

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

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

WITH

REPORT OF INDEPENDENT AUDITORS

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

WITH
REPORT OF INDEPENDENT AUDITORS

State of South Carolina



Office of the State Auditor

1401 MAIN STREET, SUITE 1200
COLUMBIA, S.C. 29201

THOMAS L. WAGNER, JR., CPA
STATE AUDITOR

(803) 253-4160
FAX (803) 343-0723

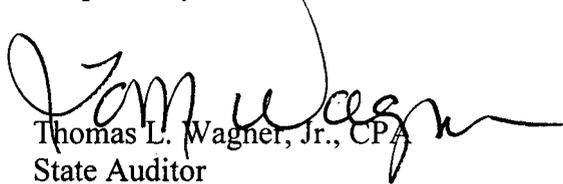
October 5, 2005

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, 2005, 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

YEAR ENDED JUNE 30, 2005

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 Revenue, Expenses, and Changes in Net Assets	14
Statement of Cash Flows	16
Notes to Financial Statements	18
Independent Auditors' Report on Internal Control	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	47

DELOACH & WILLIAMSON, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

1401 MAIN STREET, SUITE 660
COLUMBIA, SOUTH CAROLINA 29201

PHONE: (803) 771-8855

FAX: (803) 771-6001

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, 2005, 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, 2005 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.

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, 2005, 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 16, 2005, 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.

Deloitte & Williamson, L.L.P.

September 16, 2005

Management Discussion and Analysis

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. 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, 2005. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

Financial Highlights:

Business Type activities report a change in net assets of \$93,082,423 and total net assets at year-end of \$17,575,817 for the year ended June 30, 2005. In comparison, a change in net assets of \$4,408,224 was reported for the year ended June 30, 2004, with a total negative net asset balance of \$75,506,606 at the 2004-year end.

Overview of Financial Statements:

The Employee Insurance Program is an internal service fund proprietary type engaged in Governmental Activities. Following is a condensed Statement of Net Assets, a condensed Statement of Activities 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 unrestricted net assets. 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. Premium increases in plan years 2004 and 2005, along with significant plan changes in 2004, have greatly improved the net asset balance.

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, 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, 2005
(in millions)

	<u>2005</u>	<u>2004</u>
Assets:		
Current Assets	\$ 192.2	\$ 88.7
Non-Current Assets	15.8	19.5
Total Assets	<u>208.0</u>	<u>108.2</u>
Liabilities:		
Current Liabilities	189.9	183.3
Non-Current Liabilities	0.5	0.4
Total Liabilities	<u>190.4</u>	<u>183.7</u>
Net Assets:		
Investment in Capital Assets	0.2	-
Unrestricted	17.4	(75.5)
Total Net Assets	<u>\$ 17.6</u>	<u>\$ (75.5)</u>

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

Statements of Activities
(in millions)

	Year Ended June 30,	
	2005	2004
Governmental Activities:		
Program Revenues	\$ 1,364.0	\$ 1,245.7
Expenses	\$ (1,277.3)	(1,245.5)
Total governmental activities	86.6	0.2
General Revenue and Transfers:		
Earnings on Investment	6.7	4.6
Transfers to other agencies	(0.3)	(0.4)
Total general revenue and transfers	6.5	4.2
Change in net assets	93.1	4.4
Net assets, beginning of year	(75.5)	(79.9)
Net assets, end of year	\$ 17.6	\$ (75.5)

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,	
	2005	2004
Cash Flows from Operating Activities	\$ 88.9	\$ (11.1)
Cash Flows from Capital Financing Activities	(0.1)	-
Cash Flows from Noncapital Financing Activities	(0.4)	(0.4)
Cash Flows from Investing Activities	10.6	7.7
Net increase/(decrease) in cash and cash equivalents	99.0	(3.8)
Cash and cash equivalents, beginning of year	57.0	60.8
Cash and cash equivalents, end of year	\$ 156.0	\$ 57.0

Overview of the Employee Insurance Program:

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 authorized in § 1-11-740 of the South Carolina Code of Laws, and the Employee Adoption Assistance Program, pursuant to Proviso 63.28 of the 2005-2006 General Appropriations Act.

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

Self-Insured Programs

- ❑ State Health Plan:
 - Standard Plan (PPO)
 - Medicare Supplement
 - Savings Plan (HDHP)
- ❑ MUSC Options (POS)
- ❑ BlueChoice (HMO)
- ❑ CIGNA (HMO)
- ❑ State Dental Plan
- ❑ Basic Long Term Disability
- ❑ Adoption Assistance Program

Insured Programs

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

Benefits are offered to eligible employees and retirees of all State agencies and public school districts, and many local governments. Currently over 560 employers participate in the Employee Insurance Program. The State Health Plan, which encompasses medical, prescription drug, and behavioral health coverage, is the significant driver of EIP's financial activity, accounting for over 86% of all revenue.

Overview of State Health Plan:

The State Health Plan (Plan) consists of the Standard Plan, the Medicare Supplement Plan, and the Savings Plan. The majority of Plan subscribers (84%) are enrolled in the Standard Plan, a PPO option available to non-Medicare and Medicare enrollees. Of the remaining subscribers, 14% are enrolled in the Medicare Supplement, a

retiree option for those enrolled in Medicare, and 2% are enrolled in the Savings Plan. The Savings Plan is a qualified high deductible health plan (HDHP) available to non-Medicare enrollees. Effective January 2005, the Savings Plan replaced the Economy Plan, and although this option saw only limited migration (1.7%), new employees are enrolling in the Savings Plan at a rate of 7.5%.

