

State of South Carolina



Office of the State Auditor

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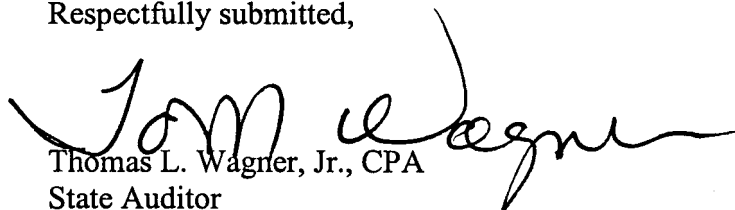
December 3, 2001

The Honorable Jim Hodges, Governor
and
Members of the South Carolina State Budget and Control Board
State of South Carolina
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Budget and Control Board Office of Insurance Services for the fiscal year ended June 30, 2001, was reissued by DeLoach & Williamson, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor. These financial statements have been modified (from those initially issued on November 3, 2001) as explained in the auditors' letter dated November 29, 2001, which immediately follows this transmittal letter.

If you have any questions regarding this report, please let us know.

Respectfully submitted,


Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/sag

DeLOACH & WILLIAMSON, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
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December 3, 2001

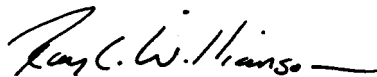
Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

Dear Mr. Wagner:

Enclosed are the financial statements of the South Carolina State Budget and Control Board, Office of Insurance Services, (the "Office") as of and for the years ended June 30, 2001 and 2000. These statements are being reissued after obtaining subsequent clarification concerning whether or not the Office was in violation of certain State statutes concerning its cash reserves. The previously issued financial statements reported that the Office was in violation of Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended. Management has now determined that there was no violation. These financial statements have been changed to reflect that.

If you have any questions, please do not hesitate to call.

Very truly yours,

A handwritten signature in cursive script, reading "Ray L. Williamson", followed by a horizontal line.

Ray L. Williamson, CPA

RLW:cwl
Enclosures

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

YEARS ENDED JUNE 30, 2001 AND 2000

WITH
REPORT OF INDEPENDENT AUDITORS

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

YEARS ENDED JUNE 30, 2001 AND 2000

WITH

REPORT OF INDEPENDENT AUDITORS

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying combined financial statements of the South Carolina State Budget and Control Board, Office of Insurance Services (the "Office") as of and for the years ended June 30, 2001 and 2000, 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, Office of Insurance Services. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

As discussed in *Note 1*, the accompanying financial statements of the South Carolina State Budget and Control Board, Office of Insurance Services 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, Office of Insurance Services.

As discussed in *Note 20*, prior to the current fiscal year, the Office incurred operating losses for the previous four years which has resulted in a retained deficit in the Health, Life and Disability Insurance Reserve Fund. Management's analysis of these losses and the accumulated deficit is more fully discussed in *Note 20*.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the funds of the South Carolina State Budget and Control Board, Office of Insurance Services, as of June 30, 2001 and 2000, and the results of operations of its governmental and proprietary fund types and cash flows of its proprietary fund type for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The other financial information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the combined financial statements. Such information has been subjected to the auditing procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

DeLoach & Williamson, C.L.P.

September 21, 2001

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED BALANCE SHEETS - ALL FUND TYPES

JUNE 30, 2001 AND 2000

	2001			2000
	Governmental Fund Type	Proprietary Fund Type	Totals (Memorandum Only)	Restated Proprietary Fund Type
	Special Revenue	Internal Service		Internal Service
Assets				
Current assets:				
Cash and cash equivalents	\$ 14,705,952	\$ 120,136,030	\$ 134,841,982	\$ 92,299,004
Premiums receivable	-	10,816,190	10,816,190	19,770,785
Reinsurance recovery receivable	-	747,084	747,084	3,644,087
Prescription Drug Rebate receivable	-	1,091,225	1,091,225	1,161,303
Current portion of notes receivable	-	326,894	326,894	1,556,018
Accrued interest	-	6,191,681	6,191,681	7,045,034
Due from South Carolina Division of Retirement	-	20,944,763	20,944,763	15,913,098
Prepaid insurance	-	2,195,112	2,195,112	2,118,094
Other assets	-	388,828	388,828	194,623
Total current assets	14,705,952	162,837,807	177,543,759	143,702,046
Non-current assets:				
Investments	-	265,658,652	265,658,652	269,536,712
Long-term notes receivable	-	21,940,735	21,940,735	23,254,956
Equipment, net of accumulated depreciation	-	952,038	952,038	858,824
Total non-current assets	-	288,551,425	288,551,425	293,650,492
Total assets	<u>\$ 14,705,952</u>	<u>\$ 451,389,232</u>	<u>\$ 466,095,184</u>	<u>\$ 437,352,538</u>
Liabilities and Fund Equity				
Current liabilities:				
Accounts payable	\$ -	\$ 485,950	\$ 485,950	\$ 449,697
Accrued payroll	-	508,889	508,889	509,470
Claims payable	-	151,170,635	151,170,635	128,955,768
Due to State General Fund	12,000,000	-	12,000,000	-
Deferred premium revenue	-	30,173,904	30,173,904	40,985,134
Claims incurred but not reported	-	158,101,553	158,101,553	179,632,638
Accrued compensated absences	-	544,483	544,483	647,053
Total current liabilities	12,000,000	340,985,414	352,985,414	351,179,760
Contingencies (Note 17)	-	-	-	-
Fund equity:				
Fund balance - reserved for South Carolina				
Seniors' Prescription Drug Program	2,705,952	-	2,705,952	-
Contributed capital	-	40,442	40,442	40,442
Retained earnings:				
Reserved for:				
Installment Purchase Program	-	35,000,000	35,000,000	35,000,000
Savannah Valley Development Loans	-	20,000,000	20,000,000	20,000,000
Unreserved	-	55,363,376	55,363,376	31,132,336
Total retained earnings	-	110,363,376	110,363,376	86,132,336
Total fund equity	2,705,952	110,403,818	113,109,770	86,172,778
Total liabilities and fund equity	<u>\$ 14,705,952</u>	<u>\$ 451,389,232</u>	<u>\$ 466,095,184</u>	<u>\$ 437,352,538</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENT OF REVENUE, EXPENDITURES,
AND CHANGES IN FUND BALANCE

ALL GOVERNMENTAL FUND TYPES

YEARS ENDED JUNE 30, 2001 AND 2000

	Governmental Fund Type	
	Special Revenue	
	2001	2000
Revenue:		
Tobacco settlement	\$ 20,000,000	\$ -
Total revenue	20,000,000	-
Expenditures:		
Administrative fees	619,034	-
Claims expense	4,675,014	-
Total expenditures	5,294,048	-
Excess of revenue over expenditures	14,705,952	-
Other financing sources (uses):		
Remitted to General Fund	(12,000,000)	-
Total other financial sources (uses)	(12,000,000)	-
Excess of revenue and other financing sources over expenditures and other financing uses	2,705,952	-
Fund balance, July 1	-	-
Fund balance, June 30	\$ 2,705,952	\$ -

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENT OF EXPENDITURES - BUDGET AND ACTUAL
ALL BUDGETED FUNDS

YEAR ENDED JUNE 30, 2000

	Budgetary General Fund			Other Budgeted Funds			Total Budgeted Funds		
	Legal Basis Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)	Legal Basis Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)	Legal Basis Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Special items:									
Healthy SC 2000 Fund									
Tobacco Settlement Senior Drug Program	\$ -	\$ -	\$ -	\$ 20,000,000	\$ 5,294,048	\$ 14,705,952	\$ 20,000,000	\$ 5,294,048	\$ 14,705,952
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,000,000</u>	<u>\$ 5,294,048</u>	<u>\$ 14,705,952</u>	<u>\$ 20,000,000</u>	<u>\$ 5,294,048</u>	<u>\$ 14,705,952</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENTS OF REVENUE, EXPENSES,
AND CHANGES IN RETAINED EARNINGS

