over to the ensuing fiscal year. State law does not require the use of encumbrance accounting.

State law does not precisely define the budgetary basis of accounting. The current Appropriation Act states that the General Assembly intends to appropriate all State funds and to authorize and/or appropriate the use of all other monies to operate State government for the current fiscal year. The State's annual budget is prepared primarily on the modified accrual basis of accounting with several exceptions, principally the cash disbursements basis for payroll expenditures.

The budget and actual comparison in Note 2 presents actual expenses on the budgetary basis of accounting compared to the legally adopted and modified budget on a line-item expense basis for the Fund's administrative costs. The level of legal control for each agency is reported in a publication of the State Comptroller General's Office titled *A Detailed Report of Appropriations and Expenditures* for each fiscal year.

Cash and Cash Equivalents

The amounts shown in the financial statements as "*cash and cash equivalents*" represent cash on hand with the State Treasurer, and cash invested in various instruments by the State Treasurer as part of the State's cash management pool.

Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The pool includes some long-term investments such as obligations of the United States and certain agencies of the 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. Most State agencies participate in the cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. For those accounts, cash equivalents included investments in short-term, highly liquid securities having a maturity of three months or less.

The State's 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. Investments in the pool are recorded at fair value. Amortization of premiums and discounts is allocated and reported as interest income. Interest earned by the agencies' 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 income receivable to the total income receivable of the pool.

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NOTES TO FINANCIAL STATEMENTS
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(Continued)

Realized gains and losses are allocated daily and are included in the accumulated income receivable. Unrealized gains and losses are allocated at year end based on the agency's percentage ownership in the pool, and are included in cash and cash equivalents.

Although the cash management pool includes some long-term investments, it operates as a demand deposit account; therefore, for credit risk information pertaining to the cash management pool, see the deposits disclosures in Note 3.

Fixed Assets

Equipment acquisitions require the use of fund financial resources and are for amounts in excess of \$250 capitalized at cost in the Fund upon acquisition. Depreciation of equipment is charged as an expense against operations, and accumulated depreciation is reported on the Fund's balance sheet. Depreciation has been provided over estimated useful lives of 5-10 years using the straight-line method of depreciation.

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 a maximum of 180 days sick leave and 45 days annual vacation leave, except that faculty members do not accrue annual leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum of 45 days, but are not entitled to any payment for unused sick leave. The South Carolina Medical Malpractice Patients' Compensation 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 as a current liability. The net change in the liability is recorded in the current year in the applicable administrative expense categories.

Statement of Cash Flows

For purposes of this statement the South Carolina Medical Malpractice Patients' Compensation Fund considers investments with the State of South Carolina cash management pool to be cash equivalents because they are readily convertible to cash with an insignificant risk of loss in value.

Unpaid Claims Liabilities

In years prior to July 1, 1993, the Fund had been classified as risk sharing, public entity risk pool (PERP), Governmental Accounting Standards Board's Statement Number 10 *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*. Effective July 1, 1993, the Fund is considered an

SOUTH CAROLINA MEDICAL MALPRACTICE
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insurance enterprise which follows the guidance of FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*. This change was due to the fact that the Medical Malpractice Patients' Compensation Fund is primarily composed of non-governmental entities, and one of the key characteristics of (PERP) is that it is composed of primarily governmental entities. This change had no effect on the method of accounting for unpaid claims liabilities. Certain supplemental disclosures required by GASB 10 are not required under FASB 60, therefore they are not included in this report.

The Fund actuarially establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. The Fund, because it carries only excess liability coverage does not incur claim adjustment expenses. The length of time for which claims costs must be estimated varies depending on the coverage involved. Because actual claims costs depend on such complex factors as medical technology changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed annually using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. An actuarial study is performed each year by an actuary with the latest done in July, 1998 for the current year. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made. No claims payable are reported as current liabilities because of the uncertainty of when they will be paid and the length of time to litigate and/or determine liabilities of individual claims.

Revenue Recognition

The Fund receives fees from members, the fee pays for coverage for a year. Due to the various effective anniversary dates a provision for unearned fees at the end of every year is actuarially estimated. The computation of unearned fees is based upon the amount of the fees and the effective membership dates for participants. This is done to recognize revenue during the coverage period.