The State Health Plan remains competitive with other southern state health plans in terms of plan deductibles, coinsurance, and prescription drug coverage. Following is a look at total enrollment in the State's medical insurance programs and enrollment in the State Health Plan (as of June 2005).

	<u>Program</u>	<u>State Health Plan</u>
Total Insured Persons:	407,473	338,901
Subscribers:	232,981	190,315
Spouses:	65,240	57,124
Children:	109,252	91,462
 Total Subscribers:	 232,981	 190,315
Employees:	173,298	132,876
Retirees:	55,654	53,643
Survivors:	2,714	2,678
COBRA:	1,315	1,118
 Active Employees:	 173,298	 132,876
State Agencies:	62,367	45,738
School Districts:	78,845	64,953
Local Government:	32,086	22,185

State Health Plan Premiums:

The State Health Plan operates under a 4-tier premium structure, varying contribution levels according to level of coverage. The coverage levels include Employee, Employee/Spouse, Employee/Child, and Full Family. At the beginning of 2005, the breakdown of coverage levels were as follows:

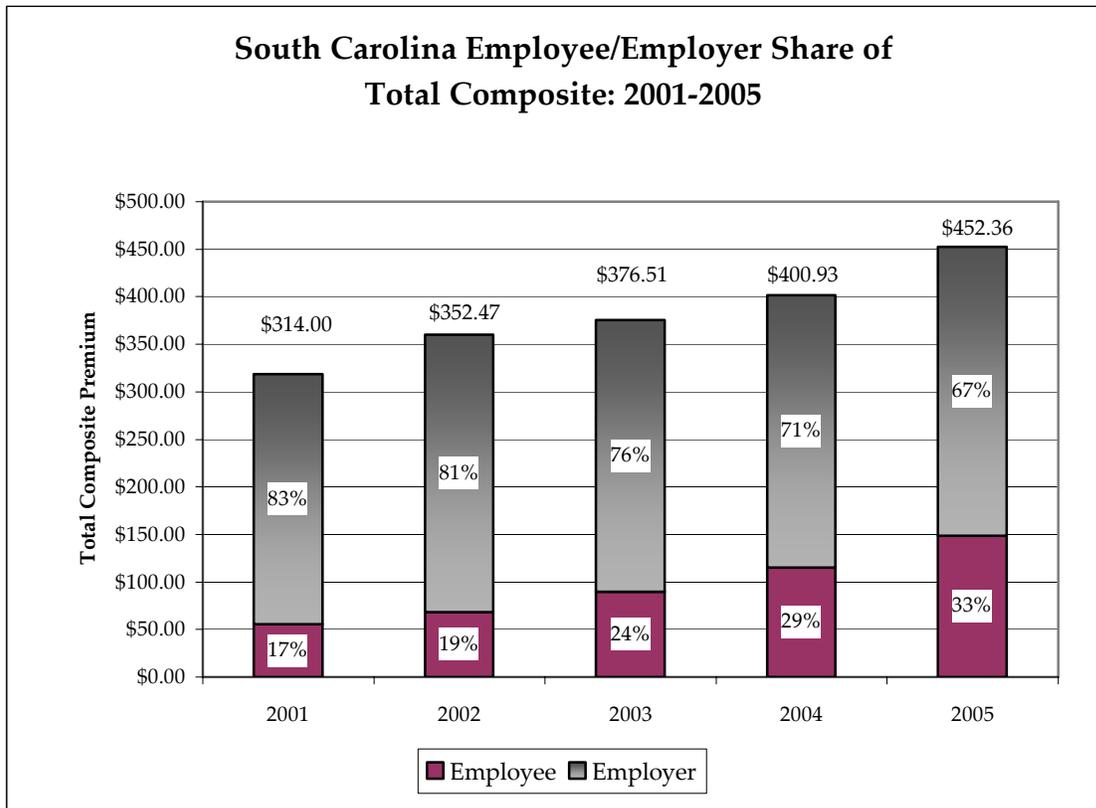
Employee	57%
Employee/Spouse	15%
Employee/Child	15%
Full Family	13%

Monthly premiums range from \$315.04 for Employee coverage to \$798.04 for Full Family coverage. Following are the 2005 State Health Plan monthly employee and employer rates.

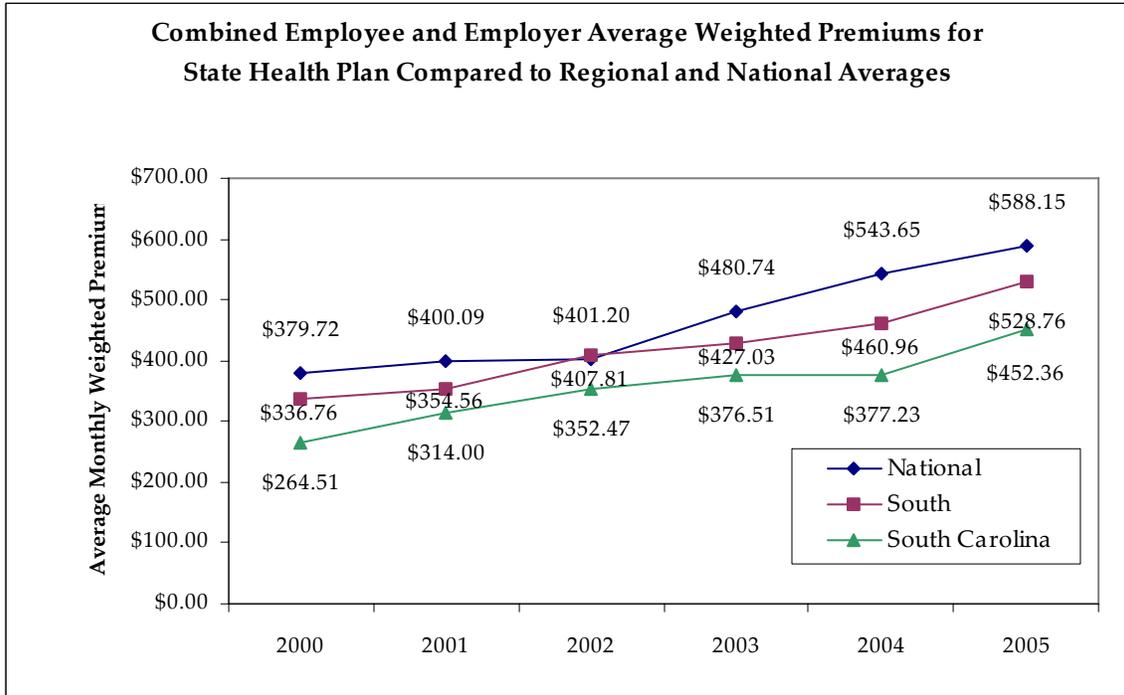
**2005 State Health Plan
(Standard Plan)
Premiums**