ALL PROPRIETARY FUND TYPES

YEARS ENDED JUNE 30, 2001 AND 2000

	Proprietary Fund Type	
	Internal Service	
	2001	Restated 2000
Operating Revenue		
Insurance premiums:		
Tort liability	\$ 25,468,863	\$ 26,220,269
Auto liability	16,390,715	16,308,557
Professional liability	5,777,645	5,678,783
Comprehensive and collision	2,436,538	2,245,419
School bus liability	3,511,621	3,512,769
Fire	7,245,803	6,932,650
Extended coverage	3,608,922	3,457,741
Inland Marine	2,725,469	2,615,386
Active employees:		
Health	627,554,321	541,261,482
Dental	40,534,932	39,443,117
Life	4,712,501	4,347,370
Long term disability	11,554,816	11,928,091
Dependent/optional life	24,673,858	21,331,102
HMO-point of service	9,911,735	5,092,262
Retirees:		
Health	43,049,569	36,403,894
Dental	2,643,275	2,458,281
Retiree surcharge	139,121,482	106,266,508
HMO-point of service	115,709	22,637
Other premium revenues	3,567,133	3,392,093
Prescription drug rebates	6,388,952	3,771,367
Income from deposits and investments	37,156,510	22,873,593
Notes receivable interest	2,030,660	1,867,687
Other	278,038	236,974
Total operating revenues	<u>1,020,459,067</u>	<u>867,668,032</u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENTS OF REVENUE, EXPENSES,
AND CHANGES IN RETAINED EARNINGS

ALL PROPRIETARY FUND TYPES

(CONTINUED)

	Proprietary Fund Type	
	Internal Service	
	2001	Restated 2000
Operating Expenses		
Reinsurance premiums	22,254,658	22,622,105
Premiums	104,338,972	104,860,221
Claims:		
Tort liability	39,522,875	23,584,585
School bus liability	2,115,849	3,361,577
Fire	742,496	2,736,434
Extended coverage	8,369,319	8,027,996
Health	719,061,951	687,831,402
Dental	43,715,326	42,651,381
Life	13,409	1,391,664
Long term disability	7,772,928	5,661,042
HMO-point of service	6,093,077	4,345,992
Hospitals and physicians	(1,592,741)	(752,018)
Auto and Inland Marine	3,210,968	2,850,950
Other	144,511	34,495
Professional and administrative fees	29,817,330	34,322,368
Administrative and planning	631,878	930,800
Insurance Benefits Administration	5,316,165	5,980,585
Insurance Reserve Administration	4,688,753	4,272,920
Total operating expenses	996,217,724	954,714,499
Operating income (loss)	24,241,343	(87,046,467)
Loss on disposal of assets	(10,303)	(12,036)
Net income (loss)	24,231,040	(87,058,503)
Retained earnings, beginning of year	86,132,336	173,190,839
Retained earnings, end of year	<u>\$ 110,363,376</u>	<u>\$ 86,132,336</u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENTS OF CASH FLOWS

ALL PROPRIETARY FUND TYPES

YEARS ENDED JUNE 30, 2001 AND 2000

	Proprietary Fund Type	
	Internal Service	
	2001	Restated 2000
Cash Flows from Operating Activities		
Operating income (loss)	\$ 24,239,676	\$ (87,046,467)
Reclassify interest and investment income to investing activity	(23,363,636)	(24,741,279)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	162,535	151,214
Change in fair values of long-term investments	(9,631,852)	5,584,733
Change in assets-(increase) decrease:		
Premiums receivable	8,954,595	(3,642,322)
Reinsurance recovery receivable	2,897,003	(756,203)
Due from South Carolina Division of Retirement	(5,031,665)	(1,499,914)
Prepaid insurance, prescription drug rebate receivable and other assets	(201,145)	(709,818)
Change in liabilities-increase (decrease):		
Accounts payable, accrued payroll and compensated absences	(66,898)	456,883
Deferred premium revenue	(10,811,230)	1,205,036
Claims payable and incurred but not reported	683,782	40,883,140
Total adjustments	(13,044,875)	41,672,749
Net cash used in operating activities	(12,168,835)	(70,114,997)
Cash Flows from Capital and Related Financing Activities		
Purchase of fixed assets	(266,053)	(108,086)
Net cash used in capital and related financing activities	(266,053)	(108,086)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENTS OF CASH FLOWS

ALL PROPRIETARY FUND TYPES

(CONTINUED)

	Proprietary Fund Type	
	Internal Service	
	2001	Restated 2000
Cash Flows from Investing Activities:		
Principal payments received on notes receivable	6,649,862	2,625,551
Funds disbursed as notes receivable	(4,106,517)	(1,224,262)
Purchases of investments	(25,195,262)	(148,406,995)
Proceeds from sales and maturity of investments	39,285,441	107,055,602
Interest received-deposits and investments	22,378,100	21,305,567
Interest received-notes receivable	1,260,290	1,867,687
Net cash provided by (used in) investing activities	40,271,914	(16,776,850)
Net increase (decrease) in cash and cash equivalents	27,837,026	(86,999,933)
Cash and cash equivalents, beginning of year	92,299,004	179,298,937
Cash and cash equivalents, end of year	<u>\$ 120,136,030</u>	<u>\$ 92,299,004</u>
Supplemental Information		
Noncash capital and related financing activities:		
Disposal of purchased fixed assets (including \$86,317 and \$106,636 of accumulated depreciation for the years ended June 30, 2001 and 2000)	\$ (96,620)	\$ (118,672)
Net (appreciation)/depreciation of investments	\$ (9,631,852)	\$ 5,584,733

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

JUNE 30, 2001 AND 2000

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, Office of Insurance Services (the "Office") were prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental entities. The Government Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Office'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 generally accepted accounting principles, 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
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Reporting Entity (Continued)

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

The South Carolina State Budget and Control Board, Office of Insurance Services, Insurance Reserve Fund; Health, Life, and Disability Insurance Reserve Fund and Seniors' Prescription Drug Program are funds of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. All funds of the Office of Insurance Services are included in this report and no other Offices or funds of the South Carolina State Budget and Control Board or any other part of the State of South Carolina primary government are included. Effective July 1, 1994, the Office of Insurance Services is one of four offices under control of the Division of Operations of the South Carolina State Budget and Control Board (the Board). 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 and account groups of the Budget and Control Board are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Office operates as a unit under the Budget and Control 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 Office's activities. The accompanying financial statements present the financial position and results of operations solely of the Office and do not include any other agencies or any component units of the State of South Carolina.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Basis of Presentation

The financial statements present all funds of the South Carolina State Budget and Control Board, Office of Insurance Services. The financial statements of the Internal Service Funds include the Balance Sheet; Statement of Revenues, Expenses, and Changes in Retained Earnings; and the Statement of Cash Flows. The financial statements of the Special Revenue Fund include the Balance Sheet; Statement of Revenue, Expenditures, and Changes in Fund Balances; and Statement of Expenditures -Budget and Actual-All Budgeted Funds.

The Internal Service Funds presented include:

- Insurance Reserve Fund (IRF)
- Health, Life, and Disability Insurance Reserve Fund (HLDIRF)

The Office of Insurance Services was created by the Budget and Control Board on June 5, 1989 to manage insurance programs provided by the State for its employees, retirees, agencies, institutions, and political subdivisions. The Office was formed with the Insurance Reserve Fund section from the Office of General Services and the Insurance Benefits section from the South Carolina Retirement Division. The Administration and Planning section was added to these two sections to complete the Office. Additionally, effective July 1, 1996, the State Life and Long-Term Disability program was transferred to the Office from the South Carolina Retirement Division. This program is accounted for in the Health, Life, and Disability Insurance Reserve Fund.

Programs managed by the Office's Insurance Reserve Fund section are authorized in the following sections of the South Carolina Code of Laws, 1976, as amended: Section 1-11-140 (tort liability, medical professional liability for individuals and entities and risk management section); Section 1-11-710 (A)(4) (risk management section); Regulation 19-612 (automobile liability); Section 10-7-10 et. seq. (property); Section 59-67-710 (school bus liability); and Section 59-67-790 (school bus pupil injury). Section 15-78-10 et. seq. (the S.C. Tort Claims Act) further defines parameters of coverage provided by the Insurance Reserve Fund.