Due to the nature of the coverage of the members refunds are often warranted. These occur because of policy holder change of personnel and/or change of information provided by the policy holders relating to employees and their ratings. Refunds are recognized in the year of the refund. These adjustments are taken into consideration in computation of the unearned fees liability.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that

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(Continued)

affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 - BUDGET COMPARISON TO ACTUAL

The Administration expenses shown on the statement of revenues, expenses and changes in retained earnings are reported on the accrual basis of accounting which differs from the legally enacted budgetary basis. The amounts shown below reflect the adjustments from the GAAP basis to actual on the budgetary basis for the year ended June 30, 1998. Adjustments of the GAAP basis of accounting to the budgetary basis consist of reversals of payroll accruals, accrued annual leave and the related fringe benefits and of reflecting equipment acquisitions as expenditures.

Administration Expenses Per Statement of Revenues, Expenses and Changes in Retained Earnings	\$	291,055
Adjustments to Budgetary Basis:		
Net Accruals:		
Personal services		(724)
Annual leave		(5,272)
Equipment purchased		<u>2,273</u>
Total Actual on Budgetary Basis	\$	<u>287,332</u>

The Administration expenses shown below are presented on the budgetary basis compared to the legally adopted and modified budget by object code category.

<u>FISCAL YEAR 1998</u>	<u>LEGAL BASIS BUDGET</u>	<u>ACTUAL ON BUDGETARY BASIS</u>	<u>VARIANCE FAVORABLE (UNFAVORABLE)</u>
Personal Services	\$ 150,130	\$ 150,130	\$ -
Employer Contributions	30,922	30,922	-
Other Operating Expenses	<u>106,677</u>	<u>106,280</u>	<u>397</u>
Total	\$ <u>287,729</u>	\$ <u>287,332</u>	\$ <u>397</u>

NOTE 3 - DEPOSITS & INVESTMENTS

All deposits of South Carolina Medical Malpractice Patients' Compensation Fund are under the control of the State Treasurer who, by law, has sole authority for investing State Funds.

SOUTH CAROLINA MEDICAL MALPRACTICE
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NOTES TO FINANCIAL STATEMENTS
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(Continued)

Deposits Held by State Treasurer

State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days. At June 30, 1998, all State Treasurer bank balances were fully insured or collateralized with securities held by the State or by its agents in the State's name.

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

NOTE 4 - CLAIMS AND AWARDS

Because medical malpractice liability insurance covers claims occurring during the coverage period and claims emerge over a long period of time and because the Fund has limited claims experience history, provisions for estimated losses incurred but not reported and claims reported but not settled are based on an actuarial formula which is used to estimate the ultimate incurred losses. An actuary does an actuarial study each year to determine these liabilities. The actuarial study as of June 30, 1998 resulted in an increase in liabilities for claims and awards of \$12,449,000.

The liability for claims and awards includes an estimate of \$15,998,000 for claims reported but not settled at June 30, 1998. Claims incurred but not reported was estimated to be \$9,251,000 at June 30, 1998.

NOTE 5 - CLAIMS LIABILITIES

As discussed in Note 1, the Fund establishes a liability for both reported and unreported insured events, which includes estimates of future payment of losses. The following represents changes in those aggregate liabilities for the last two years.

	Reconciliation of Claims Liabilities	
	<u>1998</u>	<u>1997</u>
Unpaid claims at beginning of the fiscal year	\$ <u>12,800,000</u>	\$ <u>17,241,000</u>
Incurred Claims:		
Provision for insured events of the current fiscal year	25,000	48,000
Increases (decreases) in provisions for insured events of prior fiscal years	<u>22,341,941</u>	<u>7,056,690</u>
Total Incurred Claims	<u>22,366,941</u>	<u>7,104,690</u>

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NOTES TO FINANCIAL STATEMENTS
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(Continued)

Reconciliation of Claims Liabilities (Continued):

	<u>1998</u>	<u>1997</u>
Payments of claims:		
Attributable to events of current fiscal year	-	-
Attributable to events of prior fiscal years	<u>(9,917,941)</u>	<u>(11,545,690)</u>
Unpaid claims at end of the fiscal year	<u>\$ 25,249,000</u>	<u>\$ 12,800,000</u>