	<u>Employee</u>	<u>Employer</u>	<u>Total</u>
Employee	\$ 93.46	\$ 221.58	\$ 315.04
Employee/Spouse	\$ 237.50	\$ 431.60	\$ 669.10
Employee/Child	\$ 142.46	\$ 312.60	\$ 445.06
Full Family	\$ 294.58	\$ 503.46	\$ 798.04
Composite Rate	<u>\$ 148.72</u>	<u>\$ 303.64</u>	<u>\$ 452.36</u>

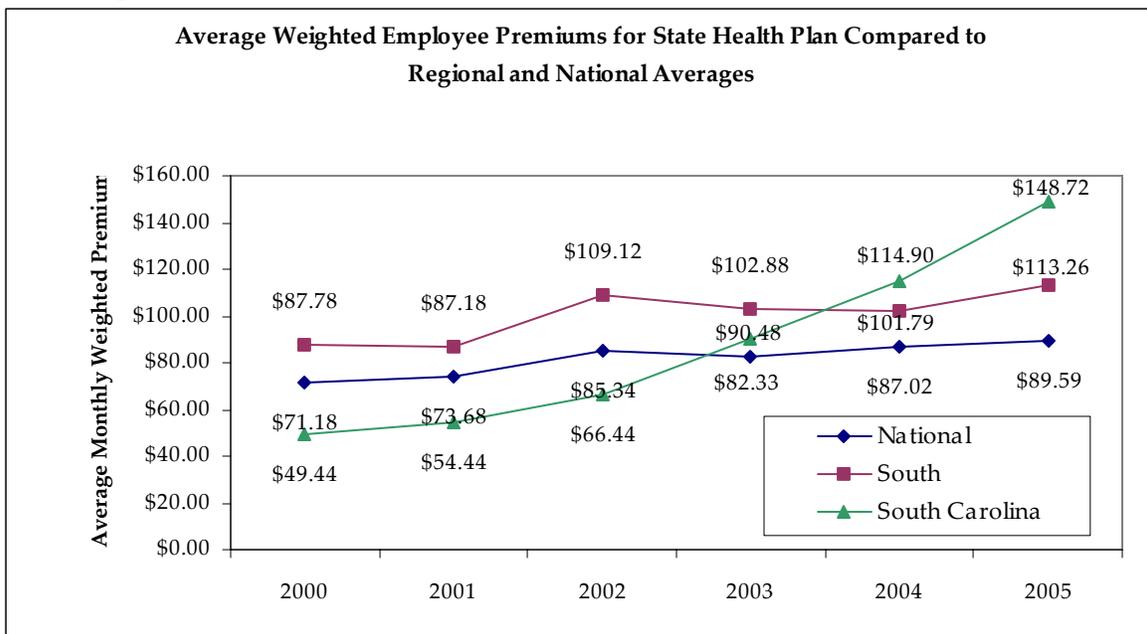
Premium revenue is shared between the employer and the employee (or retiree). The employee share continues to take on a greater percentage of the total State Health Plan premium. For 2005, the average employee share reached 33% of the total premium, compared to 2001, when the employee share represented only 17% of the total premium.



While State Health Plan premiums continue to rise, the composite total premium remains below both the southern and national levels. For 2005, the State Health Plan composite total premium was approximately 86% of the southern premium and 77% of the national premium.



With steady double-digit employee premium increases, the 2005 State Health Plan employee composite surpasses both the regional and national premium composite for the second consecutive year. In general, this increase is the result of employer contribution levels remaining either stagnant or increasing at levels insufficient to sustain claims expense.



Prior Year State Health Plan Initiatives:

Since 1999, the State Health Plan has implemented annual rate increases in an effort to meet its current financial obligations. Contribution increases since 1999 are outlined below.

State Health Plan Contribution Increases

	<u>Employer Rate Increase</u>	<u>Employee Rate Increase</u>	<u>Total</u>
1999	18.4%	---	14.2%
2000	10.2%	---	8.2%
2001	21.0%	10.2%	19.0%
2002	10.2%	22.1%	12.3%
2003	---	36.3%	6.8%
2004	---	27.1%	6.5%
2005	6.1%	29.7%	12.8%

In addition to annual rate increases, other initiatives have been necessary to maintain financial stability of the Plan. For Plan year 2003, a year in which no new employer funding was appropriated, participants and stakeholder groups expressed their desire to achieve financial stability exclusively through higher employee premium increases (no changes to Plan design). This resulted in employees experiencing an average premium increase of 36%, with overall Plan impact of 6.8%. This increase was necessary to end the year positive, but with no accumulation of Plan reserves. State Proviso 63.15 eliminated any requirement for a reserve balance at the end of the Plan year.