The group health, dental, life, accidental death and dismemberment and disability programs managed by the Office's HLDIRF 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 Office 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
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

The Office also has an administrative and planning staff responsible for overseeing the operations of the Office. Cost of operations for the administrative and planning staff are allocated equally to the IRF and the HLDIRF.

The Special Revenue Fund presented include:

- The South Carolina Seniors' Prescription Drug Program
(also known as Silver Card/Silver Card Plus Program)

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

Fund Accounting

The Office of Insurance Services uses funds to report on its financial position, the results of its operations and cash flows. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain functions or activities.

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. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds that have similar characteristics have been combined into fund types. Accordingly, all financial transactions in the combined statements have been reported by fund type.

Funds are classified into three categories: governmental, proprietary and fiduciary. Each category, in turn, is divided into separate "fund types". The Office of Insurance Services of the South Carolina State Budget and Control Board uses both Governmental and Proprietary Fund types.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Description of Funds

Government Funds-Governmental funds use the current financial resources measurement focus. Only current assets and current liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available resources during a given period. The following fund is reported as a governmental fund:

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

This program is administered by the State Budget and Control Board through its Office of Insurance Services. The purpose of the program is to provide financial assistance for purchasing prescription drugs to senior citizens who are ineligible for or do not have insurance coverage or other assistance through federal, state, or private programs for these purchases. To be eligible to participate in this program a person must:

- (1) be a South Carolina resident who has attained the age of sixty-five years;
- (2) have resided in South Carolina at least six consecutive months before participation in the program;
- (3) be ineligible for Medicaid prescription benefits;
- (4) not have any pharmacy benefits or coverage from any governmental or private insurance program providing such benefits;
- (5) have an annual income that does not exceed one hundred fifty percent of the federal poverty level. Priority must be given to applicants without Medicare supplements or other third party benefits or coverage during the six months before application.

The program is funded from proceeds received by the State in the settlement agreement and related documents, between the State and leading United States tobacco manufacturers dated November 23, 1998.

Proprietary Funds-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 for sound financial administration. Goods or services from such activities can be provided either to outside parties (enterprise funds) or to other departments or agencies primarily within the government (internal service funds). The following funds are reported as proprietary funds:

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

- (1) **Insurance Reserve Fund (internal service fund)**-The Insurance Reserve Fund insures state agencies, school districts, special purpose political subdivisions, county governments and municipal governments in South Carolina. The Insurance Reserve Fund provides property insurance on governmentally owned buildings, the contents of such buildings, equipment and automobiles. The Insurance Reserve Fund provides automobile liability insurance on governmentally owned vehicles and school buses, tort liability insurance for government premises and operations, and medical professional liability for hospitals. The Insurance Reserve Fund is a self-insurer and purchases reinsurance to limit losses in the areas of property insurance, boiler and machinery insurance, automobile liability insurance, and medical professional liability insurance. The Insurance Reserve Fund collects premiums from participating entities, issues policies, and pays claims incurred under the policies from accumulated premiums and earnings on investments and notes receivable. The premium rates are determined actuarially and approved by the South Carolina Budget and Control Board. The Insurance Reserve Fund allocates the costs of providing claims servicing and claims payments by charging each participant a premium. Interest income is considered in the premium rate setting process.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

- (2) Health, Life, and Disability Insurance Reserve Fund (internal service fund)**-The Health, Life, and Disability Insurance Reserve Fund provides health insurance to eligible employees and retirees of State agencies and school districts who elect coverage through either a health maintenance organization or through the State's self-insured health plan. In addition, effective January 1, 1999, the Office began offering a managed care pilot program limited to Medical University of South Carolina's (MUSC) employees living in Charleston, Dorchester or Berkeley counties. The "MUSC managed care program" is a self-insured HMO point of service plan. Premiums are paid through payroll deductions. The State Life and Long-Term Disability Plan is a self insured group life and long-term disability plan available to eligible active state and public school employees enrolled in a State health plan. All dental coverage is through the State's self-insured plan which is available to eligible State and public school employees and retirees. Health and dental premiums are paid from State funds and through payroll deductions for eligible State and public school employees. Premiums for participating retirees are paid by the Agencies and the School Districts through the retirement system (employer share) and directly from the employee (employee share). State agencies and the local school districts pay the premiums for the following insured plans which are available to eligible full-time employees enrolled in a State health plan: (1) basic group life, and (2) basic long-term disability plan. The dependent/optional life program is available to eligible State and public school employees. Premiums for the dependent/optional life program are paid through payroll deduction. Premiums and the retiree surcharge (see *Note 6*) for the self-insured health and dental plans are actuarially determined and approved by the South Carolina State Budget and Control Board. Long-term care insurance is also available to eligible State and public school employees. Premiums for long-term care insurance are paid through payroll deductions. The long-term care plan is fully insured. Details on eligibility requirements and coverage for all plans are contained in the *Insurance Benefits Guide*. Premium rates for all plans are reviewed on a calendar year basis annually and adjusted as considered necessary after actuarial calculation. Interest income is considered in the premium rate setting process. The State as the predominant participant retains the risk of loss for the self-insured health, dental, basic life and basic long-term disability coverages.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Basis of Accounting

The modified accrual basis of accounting is used by all governmental fund types. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). “Measurable” means the amount of the transaction can be determined and “available” means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recorded when the related fund liability is incurred.

All proprietary funds are accounted for using the economic resources accounting measurement focus which is upon determination of net income, financial position, and cash flows. Under this method, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund-type operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

All proprietary funds use 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 Insurance Reserve Fund reports claims liabilities when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. The Health, Life, and Disability Insurance Reserve Fund establishes claims liabilities when the information available prior to the issuance of the financial statements indicates it is probable a liability has been incurred by the date of the financial statements and the amount can be reasonably estimated.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for generally accepted accounting principles for all State governmental entities. The accounting policies of the Office conform to generally accepted accounting principles applicable to governmental proprietary activities as prescribed by GASB. Accordingly, the Office applies all applicable GASB pronouncements and has elected to apply only 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.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Office considers all highly liquid securities with a maturity of three months or less at the time of purchase to be cash equivalents. 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. Most State agencies participate in the internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Cash and Cash Equivalents (Continued)

Most State agencies including the Office participate in the State's internal 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 State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 4*.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Deposits in the general deposit account are recorded and reported at cost. However, the Office 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. Reported interest income includes interest earnings, realized gains/losses, and unrealized gains/losses on investments in the pool arising from changes in fair value. 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 Office's percentage ownership in 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
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Investments (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.

Premium Revenue-Insurance Reserve Fund

Premiums billed to agencies (premiums receivable) for insurance coverage are deferred and amortized into income over the term of the insurance policy.

Premium Revenue-Health, Life, and Disability Insurance Reserve Fund

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 in the Insurance Reserve Fund and the Health, Life, and Disability Insurance Reserve Fund.

Reinsurance Recovery Receivable

Reinsurance Recovery Receivable represents claims that have been paid by the Insurance Reserve Fund which are recoverable from reinsurers. Reinsurance permits partial recovery of losses from reinsurance; however, the Insurance Reserve Fund, as direct insurers remains primarily liable. Amounts deemed recoverable from reinsurance are deducted from claims expenses.

Prepaid Insurance

Payments made to insurers and reinsurers for services that will benefit future periods are recorded as Prepaid expenses and other assets. The related expense is recognized prorata over the policy periods.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Fixed Assets

Fixed assets held in proprietary funds are capitalized at cost if purchased. Fixed 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 Office has one class of fixed asset, equipment, which is depreciated on a straight-line basis over the estimated useful lives of 5-10 years.

Depreciation expense (for both purchased and contributed assets) is recorded in the applicable fund's administration account. The capitalization dollar threshold limit for fixed assets is \$1,000.