NOTE 6 - RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS

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

Substantially all employees of the South Carolina Medical Malpractice Patients' Compensation 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, 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 SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 30 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. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service. 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.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6.0 percent of all compensation. Effective July 1, 1997, the employer contribution rate became 9.466 percent which included a 1.916 percent surcharge to

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(Continued)

fund retiree health and dental insurance coverage. The Fund's actual contributions to the SCRS for the fiscal year ended June 30, 1998 were \$10,419, and equaled the required contributions of 7.55 percent (excluding the surcharge) for the year. Employer contributions for fiscal year 1997 were \$10,053 and for fiscal year 1996 were \$9,715. Also, the Fund paid employer group-life insurance contributions of \$207 in the current fiscal year at the rate of .15 percent of compensation.

The amounts paid by Fund for pension and group-life benefits are reported as employer contribution expenditures below.

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, benefits, and employee/employer contributions for each pension plan. 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).

The System does not make separate measurements of assets and pension liabilities for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plan is limited to the amounts 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 plan is limited to the contribution requirements for the applicable year from amounts appropriated therefor 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 plan.

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

Post-Retirement 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 active and certain retired State employees and certain surviving dependents of retirees. All permanent full-time employees of South Carolina Medical Malpractice Patients' Compensation 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 requirement, 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.

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(Continued)

These benefits are provided through the Fund's applicable revenue sources for active employees and the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable revenue 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 18,500 State retirees meet these eligibility requirements.

The South Carolina Medical Malpractice Patients' Compensation Fund recorded employer contribution expenses for these insurance benefits for active employees in the amount of \$5,849 for the year ended June 30, 1998. As discussed above, the Fund paid \$2,644 applicable to the 1.916% surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Division of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to the South Carolina Medical Malpractice Patients' Compensation Fund retirees is not available. By State law, the South Carolina Medical Malpractice Patients' Compensation 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 System's earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS benefits.

Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the agency have elected to participate. The multiple-employer plans, created under Internal revenue code sections 457, 401(k), and 403(b) are accounted for as agency funds of the State and included in the Comprehensive Annual Financial Report of the State of South Carolina. Employees may withdraw the current value of their contributions prior to termination if they meet requirements specified by the applicable plan.

Compensation deferred under the Section 401(k) and 403(b) plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Under the Section 457 plan, all deferred compensation plan amounts and earnings remain assets of the employer (the State) subject to the claims of the employer's general creditors, one of whom is the employee participant. It is unlikely, however, that the State would ever use plan assets to satisfy claims of the State's general creditors. The portion of assets of the Section 457 plan to which the State has access is disclosed in its annual financial report.

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On August 20, 1996, the provision of Internal Revenue Code Section 457 were amended by adding subsection (g). That subsection provides that new plans will not be considered eligible plans unless all assets and income of the plans are held in trust for the exclusive benefit of the participants and their beneficiaries. Existing plans also must comply with this requirement by January 1, 1999. South Carolina's plan adopted this change effective July 24, 1998.

NOTE 7 - RELATED PARTY TRANSACTIONS

The South Carolina Medical Malpractice Patients' Compensation Fund has significant transactions with the State of South Carolina and various other State agencies.

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

Other services received at no cost from the various divisions of the State Budget and Control Board include retirement and health plan administration, audit services, personnel management, assistance in the preparation of the State Budget, procurement services, property management and record keeping, review and approval of certain budget amendments and other centralized functions.

The South Carolina Medical Malpractice Patients' Compensation Fund also had financial transactions with various State agencies during the fiscal year. Significant payments were made to divisions of the State Budget and Control Board for office supplies, telephone, interagency mail, and data processing services. The amounts of 1998 expenses applicable to related party transactions are not readily available.

The South Carolina Medical Malpractice Patients' Compensation Fund provided no services free of charge to other State agencies during the fiscal year.

NOTE 8 - RESTRICTION ON PAYMENT OF CLAIMS

In the event the South Carolina Medical Malpractice Patients' Compensation Fund incurs a liability exceeding \$100,000 to any person under a single occurrence, the South Carolina Medical Malpractice Patients' Compensation Fund may not pay more than \$100,000 per year until the claim has been paid in full. However, the Board of Governors of the South Carolina Medical Malpractice Patients' Compensation Fund may authorize payments in excess of \$100,000 per year so as to avoid payment of interest.