In 2004, however, when faced with yet another year of no new employer money, participants and stakeholder groups voiced their preference for managing claims expenses through a combination of employee increases and benefit design changes. Effective January 2004, the State Health Plan increased employee premiums by an average of 27%. Again, this was necessary to end the Plan year positive, but without accumulating any reserves (State Proviso 63.12 eliminated reserve balance requirement).

In addition to premium increases, a variety of benefit changes were implemented. They included, 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 increased to \$2,000 single/\$4,000 family for both plans (from \$1,500 single/\$3,000 family). Also, per-occurrence deductibles increased to \$75 for outpatient hospital visits (from \$50) and \$125 for emergency room visits (from \$100). A new \$10 per-visit deductible was applied for all physician office visits beginning in 2004. Other benefit design changes included a 20% out-of-network fee, and changes to the prescription drug benefit. A third tier drug co-payment was added, and drug co-payments increased from \$7/generic and

\$22/brand to a co-payment structure including \$10/generic, \$25/brand and \$40/non-preferred brand. The prescription drug out-of-pocket maximum increased from \$1,100 to \$2,500, and the State Health Plan participated in Medco Health's Select Network, garnering a greater percentage of discounts off of prescription drug charges.

Also, effective July 1, 2004, EIP implemented experience rating for optional employers. These employers, unlike state agencies and public school districts, participate at their option, as authorized under §1-11-720 of the South Carolina Code of Laws. Employers are tiered according to enrollment, and their enrollment along with claims experience determines any "load factor" to be applied to their total premium. This load factor is reevaluated annually, and may reach as high as 150% of the basic State Health Plan rate. Based on 2003/2004 claims data, overall claims experience for optional employers was approximately 7.5% higher than that of the mandatory participants.

2005 Plan Initiatives:

For the Plan year 2005, the General Assembly approved an average 6.1% increase in employer funding. This funding increase, however, was not projected to be sufficient to sustain claims expense through the end of the year, even without accumulating any reserve balance (State Proviso 63.10 eliminated any reserve requirement). To forgo another year of significant Plan design changes, employees absorbed an average premium increase of nearly 30%. This increase was effective January 2005, and impacted total Plan revenue by 6.1%. Other minor benefit design changes included a separate, out-of-network coinsurance maximum of \$4,000/single and \$8,000/family, and the elimination of gastric bypass surgery as a covered benefit. Also, mail order co-payments increased to \$25 from \$23 (generic), to \$62 from \$56 (preferred brand), and to \$100 from \$90 (non-preferred brand).

Another change enacted January 2005, was the replacement of the Economy Plan with a new option, a qualified high deductible health plan, referred to as the Savings Plan. In the face of rising health care costs, this new plan was part of EIP's effort to provide subscribers an economical health insurance option, distinctly different from the Standard Plan. The Savings Plan has significantly lower rates than the Standard Plan, \$9.28 versus \$93.46 for Employee coverage, and \$108.56 versus \$294.58 for Family coverage. In exchange for lower premiums, the Savings Plan has significantly higher deductibles and coinsurance. Deductible/coinsurance is \$3,000/\$2,000 for single coverage, and \$6,000/\$4,000 for family coverage. Family coverage is any coverage other than single coverage. After the deductible is met, the Plan pays covered benefits at 80% in-network, and 60% out-of-network (no coinsurance maximum for out-of-network services). Subscribers enrolled in the Savings Plan are eligible for establishing a Health Savings Account (HSA) for setting aside tax-free dollars to pay for qualified medical expenses. Eligibility is based on the subscriber not being covered in any other health coverage, which is not considered to be a high deductible health plan. The Internal Revenue Code governs maximum HSA contribution limits.

Claims Trend and Looking Forward:

Plan changes enacted in 2004 have improved the State Health Plan’s financial condition. The Plan achieved a 0.5% reduction in expenditure per person in 2004, compared to 12.8% spending growth per person in 2003. Plan payout at the end of 2004 was \$23.5 M. less than in 2003, and the Plan’s cash balance at the end of June 2005 was \$103.8 M. equal to 1.34 months of claims reserves.

Driving this trend is the reduction seen in utilization of certain health care services. Specifically, the Plan saw a reduction in Emergency Room visits from 2003 to 2004 of 7.7%, and a significant reduction in physician office visits for this same period of 2.2%. And, although prescription drugs continue to make up approximately 28% of total Plan payout, increased member cost shifting has impacted utilization and Plan cost. For 2004, the generic dispensing rate increased to 43.3% compared to 39.1% for 2003, and the mail service dispensing rate increased to 9.6% for 2004, up from 4.7% in 2003. The overall drug payout per person dropped from 22.7% in 2003 to 0.4% in 2004. Following are four years of State Health Plan payout per person and percent of prescription drugs to total Plan cost.

	Plan Payout Growth/Person	Percent of Rx to Total Payout
2001	11.0%	23.7%
2002	8.3%	25.5%
2003	12.8%	27.8%
2004	(0.5%)	28.1%

Looking forward to Plan Year 2006, the General Assembly fully funded the requested budget requirements. Employer contributions will increase approximately 4.8% effective January 1, 2006, and, for the first time since 2000, employees will not see a premium increase. For the Savings Plan, a separate, out-of-network, coinsurance maximum will be added for 2006 (\$4,000/single and \$8,000/family).

The State Health Plan is adding a new benefit for 2006. Subscribers will be able to participate in a tobacco cessation program. This program combines counseling and nicotine replacement therapy and will be funded entirely by the Plan.