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 Office establishes an unpaid claim liability for claims in the process of review, and for IBNR claims. The liability for IBNR claims is actuarially estimated based on the most current historical claims experience of previous payments, changes in number of members and participants, inflation, award trends, and estimates of health care trend (cost, utilization and intensity of services) changes. Estimates of liabilities for incurred claims are continually reviewed and revised as changes in these factors occur and revisions are reflected in the current year's operating statement in the applicable claims expense. The liability is reported net of estimated receivables for salvage subrogation and reinsurance for the Insurance Reserve Fund. Claims payable and the related expense have been reduced by reinsurance recoveries receivable for claims paid and for estimated receivables for claims to be paid of approximately \$4,200,000 and \$6,100,000 as of June 30, 2001 and 2000, respectively. 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 5.75% and 5.50% for 2001 and 2000, compounded annually.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Claims Payable-Insurance Reserve Fund

Claims payable represents claims resulting from losses that have been incurred and not paid at June 30. The claims payable balance is based on actual losses incurred and settled and estimated losses for claims in the final stages of review and settlement.

Claims Payable-Health, Life, and Disability Insurance Reserve Fund

Claims payable in the Health, Life, and Disability Insurance Reserve Fund represents claims related to health claims, dental claims, and State Life and Long-Term Disability claims payable at June 30. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Health, Life, and Disability Insurance Reserve 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 which commenced on or before June 30, 2001. The Office 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 each applicable internal service fund. The net change in the liability is recorded in the current year in the applicable fund's administration account.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

Fund Equity

Contributed capital is recorded in proprietary funds that have received contributions of property or other assets from other funds and other agencies. Reservations of retained earnings are limited to outside third-party restrictions. Retained earnings are recorded in proprietary funds to reflect the net accumulated earnings of the fund. Reservations of fund balances of governmental funds are created to either (1) satisfy legal covenants that require that a portion of the balance be segregated for a specific future use or (2) identify the portion of the fund balance that is not appropriable for future discretionary expenditures. The unreserved component of fund equity is computed as total fund equity less reserved amounts.

Budget Policy

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

The accompanying financial statements include a Combined Statement of Expenditures-Budget and Actual-All Budgeted Funds. The Budgetary General Fund category on that statement corresponds to the General Funds column in the Appropriation Act and Other Budgeted Funds category represents the difference between Total Funds and General Funds columns in the Appropriations Act.

The current Appropriations Act states that the General Assembly intends to appropriate all monies to operate state government for the current fiscal year. Any unexpended state General Fund appropriations lapse to the General Fund of the State on July 31 unless specific authorization is given to carryover the funds to the ensuing fiscal year. Appropriations carried forward for a specific purpose are reported as reserved fund balance. Proviso 63B.10 of the 2001/2002 Appropriations Act authorizes the South Carolina Seniors' Prescription Drug Program to carry forward unspent State General Fund appropriations.

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

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

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

Use of Estimates

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

New GASB Pronouncement

June 30, 1999 Governmental Accounting Standards Board (GASB) issued Statement Number 34, "Basic Financial Statements - and Managements Discussion, and Analysis - for State and Local Governments". This statement will change the reporting model of governmental entities.

The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999.

- Phase 1 governments with total annual revenues of \$100 million or more should implement this Statement in financial statements for periods beginning after June 15, 2001.
- Phase 2 governments with total annual revenues of \$10 million or more but less than \$100 million should implement this Statement in financial statements for periods beginning after June 15, 2002.
- Phase 3 governments with total annual revenues less than \$10 million should implement this Statement in financial statements for periods beginning after June 15, 2003.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

The State will implement this pronouncement for the fiscal year beginning July 1, 2001. The Office will follow the implementation schedule for the State.

Total Columns (Memorandum Only)

Total columns on the combined statements are captioned "memorandum only" to indicate that they are presented only to aid in financial analysis. Interfund eliminations have not been made in the aggregation of this data; and it is, therefore, not comparable to a consolidation.

2. Budgetary Reporting Basis

Financial statements prepared on the legally enacted basis differ from GAAP basis statements. All of the Office's Special Revenue Fund resources are included in the total funds authorized by the General Assembly. The Combined Statement of Expenditures-Budget and Actual-All Budgeted Funds presented on page 5 present all funds for which a legal budget was enacted.

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

The following schedule reconciles the differences:

	<u>Financial Statement Fund Type Special Revenue</u>	<u>Budgetary Fund Category Other</u>
Expenditures on GAAP basis	\$ 5,294,048	\$ -
Fund reclassification:		
Other budgeted funds	(5,294,048)	5,294,048
Expenditures on legal basis	<u>\$ -</u>	<u>\$ 5,294,048</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

3. Other Budgeted Funds

The 2000-2001 original appropriations are the base budget amounts for the South Carolina Seniors' Prescription Drug Program budgetary units and are presented in the Total Funds column of Section 63B.IV.D of the Appropriations Act.

Proviso 63B.10 of the 2002 Appropriations Act cites the authority for the Office to carry forward unspent appropriations from fiscal year 2001 to expenditure in fiscal year 2002. The restricted purposes are noted in the captions for the referenced amounts on page 3.

Annual fiscal year 2001 appropriations of \$2,705,952 for Seniors' Prescription Drug Program, is approved for carry forward to fiscal year 2002 for expenditure for the same purpose.

4. Investments and Deposits

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

The following table presents the amortized cost and fair values of the long-term investments of the Office at June 30, 2001 and 2000.

	Amortized Cost		Fair Value	
	2001	2000	2001	2000
U. S. Treasury obligations	\$ 22,416,409	\$ 22,395,092	\$ 28,735,327	\$ 28,286,800
U. S. Government agencies and government-incurred securities	28,742,316	27,749,485	31,006,971	28,438,030
Corporate bonds	115,722,923	119,210,938	119,821,312	118,111,876
Financial and other	84,392,357	95,480,664	86,095,042	94,700,006
Total	<u>\$ 251,274,005</u>	<u>\$ 264,836,179</u>	<u>\$ 265,658,652</u>	<u>\$ 269,536,712</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

At June 30, 2001, the amortized cost of the above investments was comprised of the following:

	<u>Par Value</u>	<u>Unamortized Premiums</u>	<u>Unaccreted Discounts</u>	<u>Amortized Cost</u>
U. S. Treasury obligations	\$ 23,285,000	\$ 27,952	\$ 896,543	\$ 22,416,409
U. S. Government agencies and government-incurred securities	30,631,906	-	1,889,590	28,742,316
Corporate bonds	119,345,000	467,862	4,089,939	115,722,923
Financial and other	84,700,000	866,384	1,174,027	84,392,357
Total	<u>\$ 257,961,906</u>	<u>\$ 1,362,198</u>	<u>\$ 8,050,099</u>	<u>\$ 251,274,005</u>

At June 30, 2000, the amortized cost of the above investments was comprised of the following:

	<u>Par Value</u>	<u>Unamortized Premiums</u>	<u>Unaccreted Discounts</u>	<u>Amortized Cost</u>
U. S. Treasury obligations	\$ 23,285,000	\$ 28,698	\$ 918,606	\$ 22,395,092
U. S. Government agencies and government-incurred securities	29,712,910	-	1,963,425	27,749,485
Corporate bonds	122,890,000	545,266	4,224,328	119,210,938
Financial and other	95,975,000	883,490	1,377,826	95,480,664
Total	<u>\$ 271,862,910</u>	<u>\$ 1,457,454</u>	<u>\$ 8,484,185</u>	<u>\$ 264,836,179</u>

The accounts classified as investments in the financial statements comprise investments held for the Office 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

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 years ended June 30, 2001 and 2000. 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.

In accordance with State Law, the IRF and the HLDIRF 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.

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

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

At June 30, 2001 and 2000, all of the Office's long-term investments were in Category (1).

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, 2001 and 2000, 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

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.