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(Continued)

NOTE 9 - LEASES

The South Carolina Medical Malpractice Patients' Compensation Fund leases its office space and certain equipment under operating leases. The obligations under these leases having remaining noncancelable terms of more than one year, are as follows:

FOR THE YEAR
ENDING JUNE 30

1999	\$ 25,194
2000	1,206
2001	1,206
2002	<u>603</u>
Total	<u>\$ 28,209</u>

A new copier was leased effective January 1, 1997 for five years. The monthly payment for the new copier is \$100.

In July 1994 a lease was extended obligating South Carolina Medical Malpractice Patients' Compensation Fund to a five year rental for commercial office space. The monthly payments required under the lease are \$1,999 per month, and are included in the above projections.

During fiscal year 1998, the South Carolina Medical Malpractice Patients' Compensation Fund recorded payments under operating leases of \$25,157.

NOTE 10 - UNEARNED MEMBERS FEES

Unearned fees liability at June 30, 1998 is \$4,050,000 for unearned fees based on the one year advance payment of fees.

NOTE 11 - RISK MANAGEMENT

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for certain risks. Management believes such coverage is sufficient to preclude any significant uninsured losses to the Fund. The Fund has not had any claims in the past three years. There were no significant reductions in insurance coverage from coverage in the prior year. the Fund pays insurance premiums to certain other State agencies and commercial insurers to cover risk that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered premium losses sustained during the policy period in accord with the insurance policy and benefit program limits. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

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FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

1. Claims of covered employees for health and dental insurance benefits (Office of Insurance Services); and
2. Claims of covered public employees for long-term disability and group-life insurance benefits (Office of Insurance Services).
3. Claims of covered public employees for workers' compensation insurance benefits (State Accident Fund).
4. Claims of covered public employees for unemployment compensation insurance benefits (Employment Security Commission).

The Fund and other entities pay premiums to the states Insurance Reserve Fund (IRF) which issues policies, accumulate assets to cover the risks of loss and pays claims incurred for covered losses related to the following Fund assets, activities, and/or events.

1. Personal property and equipment - Eighty percent of each loss is covered by the IRF. Losses are subject to a \$250 deductible.
2. Data processing equipment - Coverage is up to \$100,000 per loss with a \$250 deductible.
3. Torts

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

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

The Fund does not purchase insurance coverage for employee fidelity bond insurance coverage arising from theft or misappropriations. Management believes based on exposure and likelihood of loss that this coverage is not necessary.

The Fund has not recorded any estimated losses or expense related to the deductible or policy limits because there is no evidence of asset impairment or other information to indicate a loss should be recorded.

NOTE 12 - DEFICIT ASSESSMENT

In April 1998, the Fund's Board imposed a deficit assessment equal to 100% of member premiums for members covered during the prior of June 1, 1997 to May 1, 1998. The total amount billed was \$7,614,996. Of this amount \$7,199,058 was

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(Continued)

collected by June 30, 1998. \$248,300 is included in accounts receivable and are amounts that were collected or can be reasonably expect to be collected after June 30, 1998. The balance of \$167,638 is not expected to be collected as a result of members who have moved or dropped their coverage.

NOTE 13 - NET LOSS AND RETAINED EARNINGS DEFICIT

The Fund has experienced large losses for the last two years which has resulted in a retained earnings deficit. As a result the Fund has increased premiums effective June 1, 1997 and again effective June 1, 1998. This should effectively double the premiums for the fiscal year 1998, excluding \$7,447,358 of deficit assessment revenues recognized in 1998. Also, the Fund if needed can assess members additional premiums. This authority was exercised in April 1998 as explained in Note 12. Also to conserve cash, if necessary, the Fund can restrict payment of claims as discussed in Note 8.

NOTE 14 - ACCOUNTING CHANGES AND PRIOR PERIOD ADJUSTMENTS

Effective July 1, 1997, the Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement requires that most investments of governmental entities be stated at fair value rather than at cost. For internal (and external) investment pools, this statement requires the equity position of each fund that sponsors the pool to be reported as assets in those funds. The effect of this change on the beginning balance at July 1, 1997, was not material and therefore no prior period adjustment was necessary. The unrealized gains included in cash and cash equivalents at June 30, 1998, was \$124,000.

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