The Plan also expects to receive an estimated \$25 M. in new funds from the federal government in subsidies for prescription drug coverage for Medicare retirees.

Contact Information:

Please direct questions related to the Management Discussion & Analysis and the accompanying financial statements to Phyllis Buie, Chief Financial Officer, at (803) 734-0326.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF NET ASSETS

JUNE 30, 2005

Assets

Current assets:

Cash and cash equivalents <i>(Note 2)</i>	\$ 155,970,218
Premiums receivable <i>(Note 3)</i>	486,981
Prescription Drug Rebate receivable	7,900,720
Accrued interest	196,606
Due from South Carolina Division of Retirement <i>(Note 4)</i>	27,619,649
Total current assets	192,174,174

Non-current assets:

Investments <i>(Note 2)</i>	15,647,615
Capital assets, net of accumulated depreciation <i>(Note 5)</i>	177,893
Total non-current assets	15,825,508

Total assets

207,999,682

Liabilities

Current liabilities:

Accounts payable	645,075
Accrued payroll	360,492
Claims payable	48,054,915
Deferred premium revenue	4,013,175
Claims incurred but not reported	136,873,580
Accrued compensated absences - current portion <i>(Note 14)</i>	22,885
Total current liabilities	189,970,122

Long-term liabilities:

Contingencies <i>(Note 11)</i>	
Accrued compensated absences - long term <i>(Note 14)</i>	453,743
Total long-term liabilities	453,743

Total liabilities

190,423,865

Net Assets

Investment in capital assets	177,893
Unrestricted	17,397,924
Total net assets	\$ 17,575,817

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2005

Operating Revenue

Insurance premiums:	
Active employees:	
Health	\$ 757,822,725
Dental	50,188,147
Life	736,068
Long-term disability	12,943,945
Dependent/optional life	30,447,452
HMO-point of service	186,734,897
Retirees:	
Health	95,762,212
Dental	5,322,817
Retiree surcharge	196,204,743
HMO-point of service	3,772,952
Other premium revenues	2,482,277
Prescription drug rebates	21,529,396
Other	62,795
Total operating revenue	1,364,010,426

Operating Expenses:

Premiums	58,563,823
Claims:	
Health	659,246,101
Dental	48,638,551
Life	78,000
Long-term disability	6,954,044
HMO-point of service	165,498,366
Prescription drug	281,570,987
Salaries and benefits	4,195,065
Professional services	48,269,874

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

(CONTINUED)

Telephone and utilities	91,568
Supplies	654,274
Other services	3,249,276
Printing and publication	112,547
Postage and shipping	138,964
Depreciation	20,152
Total operating expenses	<u>1,277,281,592</u>
Operating income	<u>86,728,834</u>
Non-operating revenue:	
Income from deposits and investments	<u>6,706,690</u>
Income before transfers	93,435,524
Interfund transfers	<u>(353,101)</u>
Change in net assets	93,082,423
Net assets (deficit), beginning of year	<u>(75,506,606)</u>
Net assets , end of year	<u><u>\$ 17,575,817</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2005

Cash Flows from Operating Activities

Insurance premiums from customers	\$ 1,343,615,863
Other receipts	17,243,855
Payments to employees	(4,066,431)
Payments to suppliers	(1,268,009,948)
Other operating payments	123,791
Net cash provided by operating activities	88,907,130

Cash Flows from Capital Financing Activities

Purchase of Capital Assets	(146,919)
Net cash used in capital financing activities	(146,919)

Cash Flows from Noncapital Financing Activities

Transfers to other state agencies	(353,101)
Net cash used in noncapital financing activities	(353,101)

Cash Flows from Investing Activities

Purchases of investments	(401,180)
Proceeds from sales and maturity of investments	4,196,357
Interest received-deposits and investments	6,768,361
Net cash provided by investing activities	10,563,538

Net increase in cash and cash equivalents	98,970,648
Cash and cash equivalents, beginning of year	56,999,570
Cash and cash equivalents, end of year	\$ 155,970,218

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

STATEMENT OF CASH FLOWS

(CONTINUED)

Reconciliation of income to net cash provided by operating activities

Operating income	\$	86,728,834
Adjustments to reconcile operating income to net cash used in operating operating activities:		
Depreciation expense		20,152
Disposal of fixed assets		
Change in assets-(increase) decrease:		
Premiums receivable		1,126,230
Due from South Carolina Division of Retirement		(4,348,336)
Prescription drug rebate receivable		(1,374,773)
Change in liabilities-increase (decrease):		
Accounts payable, accrued payroll and compensated absences		252,425
Deferred premium revenue		1,446,171
Claims payable and incurred but not reported		5,056,427
Net cash provided by operating activities	\$	<u>88,907,130</u>

Supplemental Information

Unrealized gain on investments	\$	<u>307,942</u>
Increase in investments for amortization/accretion	\$	<u>68,668</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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 is a fund of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. This report contains only the Fund 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.

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.

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.

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 Employee Insurance Program provides health insurance to eligible employees and retirees of State agencies and its political subdivisions who elect coverage. Coverage elections include five self-insured health plans. The State Health Plan offers a High Deductible Health Plan (SHP Savings Plan) and a Preferred Provider Organization (SHP Standard Plan). The Traditional HMOs offered are the Companion HMO and CIGNA HMO. The HMO with the Point of Service Option is MUSC Options. All dental coverage is through the State's self-insured plan, which is available to eligible employees and retirees. An additional dental option is offered to subscribers, Dental Plus, which is a fully insured product. The Basic Long-Term Disability Plan is a self-insured group long-term disability plan available to eligible active employees enrolled in a State health plan. Supplemental long-term disability, a fully insured product, is also offered to subscribers. Optional Life and Dependent Life are fully insured products offered to eligible employees. Long-term care insurance, a fully insured program, is also available to eligible employees. For active employees, the employee share of premiums is paid through payroll deductions. The respective employer pays the employer's premium portion for active employees. For retirees of the State and School Districts, the employee portion of the premiums is withheld from the individual retirement check. The employer premium share for retirees of the State and School Districts is paid through retiree insurance surcharge (*see Note 4*). For Local Subdivisions, the employer is responsible for collecting the retiree premium and remitting the entire premium to the Employee Insurance Program.