During 2001 and 2000, the following amounts (which apply to all investments) were included in interest income:

Cash and cash equivalents whose amortized cost reported amounts approximate fair value at June 30, 2001 and 2000, were composed of the following:

	<u>2001</u>	<u>2000</u>
Discount accretion	\$ 783,089	\$ 583,751
Premium amortization	(116,996)	(336,840)
Net accretion/amortization included in interest income	<u>\$ 666,093</u>	<u>\$ 246,911</u>

	<u>June 30, 2001</u>		
	<u>Cash</u>	<u>Repurchase</u>	
	<u>Deposits</u>	<u>Agreements</u>	<u>Total</u>
<u>Governmental Fund Type</u>			
South Carolina Seniors'			
Prescription Drug Program	\$ 14,705,952	\$ -	\$ 14,705,952
<u>Proprietary Fund Type</u>			
IRF	4,658,933	87,780,000	92,438,933
HLDIRF	17,657,097	10,040,000	27,697,097
	<u>\$ 37,021,982</u>	<u>\$ 97,820,000</u>	<u>\$ 134,841,982</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

	<u>June 30, 2000</u>		<u>Total</u>
	<u>Cash</u>	<u>Repurchase</u>	
	<u>Deposits</u>	<u>Agreements</u>	
<u>Governmental Fund Type</u>			
South Carolina Seniors' Prescription Drug Program	\$ -	\$ -	\$ -
<u>Proprietary Fund Type</u>			
IRF	(333,419)	53,345,000	53,011,581
HLDIRF	31,202,311	8,085,112	39,287,423
	<u>\$ 30,868,892</u>	<u>\$ 61,430,112</u>	<u>\$ 92,299,004</u>

At June 30, 2001 and 2000, the IRF bank balances totaled \$3,327,148 and \$919,439, respectively and the HLDIRF bank balances totaled \$18,325,897 and \$31,383,135, respectively, and the Seniors' Prescription Drug Program bank balance total \$14,705,952 as of June 30, 2001. All of these amounts were on deposit with the South Carolina State Treasurer's Office.

The Office held no short-term investments at June 30, 2001 and 2000. Short-term investments held during both fiscal years 2001 and 2000 consisted of U.S. Government agency and government-insured securities whose amortized cost reported amounts approximate fair value at June 30, 2001.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

The investment types listed above include all investment types in which monies were held throughout the year ended June 30, 2001 and 2000. Due to higher cash flows at certain times during the year, the Office's investment in repurchase agreements and short-term investments fluctuated significantly. The maximum amounts held in these classifications during the year ended June 30, 2001 and 2000, were as follows:

	<u>2001</u>	<u>2000</u>
Short-term investments	<u>\$ 30,000,000</u>	<u>\$ 30,000,000</u>
Repurchase agreements	<u>\$ 98,000,000</u>	<u>\$ 71,000,000</u>

A summary of total investments is as follows:

	<u>2001</u>		<u>2000</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Long-term investments	\$ 251,274,005	\$ 265,658,652	\$ 264,836,179	\$ 269,536,712
Repurchase agreements	97,820,000	97,820,000	61,430,112	61,430,112
	<u>\$ 349,094,005</u>	<u>\$ 363,478,652</u>	<u>\$ 326,266,291</u>	<u>\$ 330,966,824</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

4. Investments and Deposits (Continued)

A summary of long-term investments (at fair value) by internal service fund is as follows:

	<u>2001</u>	<u>2000</u>
Governmental Fund Type		
South Carolina Seniors'		
Prescription Drug Program	\$ -	\$ -
Proprietary Fund Type		
IRF	247,349,450	251,098,185
HLDIRF	18,309,202	18,438,527
	<u>\$ 265,658,652</u>	<u>\$ 269,536,712</u>

5. Premiums Receivable

Premiums receivable at June 30, 2001 and 2000, consist of the following:

<u>June 30, 2001:</u>	<u>Due to:</u>		
	Insurance Reserve Fund	Health, Life and Disability Insurance Reserve Fund	Total
<u>Due From:</u>			
Local government	\$ 7,487,456	\$ 119,021	\$ 7,606,477
State government	2,491,073	253,436	2,744,509
Other	229,111	236,093	465,204
	<u>\$ 10,207,640</u>	<u>\$ 608,550</u>	<u>\$ 10,816,190</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

5. Premiums Receivable (Continued)

<u>June 30, 2000:</u>	<u>Due to:</u>		
<u>Due From:</u>	<u>Insurance Reserve Fund</u>	<u>Health, Life and Disability Insurance Reserve Fund</u>	<u>Total</u>
Local government	\$ 9,792,628	\$ 8,418	\$ 9,801,046
State government	9,215,404	298,187	9,513,591
Other	367,617	88,531	456,148
	<u>\$ 19,375,649</u>	<u>\$ 395,136</u>	<u>\$ 19,770,785</u>

Premiums receivable and deferred premium revenue include approximately \$7,000,000 and \$16,000,000 attributable to premiums billed in advance of coverage as of June 30, 2001 and 2000, respectively.

6. Due from South Carolina Division of Retirement

\$20,944,763 and \$15,913,098 (\$20,206,994 and \$15,322,911 from South Carolina Retirement System and \$737,769 and \$590,187 from Police Officers Retirement System) were due from the South Carolina Retirement Systems at June 30, 2001 and 2000, respectively. The above amounts represent revenues recognized on behalf of Health, Life, and Disability Insurance Reserve 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 percentages in effect were 2.52% from July 1, 2000 to June 30, 2001 and 1.95% from July 1, 1999 to December 31, 1999 and 2.16% for January 1, 2000 to June 30, 2000. 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

7. Notes Receivable

Amounts due from notes receivable in the Insurance Reserve Fund at June 30, 2001 and 2000, consist of the following:

	<u>2001</u>	<u>2000</u>
Due from State Agencies		
One and six notes respectively, due under the I.P.P. program in monthly/annual installments, including interest at 6.5%; collateralized by the assignment of notes issued by the Office of General Services for the Installment Purchase Program; maturity date is August 1, 2001.	\$ 9,561	\$ 6,160,099
Due from Engineering Services Section of the Office of General Services		
Three notes, due in annual installments, including interest from 5.5% to 8%; range of maturity 2004 to 2009.	1,488,067	1,787,393
Due from South Carolina Grain Dealers Guaranty Fund administered by the South Carolina Department of Agriculture		
One note in the principal amount of \$3,500,000 with interest at 8.75%; maturity date is October 24, 2005.	3,500,000	-
Due from Savannah Valley Development Division of the Department of Commerce		
One note in the principal amount of \$3,306,893 with interest at 8%; maturity date is January 31, 2021.	776,892	976,892
One note in the principal amount of \$2,500,000 with interest at 8%; maturity date is January 31, 2022.	2,500,000	2,500,000
One note in the principal amount of \$121,239 with interest at 8%; maturity date is January 31, 2022.	121,239	121,239
One note in the principal amount of \$1,227,733 with interest at 8%; maturity date is January 31, 2023.	1,227,733	1,227,733

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

7. Notes Receivable (Continued)

	<u>2001</u>	<u>2000</u>
One note in the principal amount of \$2,690,812 with interest at 8%; maturity date is January 31, 2024.	2,690,812	2,690,812
One note in the principal amount of \$1,260,186 with interest at 8%; maturity date is January 31, 2024.	1,260,186	1,260,186
One note in the principal amount of \$1,569,410 with interest at 8%; maturity date is January 31, 2024.	1,569,410	1,569,410
One note in the principal amount of \$1,730,361 with interest at 8%; maturity date is January 31, 2027.	1,730,361	1,730,361
One note in the principal amount of \$1,139,070 with interest at 8%; maturity date is January 31, 2028.	1,139,070	1,139,070
One note in the principal amount of \$2,423,517 with interest at 8%; maturity date is January 31, 2029.	2,423,517	2,423,517
One note in the principal amount of \$1,224,262 with interest at 8%; maturity date is January 31, 2030.	1,224,262	1,224,262
One note in the principal amount of \$606,519 with interest at 8%; maturity date is January 31, 2031.	606,519	-
Total	<u>22,267,629</u>	<u>24,810,974</u>
Less current portion	<u>(326,894)</u>	<u>(1,556,018)</u>
Total	<u><u>\$ 21,940,735</u></u>	<u><u>\$ 23,254,956</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

8. Fixed Assets and Contributed Capital

The following are summaries of changes in fixed assets of the Internal Service Funds for each year.