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 and adjusted as considered necessary after actuarial calculation.

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

Basis of Presentation

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

The financial statement presentation for the Fund meets the requirements of Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*.

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)

As an internal service fund, the Fund in its stand-alone financial statements is considered a proprietary fund under the guidance of GASB Statement No. 34. However, the guidance requires internal service funds included in the basic financial statements of the primary government to be reported as part of the governmental activity. Therefore, presentation in the Comprehensive Annual Financial Report of the State of South Carolina will include this fund as a governmental activity. The financial statement presentation provides a comprehensive, entity-wide perspective of the Fund's net assets, revenue, expenses and changes in net assets and cash flows that replaces the fund-group perspective previously required.

Financial Statements

Employee Insurance Programs is an internal service fund within the South Carolina Budget and Control Board as the State's managers have determined that the State is the predominant participant in the Fund.

Basis of Accounting

The Fund's financial statements have been presented using the economic resources measurement focus, which is based upon a determination of net income, financial position, and cash flows. Under this method, all assets and all liabilities associated with the operation of the Fund are included on the statement of net assets. Net assets are segregated into investment in capital assets, net of related debt, restricted net assets and unrestricted net assets components.

The Fund uses 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 Fund reports claims liabilities when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

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 including the Fund 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 2*.

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 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.

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

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)

(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 2005 compounded annually.

Claims Payable

Claims payable represents claims related to health claims, dental claims and Long-Term Disability claims payable at June 30, 2005. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Fund.

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.

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)

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.

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. 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.

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, 2005.

	Amortized Cost	Unrealized		Market Value
		Gains	Losses	
U. S. Treasury notes	\$ 248,809	\$ -	\$ (157)	\$ 248,652
U. S. Government agencies securities	499,590	-	(8,025)	491,565
Collateralized mortgage-backed obligations	4,055,246	218,808	-	4,274,054
Other Governmental guaranteed investments	219,386	953	-	220,339
Repurchase agreement	8,155,000	-	-	8,155,000
Corporate bonds	7,554,645	743,146	(8,464)	8,289,327
Financial paper	2,003,508	127,464	(7,294)	2,123,678
Total	\$ 22,736,184	\$ 1,090,371	\$ (23,940)	\$ 23,802,615

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

At June 30, 2005, the amortized cost of the above investments was comprised of the following:

	<u>Par Value</u>	<u>Unamortized Premiums</u>	<u>Unaccrued Discounts</u>	<u>Amortized Cost</u>
U. S. Treasury notes	\$ 250,000	\$ -	\$ (1,191)	\$ 248,809
U. S. Government agencies	500,000	-	(410)	499,590
Collateralized mortgage- backed obligations	4,067,486	-	(12,240)	4,055,246
Other Government guaranteed investments	219,386	-	-	219,386
Repurchase agreement	8,155,000	-	-	8,155,000
Corporate bonds	7,634,881	75,478	(155,714)	7,554,645
Financial paper	2,000,000	11,245	(7,737)	2,003,508
Total	<u><u>\$ 22,826,753</u></u>	<u><u>\$ 86,723</u></u>	<u><u>\$ (177,292)</u></u>	<u><u>\$ 22,736,184</u></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, 2005. 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, 2005. Short-term investments held during the fiscal year 2005 consisted of U.S. Government agency and government-insured securities whose amortized cost approximates fair value at June 30, 2005.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

The investment types listed above include all investment types in which monies were held throughout the year ended June 30, 2005. Due to higher cash flows at certain times during the year, the Fund's investment in repurchase agreements fluctuated significantly. The maximum amounts held in this classification during the year ended June 30, 2005, was as follows:

Repurchase agreements	<u><u>\$ 8,155,000</u></u>
-----------------------	----------------------------

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, 2005, the Fund had no deposits with financial institutions. The Fund had cash and pooled investments of \$3,863,446 and \$143,951,772, respectively, held by the State Treasurer as of June 30, 2005.

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:

Interest earned	\$ 6,393,222
Discount accretion	9,331
Premium amortization	(39,924)
Realized gains (losses)	36,119
Change in unrealized gains (losses)	<u>307,942</u>
Investment earnings	<u><u>\$ 6,706,690</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. 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 State Treasurer:		
Cash and cash equivalents	\$ 155,970,218	\$ 3,863,446
Pooled investments	-	143,951,772
Specifically identified investments	15,647,615	23,802,615
Total	\$ 171,617,833	\$ 171,617,833

3. Premiums Receivable

Premiums receivable at June 30, 2005, consist of the following:

Local government	\$ 195,286
State government (<i>Note 10</i>)	240,921
Other	50,774
	\$ 486,981

As of June 30, 2005, 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, 2005.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Due to or from South Carolina Division of Retirement

At June 30, 2005, a total of \$27,619,649 consisting of \$27,125,671 from South Carolina Retirement System and \$493,978 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 3.25% from July 1, 2004 to June 30, 2005.

5. Capital Assets

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

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Furniture and equipment	\$ 174,214	\$ 146,919	\$ -	\$ 321,133
Accumulated depreciation	(123,088)	(20,152)	-	(143,240)
Capital assets, net	\$ 51,126	\$ 126,767	\$ -	\$ 177,893

Depreciation expense for the year ended June 30, 2005 was \$20,152.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

6. 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 was amended effective July 1, 2005, with a base charge of \$6.85 per square foot. This lease expires on June 30, 2008. Rental expense under this lease for the year ended June 30, 2005 was \$384,413.

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, 2005, expenses under these leases were approximately \$24,910.

The following schedule summarizes the Fund's obligations under noncancelable operating leases having remaining terms in excess of one year as of June 30, 2005:

<u>Ending June 30,</u>	<u>Total</u>
2006	\$ 314,617
2007	314,617
2008	<u>314,617</u>
Total	<u><u>\$ 943,851</u></u>

7. 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

7. Pension Plans (Continued)

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.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

7. Pension Plans (Continued)

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, 2005, the employer contribution rate was 10.95 percent (including a surcharge to fund retiree health and dental insurance coverage of 3.25 percent). The Fund's actual contributions to the SCRS was approximately \$340,640, 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, 2005.

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).

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. 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 21,400 State retirees meet these eligibility requirements.

The Fund recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$252,000, for the year ended June 30, 2005. The Fund paid approximately \$108,000 for the year ended June 30, 2005, applicable to the surcharge included with the employer contributions for retirement benefits (3.25% for 2005).

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. 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.

This Fund made no contributions for the fiscal year ending June 30, 2005.

10. 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)

10. 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, 2005:

SC State Senate - Clerical	\$ 354,888
SC State Senate - Senators	210,722
House of Representatives - Clerical	299,520
House of Representatives - Senators	413,054
Legislative Council	106,081
Legislative Printing and Information	79,286
Legislative Audit Council	53,875
SC Education Oversight Committee	27,311
Judicial Department	1,884,609
SC Administrative Law Judge Division	66,975
Governor's Office - Executive Control of State	38,657
State Law Enforcement Division	1,628,639
Governor's Office - Executive Policy & Programs	845,406
Governor's Office - Mansion & Grounds	34,026
Lt. Governor's Office	139,632
Secretary of State	94,534
Comptroller General's Office	227,638
State Treasurer	213,122
Attorney General	475,167
SC Commission on Prosecution Coordination	160,563
SC Commission of Appellate Defense	47,173
Commission on Indigent Defense	18,394
Adjutant General's Office	751,327
State Election Commission	45,148
SC Budget & Control Board	4,052,289
SC Budget & Control Board - State Auditor	135,836
Commission on Higher Education	146,019
Higher Education Tuition Grants Commission	15,397

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. Transactions with State Entities (Continued)

The Citadel	2,153,147
Clemson University	14,583,656
College of Charleston	4,163,752
Coastal Carolina University	2,569,184
Francis Marion University	1,522,006
Lander University	1,161,297
SC State University	2,584,685
University of South Carolina	20,935,676
Winthrop University	2,632,654
Medical University of South Carolina	13,849,933
State Board for Technical & Comprehensive Education	336,752
Trident Technical College	1,969,357
Northeastern Technical College	324,135
Florence-Darlington Technical College	885,060
Greenville Technical College	2,402,777
Horry-Georgetown Technical College	1,051,922
Midlands Technical College	2,050,636
Orangeburg-Calhoun Technical College	642,383
Piedmont Technical College	1,006,387
Spartanburg Technical College	923,658
Central Carolina Technical College	647,808
Tri County Technical College	949,020
York Technical College	965,879
Aiken Technical College	485,426
Technical College of Low Country	490,006
Denmark Technical College	308,029
Williamsburg Technical College	208,322
Department of Education	3,770,083
SC Educational Television Commission	832,395
Wil Lou Gray Opp School	168,725
Vocational Rehabilitation	3,795,892
SC School for the Deaf & Blind	1,439,249
Department of Archives & History	251,052
SC State University	138,740
SC Arts Commission	97,743

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. Transactions with State Entities (Continued)

SC Museum Commission	115,321
Health & Human Services Financial	3,885,411
Department of Health & Environmental Control	16,428,131
Department of Mental Health	16,863,934
SC Department of Disabilities & Special Needs	7,968,824
SC Department of Alcohol & Other Drug Abuse Services	140,924
SC Department of Public Safety	5,371,488
Department of Social Services	12,001,645
John De La Howe School	300,077
SC Commission for the Blind	353,642
SC State Housing Finance & Development Authority	377,020
SC Human Affairs Commission	145,045
State Commission for Minority Affairs	17,672
SC Department of Corrections	17,895,934
SC Department of Probations, Parole & Pardon Services	2,323,350
SC Department of Juvenile Justice	4,609,826
Forestry Commission	1,440,882
Department of Agriculture	475,587
Department of Natural Resources	2,864,886
Sea Grant Consortium	41,457
Department of Parks, Recreation & Tourism	1,691,466
SC Department of Commerce	356,649
SC Jobs - Economic Development Authority	10,458
Business Carolina, Inc.	39,444
Patriots Point Development Authority	232,052
Public Service Commission	209,789
Office of Regulatory Staff	131,521
SC Workers' Compensation Commission	194,894
State Accident Fund	254,371
Patients Compensation Fund	18,039
Second Injury Fund	71,239
SC Department of Insurance	283,541
State Board of Financial Institutions	118,078
SC Department of Consumer Affairs	120,845
Department of Labor, Licensing, & Regulation	1,300,035

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. Transactions with State Entities (Continued)