	Balance June 30, 2000	Additions	Deletions	Balance June 30, 2001
Furniture and equipment	<u>\$ 2,175,544</u>	<u>\$ 266,053</u>	<u>\$ 96,620</u>	<u>\$ 2,344,977</u>

	Balance June 30, 1999	Additions	Deletions	Balance June 30, 2000
Furniture and equipment	<u>\$ 2,186,130</u>	<u>\$ 108,086</u>	<u>\$ 118,672</u>	<u>\$ 2,175,544</u>

A summary of fixed assets by fund at June 30, 2001 and 2000, is as follows:

June 30, 2001	Furniture and Equipment	Accumulated Depreciation	Net Book Value
Insurance Reserve Fund	\$ 992,992	\$ 739,769	\$ 253,223
Health, Life and Disability Insurance Reserve Fund	1,351,985	653,170	698,815
Total	<u>\$ 2,344,977</u>	<u>\$ 1,392,939</u>	<u>\$ 952,038</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

8. Fixed Assets and Contributed Capital (Continued)

<u>June 30, 2000</u>	<u>Furniture and Equipment</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Insurance Reserve Fund	\$ 962,653	\$ 708,197	\$ 254,456
Health, Life and Disability Insurance Reserve Fund	1,212,891	608,523	604,368
Total	<u>\$ 2,175,544</u>	<u>\$ 1,316,720</u>	<u>\$ 858,824</u>

Depreciation expense for the years ended June 30, 2001 and 2000, was \$162,535 and \$151,214, respectively.

The following is a schedule of changes in contributed capital for the years ended June 30, 2001 and 2000.

	<u>Health, Life, and Disability Insurance Reserve Fund</u>
Balance, June 30, 1999	\$ 40,442
Donated assets-year ended June 30, 2000	-
Disposal of assets-year ended June 30, 2000	-
Balance, June 30, 2000	40,442
Donated assets-year ended June 30, 2001	-
Disposal of assets-year ended June 30, 2001	-
Balance, June 30, 2001	<u>\$ 40,442</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

9. Due to State General Fund

Amounts due to State General Fund represent monies which must be remitted to the General Fund of the State at year end under the 2001-2002 Appropriations Bill 3687 Part IB, 72.110. The Special Revenue Fund had \$12,000,000 due to the State General Fund at June 30, 2001.

10. Lease Obligations

The Office leases office space accounted for as an operating lease. The office space lease was amended effective July 1, 2001, and now expires June 30, 2005. Rental expense under this lease for the years ended June 30, 2001 and 2000 was \$765,829 and \$791,107.

The following schedule summarizes the Office's obligations under operating leases having remaining terms in excess of one year as of June 30, 2001:

Fiscal Year Ending June 30,	Total
2002	\$ 765,890
2003	756,525
2004	756,525
2005	756,525
Total	<u>\$ 3,035,465</u>

The Office has also entered into a number of operating leases which expire in various years from 2003 through 2004 for office equipment which contain cancellation provisions and are 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 years ended June 30, 2001 and 2000, expenses under these leases were approximately \$23,924 and \$26,550, respectively.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

11. Retained Earnings-Reserved

Installment Purchase Program-The Insurance Reserve Fund “Installment Purchase Program” consists of notes issued by State agencies and institutions to the Division of General Services to finance the purchase of office, telecommunications, medical, and data processing equipment. The program is authorized under South Carolina State Code 1-1-1020. The program is funded through loans from the Insurance Reserve Fund to the Office of General Services. Effective July 1, 1994, this program is administered by the State Treasurer’s Office. At June 30, 2001 and 2000, \$35,000,000 of the retained earnings of the Insurance Reserve Fund was reserved for support of the program. The total balance outstanding at June 30, 2001 and 2000, was \$9,561 and \$6,160,099, respectively.

Savannah Valley Development Program-At June 30, 2001 and 2000, \$20,000,000 of the Insurance Reserve Fund retained earnings has been reserved for loans to the Savannah Valley Development Division of the Department of Commerce, as authorized under South Carolina State Code 13-9-10, formerly the Clark’s Hill-Russell Authority (a Joint Resolution; R-22, H2516; of the State, approved March 12, 1987, and R-755, H2680; of the State, approved June 20, 1988). As of June 30, 2001 and 2000, \$17,469,999 and \$16,863,482, respectively, was outstanding.

12. Fund Balance-Reserved

South Carolina Seniors’ Prescription Drug Program (the “Program”) at June 30, 2001, had \$2,705,952 in fund balance. These funds are restricted for claims and administrative expenditures of the Program.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

13. 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 Office Box 11960, Columbia, South Carolina 29211-1960. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

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

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

13. Pension Plans (Continued)

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

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. For the years ended June 30, 2001, 2000 and 1999 the employer contribution rate was 7.55 percent (before a surcharge to fund retiree health and dental insurance coverage). The Office's actual contributions to the SCRS for those years were approximately \$532,000 \$473,000 and \$427,000, respectively, and equaled the required contributions of 7.55 percent (excluding the surcharge) for each year. Also, the Office paid employer group-life insurance contributions at the rate of .15 percent of compensation for the years ended June 30, 2001, 2000 and 1999.

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

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

13. Pension Plans (Continued)

The Systems do not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Office'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 Office's liability under the pension plans is limited to the amounts appropriated therefore in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Office 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.

14. 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 Office 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 Office 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 Office for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Currently, approximately 20,100 State retirees meet these eligibility requirements.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

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

The Office recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$384,000, \$332,000 and \$288,000 for the years ended June 30, 2001, 2000 and 1999, respectively. As discussed in *Note 13*, the Office paid approximately \$131,000, \$94,000 and \$91,000 for the years ended June 30, 2001, 2000 and 1999, respectively, applicable to the surcharge included with the employer contributions for retirement benefits (2.52% for 2001, 1.95% for 2000, and 2.03% for 1999).

Information regarding the cost of insurance benefits applicable to Office retirees is not available. By State law, the Office 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.

15. Deferred Compensation Plans

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
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NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

15. Deferred Compensation Plans (Continued)

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

This Office contributed \$25,900 for the fiscal year ending June 30, 2001.

16. Transactions with State Entities

The Office 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 Insurance Reserve Fund and the Health, Life, and Disability Insurance Reserve Fund. Total amounts of premiums received from other state agencies is not readily available.

Health, Life, and Disability Insurance Fund:

Health, dental, basic group-life and disability, and State Life and Long-Term Disability insurance coverage for state agencies and local governments

Insurance Reserve Fund:

Property coverage for state and local governments

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

16. Transactions with State Entities (Continued)

A significant portion of the Office'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 were \$2,744,509 and \$9,223,822 at June 30, 2001 and 2000, respectively.

The following details the insurance premiums charged by the Office to other state agencies and divisions of the South Carolina State Budget and Control Board during the years ended June 30, 2001 and 2000:

	2001	2000
Tort liability	\$ 13,306,169	\$ 13,928,475
Auto liability	5,883,712	5,228,448
Professional liability	5,107,838	5,138,563
Comprehensive and collision	235,024	223,177
School bus liability	3,080,188	31,107
Fire	2,326,329	3,292,996
Extended coverage	1,158,676	1,642,421
Inland Marine	660,678	915,687
Active employees:		
Health	246,457,296	221,770,332
Dental	16,089,416	16,376,868
Life	2,248,445	2,096,207
Long-term disability	4,704,888	5,091,545
Dependent/optional life	11,683,161	10,468,539
HMO-point of service	9,911,735	5,092,262
Retirees:		
Health	17,881,737	15,814,628
Dental	1,177,134	1,112,711
Retiree surcharge	55,639,468	46,612,711
HMO-point of service	115,709	22,637
Other premium revenues	1,720,340	1,628,281
	<u>\$ 399,387,943</u>	<u>\$ 356,487,595</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

16. Transactions with State Entities (Continued)

The Office had financial transactions with various State agencies during the fiscal year. Significant payments were made to Divisions (Offices) of the State Budget and Control Board for retirement and insurance plans contributions, vehicle rental, surplus property disposal fees, office supplies, printing, and telephone, interagency mail, data processing services, purchasing, record maintenance, internal audit and personnel services. Significant payments were also made for unemployment and workers' compensation coverage for employees to other agencies. The amounts of 2001 and 2000 expenditures applicable to related party transactions are not readily available.