SC Department of Motor Vehicles	3,432,298
Department of Revenue and Taxation	2,096,123
State Ethics Commission	22,957
Employment Security Commission	3,671,955
Procurement Review Panel	6,688
Department of Transportation	18,210,427
Aid to Subdivisions	264,136
South Carolina Education Lottery	448,822
COBRA and Retirees of State Agencies	737,253
	<u>\$ 232,406,850</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 2005 expenses applicable to related party transactions are as follows:

South Carolina Retirement Division	\$ 340,670
State Accident Fund	10,553
South Carolina Employment Security Commission	5,707
South Carolina Budget and Control Board	539,138
	<u>\$ 896,068</u>

In addition, interfund transfers include the following:

State Budget & Control Board - General Services -	<u>\$ 353,101</u>
---	-------------------

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. 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, 2005 were:

SC State Senate - Senators	\$	194
House of Representatives - Clerical		94,620
Legislative Council		247
SC Education Oversight Committee		60
State Law Enforcement Division		93
Governor's Office - Executive Policy & Programs		2,598
LT Governor's Office		1,089
Comptroller Generals Office		26
State Treasurer		4
Attorney General		25
SC Commission of Appellate Defense		827
Commission on Indigent Defense		19
Adjutant General's office		142
State Election Commission		4
SC Budget & Control		87
Commission on Higher Education		19
Lander University		241
University of South Carolina		13
Medical University of South Carolina		14
State Board for Technical & Comprehensive Education		288
SC Educational Television		2,293
Wil Lou Gray Opportunity School		5
Vocational Rehabilitation		82
SC State Library		222
SC Arts Commission		17
SC Museum Commission		7
Health & Human Services Finance		18,848
Department of Health & Environmental Control		2,911
Department of Mental Health		10,281
SC Department of Disabilities & Special Needs		2,283

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. Transactions with State Entities (Continued)

SC Department of Public Safety	152
Department of Social Services	21,370
SC Commission for the Blind	26
State Commission for Minority Affairs	28
SC Department of Corrections	36,378
SC Department of Probation Parole & Pardon Services	235
SC Department of Juvenile Justice	847
Forestry Commission	2,265
Department of Natural Resources	231
Sea Grant Consortium	15
Department of Parks, Recreation & Tourism	636
SC Department of Commerce	241
Business Carolina Inc	694
Patriot's Point Development Authority	357
Public Service Commission	734
Office of Regulatory Staff	17,705
SC Workers' Compensation Commission	32
State Accident Fund	14
Patients Compensation Fund	1,489
Second Injury Fund	68
SC Department of Consumer Affairs	532
Department of Labor, Licensing and Regulation	11
SC Department of Motor Vehicles	1,101
Department of Revenue and Taxation	14,356
Employment Security Commission	2,967
Procurement Review Panel	89
Department of Transportation	470
Aid to Subdivisions	7
SC Education Lottery	312
Total State Institutions	\$ 240,921

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

10. 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 fiduciary for premiums collected from state agencies for State Life and Long-Term Disability. During the year ended June 30, 2005, \$2,097,379 was collected from state agencies and disbursed to the State Life and Long-Term Disability carrier.

Additionally, refer to *Note 4* for a description of the amounts due from South Carolina Division of Retirement.

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

11. 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. 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 (Employee Insurance Programs).
5. Claims of covered property damage, theft, collision (automobile), liability, and general tort (Insurance Reserve Fund).

Employees elect health coverage through the State Health Plan, a health maintenance organization, or Tricare Supplement. All health plans offered through the Fund are self-insured products except Tricare Supplement.

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Risk Management/Reinsurance (Continued)

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, 2005, 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 offers HMO products through Companion and Cigna, which are self-insured. The basic long-term disability product is a self-insured product. The Fund also offers Dental Plus and State Life products, which are fully insured. The Fund purchases coverage for basic life, optional life, dependent life, supplemental long-term disability, and long-term care from commercial carriers.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
EMPLOYEE INSURANCE PROGRAMS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

13. 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)	
	2005	2004
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 179,872	\$ 188,153
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	914,409	905,812
Increases (decreases) in provision for insured events of prior fiscal years	247,578	237,396
Total incurred claims and claim adjustment expenses	1,161,987	1,143,208
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	\$ 804,254	\$ 775,279
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	352,676	376,210
Total payments	1,156,930	1,151,489
Total unpaid claims and claim adjustment expenses at end of the fiscal year	\$ 184,929	\$ 179,872
The above totals are comprised of the following:		
Claims payable	\$ 48,055	\$ 42,772
Claims incurred but not reported	136,874	137,100
Total	\$ 184,929	\$ 179,872

The HMO self-insured managed care plan liability at June 30, 2005 and 2004 was \$4,241,931 and \$3,440,483, 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)

14. Changes in Long-Term Liabilities

Changes in long-term obligations for the year ended June 30, 2005, were as follows:

	Beginning Balance July 1, 2004	Increases	Decreases	Ending Balance June 30, 2005	Due Within One Year
Compensated absences payable	\$ 399,613	\$106,737	\$ (29,722)	\$ 476,628	\$ 22,885

15. Subsequent Events

Effective July 1, 2005, retired SCRS or PORS members, including TERI participants, who work for a covered employer, will make the active employee's contributions. The SCRS employee's contribution will increase by 0.25 percent beginning July 1, 2005, and the SCRS employer's contribution will increase by 1 percent over two years beginning July 1, 2006.

DELOACH & WILLIAMSON, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

1401 MAIN STREET, SUITE 660
COLUMBIA, SOUTH CAROLINA 29201

PHONE: (803) 771-8855

FAX: (803) 771-6001

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

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, 2005, and have issued our report thereon dated September 16, 2005. 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.

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 an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not

express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

* * * * *

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

Rebeck & Williamson, L.L.P.

September 16, 2005