The following services are received from other Divisions (Offices) 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 Office acted as fiduciary for premiums collected from state agencies for State Life and Long-Term Disability. During the year ended June 30, 2001 and 2000, \$2,026,604 and \$1,969,841, respectively was collected from state agencies and disbursed to the State Life and Long-Term Disability carrier.

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

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

17. Contingencies

By the nature of its operations and responsibilities as an insurer, the Office 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.

18. Risk Management/Reinsurance

The Office 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 Office pays insurance premiums to itself, 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 (Office of Insurance Services); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Office of Insurance Services).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

18. Risk Management/Reinsurance (Continued)

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

The Office and other entities pay premiums to the Insurance Reserve Fund which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following Office assets, activities, and/or events:

1. Theft of, damage to, or destruction of assets;
2. Auto liability for non-state owned vehicles; and
3. General torts.

State agencies and other entities are the primary participants in the HLDIRF and in IRF.

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

The Office has not transferred the portion of the risk of loss related to insurance policy deductibles and limits. The Office has not reported an estimated claims loss expense, and the related liability at June 30, 2001 or 2000, 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

18. Risk Management/Reinsurance (Continued)

The Insurance Reserve Fund purchases insurance and reinsurance and separately reports the related reinsurance premium and premium expenses. Insurance is purchased to cover risks where the Insurance Reserve Fund has limited expertise (aircraft insurance and ocean marine insurance). Reinsurance is purchased to limit the Insurance Reserve Fund's liability for catastrophic loss (property reinsurance and medical professional liability reinsurance), to obtain specialized engineering services (boiler and machinery reinsurance), or to obtain services for which the Insurance Reserve Fund is not adequately staffed (automobile liability reinsurance).

The Office of Insurance Services, Health, Life, and Disability Insurance Reserve Fund self-insures health and dental insurance for all participating governmental employees, including those of the Office. Additionally, effective January 1, 1999, the HLDIRF began offering a self-insured HMO point of service plan to certain employees of MUSC. The HLDIRF purchases coverage for basic group life, dependent life, optional supplemental life, group optional life and basic disability from commercial carriers. The State Life and Long-Term Disability program is also self-insured.

The Office of Insurance Services, Insurance Reserve Fund self insures Tort Liability Insurance, Automobile Physical Damage Insurance, and the self insured retention for Property, Medical Professional Liability, and Boiler and Machinery Insurance.

Reinsurance for catastrophic losses is purchased for losses above the following loss levels:

Property-\$2,000,000 per location/\$10,000,000 per occurrence
Medical malpractice-\$250,000

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
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NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

19. Restatement

Retained earnings for fiscal year 2000 was understated due to an overstatement of depreciation expense of \$139,576. Beginning retained earning and accumulated depreciation have been restated. Adjustments to the previously presented 2000 amounts are as follows:

	<u>As Previously Reported</u>	<u>Increase (Decrease)</u>	<u>As Restated</u>
Balance Sheet			
Assets:			
Furniture and equipment, net of accumulated deposition	\$ 719,248	\$ 139,576	\$ 858,824
Fund equity:			
Retained earnings	85,992,760	139,576	86,132,336
Statement of Revenue, Expenditures and Changes in Fund Balance			
Operating Expenses:			
Professional and administrative fees	34,461,944	(139,576)	34,322,368
Statement of Cash Flows:			
Operating income (loss)	(87,186,043)	139,576	(87,046,467)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities			
Depreciation expense	290,790	(139,576)	151,214

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

20. Discussion of Fund Deficit in FY 2000-2001

During 2000/2001, the Health, Life and Disability Insurance Reserve Fund reported a net income of \$9,594,574. This income, along with losses in recent years, has resulted in a retained deficit of \$72,303,889 for the Fund at June 30, 2001. Additionally, Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended, stipulates that “a reserve equal to not less than an average of one and one-half months’ claims must be maintained in the accounts and all funds in excess of the reserve must be used to reduce premium rates or expand benefits as funding permits.” Under Proviso 63B.9 the reserve requirement was changed. The Proviso reads “Notwithstanding any other provision of law, the State Health Plan is only required to seek a twenty-two day reserve fund by the end of calendar year 2001.” As of June 30, 2001, the HLDIRF does not have a twenty-two day reserve fund. Management of the HLDIRF has reviewed the above situations and offers their analysis below. Although certain changes in the funding and coverages have taken place, there is no guarantee that the HLDIRF will return to a surplus position or that cash will be adequate to cover claims and administrative costs. Additional funding sources, such as further rate increases, State appropriations, etc. may be necessary to provide for the costs of the continued existence of the Plan.

Management’s analysis:

The State Health Plan continues to experience unprecedented claims expenditure growth. This is a result of continued dramatic increases in service volume and prescription drug costs. As was anticipated during calendar year 2000, State Health Plan expenditures exceeded income. Effective January 2001, a combination of increased funding and benefit payment reductions were enacted in an effort to improve the Plan's financial condition and restore Plan reserves. However, those measures were not sufficient to garner financial stability of the Plan. Further measures have been deemed necessary and additional funding increases and cost sharing initiatives have been enacted with an effective date of January 2002. These measures include a \$12 per month employee increase and an approximate average 9.5% increase in employer funding. In addition to increased funding, several cost sharing initiatives are slated for implementation. They include a \$100 deductible for Emergency Room services (waived if admitted), a \$50 deductible for Outpatient services (waived for oncology, physical therapy and Emergency Room), a \$2 copayment increase for prescription drugs, a “pay the difference” generic substitution policy and a \$100/person increase in the out-of-pocket prescription drug maximum.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

20. Discussion of Fund Deficit in FY 2000-2001 (Continued)

Additionally, beginning in 2002, the State Health Plan will be operating under a new Administrative Services Only contract with BCBSSC. This contract will allow for further cost savings initiatives for the Plan. Most notably, a nationwide network of hospitals and physicians, for which discounts will be made available to the Plan for members receiving services outside of South Carolina.

Management is and will be continually monitoring the financial condition of the State Health Plan, as well as keeping the Board and other interested parties updated as to the Plan's financial status.

21. Subsequent Event

In February 2001, the South Carolina Budget and Control Board reorganized the Office of Insurance Services. This reorganization, however, did not become effective from an accounting and budgetary basis until July 1, 2001.

The Insurance Reserve Fund was transferred to the Office of General Services. The Health, Life, and Disability Insurance Reserve Fund was transferred to the new Employee Benefits Division in the South Carolina Retirement System. The new name of the Health, Life, and Disability Insurance Reserve fund is the Employee Insurance Program.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

(CONTINUED)

22. Reconciliation of Claims Liabilities by Fund

The schedule below presents the changes in claims liabilities for the past two years for the Office's two internal service funds.

	Insurance Reserve Fund		Health, Life, and Disability Insurance Reserve Fund	
	2001	2000	2001	2000
	(In thousands)		(In thousands)	
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 151,149	\$ 138,899	\$ 157,439	\$ 128,806
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current fiscal year	37,430	36,860	629,985	666,644
Increases (decreases) in provision for insured events of prior fiscal years	15,083	2,984	146,672	75,238
Total incurred claims and claim adjustment expenses	52,513	39,844	776,657	741,882
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	8,659	7,422	554,842	566,987
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	26,760	20,172	238,225	146,262
Total payments	35,419	27,594	793,067	713,249
Total unpaid claims and claim adjustment expenses at end of the fiscal year	<u>\$ 168,243</u>	<u>\$ 151,149</u>	<u>\$ 141,029</u>	<u>\$ 157,439</u>
The above totals are comprised of the following:				
Claims payable	\$ 106,986	\$ 89,916	\$ 44,185	\$ 39,039
Claims incurred but not reported	61,257	61,233	96,844	118,400
Total	<u>\$ 168,243</u>	<u>\$ 151,149</u>	<u>\$ 141,029</u>	<u>\$ 157,439</u>

The HMO self-insured managed care plan liability at June 30, 2001 was \$1,368,267 and is included in the claims liability of HLDIRF listed above.

OTHER FINANCIAL INFORMATION

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING BALANCE SHEET - ALL INTERNAL SERVICE FUNDS

JUNE 30, 2001

(With comparative totals for June 30, 2000)

	Insurance Reserve Fund	Health, Life and Disability Insurance Reserve Fund	Totals	Restated 2000
Assets				
Current assets:				
Cash and cash equivalents	\$ 92,438,933	\$ 27,697,097	\$ 120,136,030	\$ 92,299,004
Premiums receivable	10,207,640	608,550	10,816,190	19,770,785
Reinsurance recovery receivable	747,084	-	747,084	3,644,087
Prescription Drug Rebate receivable	-	1,091,225	1,091,225	1,161,303
Current portion of notes receivable	326,894	-	326,894	1,556,018
Accrued interest	5,368,342	823,339	6,191,681	7,045,034
Due from South Carolina Division of Retirement	-	20,944,763	20,944,763	15,913,098
Prepaid insurance	2,195,112	-	2,195,112	2,118,094
Other assets	387,097	1,731	388,828	194,623
Total current assets	<u>111,671,102</u>	<u>51,166,705</u>	<u>162,837,807</u>	<u>143,702,046</u>
Non-current assets:				
Investments	247,349,450	18,309,202	265,658,652	269,536,712
Long-term notes receivable	21,940,735	-	21,940,735	23,254,956
Furniture and equipment, net of accumulated depreciation	253,223	698,815	952,038	858,824
Total non-current assets	<u>269,543,408</u>	<u>19,008,017</u>	<u>288,551,425</u>	<u>293,650,492</u>
Total assets	<u><u>\$ 381,214,510</u></u>	<u><u>\$ 70,174,722</u></u>	<u><u>\$ 451,389,232</u></u>	<u><u>\$ 437,352,538</u></u>
Liabilities and Fund Equity				
Current liabilities:				
Accounts payable	\$ 197,140	\$ 288,810	\$ 485,950	\$ 449,697
Accrued payroll	242,678	266,211	508,889	509,470
Claims payable	106,985,544	44,185,091	151,170,635	128,955,768
Deferred premium revenue	29,592,964	580,940	30,173,904	40,985,134
Claims incurred but not reported	61,257,339	96,844,214	158,101,553	179,632,638
Accrued compensated absences	271,580	272,903	544,483	647,053
Total current liabilities	<u>198,547,245</u>	<u>142,438,169</u>	<u>340,985,414</u>	<u>351,179,760</u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING BALANCE SHEET - ALL INTERNAL SERVICE FUNDS

(CONTINUED)

	Insurance Reserve Fund	Health, Life and Disability Insurance Reserve Fund	Totals	Restated 2000
Fund equity:				
Contributed capital	-	40,442	40,442	40,442
Retained earnings:				
Reserved for:				
Installment Purchase Program				
Savannah Valley				
Development	35,000,000	-	35,000,000	35,000,000
Savannah Valley Development				
Loans	20,000,000	-	20,000,000	20,000,000
Unreserved	127,667,265	(72,303,889)	55,363,376	31,132,336
Total retained earnings	182,667,265	(72,303,889)	110,363,376	86,132,336
Total fund equity	182,667,265	(72,263,447)	110,403,818	86,172,778
Total liabilities and fund equity	<u>\$ 381,214,510</u>	<u>\$ 70,174,722</u>	<u>\$ 451,389,232</u>	<u>\$ 437,352,538</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN RETAINED EARNINGS-
ALL INTERNAL SERVICE FUNDS

YEARS ENDED JUNE 30, 2001
(With comparative totals for the year ended June 30, 2000)

	2001			2000
	Health, Life, and Disability			
	Insurance	Insurance	Totals	Restated
	Reserve Fund	Reserve Fund		Totals
Operating Revenue				
Insurance premiums:				
Tort liability	\$ 25,468,863	\$ -	\$ 25,468,863	\$ 26,220,269
Auto liability	16,390,715	-	16,390,715	16,308,557
Professional liability	5,777,645	-	5,777,645	5,678,783
Comprehensive and collision	2,436,538	-	2,436,538	2,245,419
School bus liability	3,511,621	-	3,511,621	3,512,769
Fire	7,245,803	-	7,245,803	6,932,650
Extended coverage	3,608,922	-	3,608,922	3,457,741
Inland Marine	2,725,469	-	2,725,469	2,615,386
Active employees:				
Health	-	627,554,321	627,554,321	541,261,482
Dental	-	40,534,932	40,534,932	39,443,117
Life	-	4,712,501	4,712,501	4,347,370
Long term disability	-	11,554,816	11,554,816	11,928,091
Dependent/optional life	-	24,673,858	24,673,858	21,331,102
HMO-point of service	-	9,911,735	9,911,735	5,092,262
Retirees:				
Health	-	43,049,569	43,049,569	36,403,894
Dental	-	2,643,275	2,643,275	2,458,281
Retiree surcharge	-	139,121,482	139,121,482	106,266,508
HMO-point of service	-	115,709	115,709	22,637
Other premium revenues	2,643,172	923,961	3,567,133	3,392,093
Prescription drug rebates	-	6,388,952	6,388,952	3,771,367
Income from deposits and investments	31,184,655	5,971,855	37,156,510	22,873,593
Notes receivable interest	2,030,660	-	2,030,660	1,867,687
Other	68,914	209,124	278,038	236,974
Total operating revenues	103,092,977	917,366,090	1,020,459,067	867,668,032

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN RETAINED EARNINGS-
ALL INTERNAL SERVICE FUNDS

(CONTINUED)

	2001			2000
	Insurance	Health, Life, and Disability		
	Reserve Fund	Insurance Reserve Fund	Totals	Restated Totals
Operating Expenses				
Reinsurance premiums	22,254,658	-	22,254,658	22,622,105
Premiums	973,333	103,365,639	104,338,972	104,860,221
Claims:				
Tort liability	39,522,875	-	39,522,875	23,584,585
School bus liability	2,115,849	-	2,115,849	3,361,577
Fire	742,496	-	742,496	2,736,434
Extended coverage	8,369,319	-	8,369,319	8,027,996
Health	-	719,061,951	719,061,951	687,831,402
Dental	-	43,715,326	43,715,326	42,651,381
Life	-	13,409	13,409	1,391,664
Long term disability	-	7,772,928	7,772,928	5,661,042
HMO-point of service	-	6,093,077	6,093,077	4,345,992
Hospitals and physicians	(1,592,741)	-	(1,592,741)	(752,018)
Auto and Inland Marine	3,210,968	-	3,210,968	2,850,950
Other	144,511	-	144,511	34,495
Professional and administrative fees	7,705,167	22,112,163	29,817,330	34,322,368
Administrative and planning	315,939	315,939	631,878	930,800
Insurance Benefits Administration	-	5,316,165	5,316,165	5,980,585
Insurance Reserve Administration	4,688,753	-	4,688,753	4,272,920
Total operating expenses	88,451,127	907,766,597	996,217,724	954,714,499
Operating income (loss)	14,641,850	9,599,493	24,241,343	(87,046,467)
Loss on disposal of assets	(5,384)	(4,919)	(10,303)	(12,036)
Net income (loss)	14,636,466	9,594,574	24,231,040	(87,058,503)
Retained earnings, beginning of year	168,030,799	(81,898,463)	86,132,336	173,190,839
Retained earnings, end of year	<u>\$ 182,667,265</u>	<u>\$ (72,303,889)</u>	<u>\$ 110,363,376</u>	<u>\$ 86,132,336</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING STATEMENT OF CASH FLOWS-ALL INTERNAL SERVICE FUNDS

YEARS ENDED JUNE 30, 2001
(With comparative totals for the year ended June 30, 2000)

	2001			2000
	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Totals	Restated Totals
Cash Flows from Operating Activities				
Operating income (loss)	\$ 14,641,850	\$ 9,597,826	\$ 24,239,676	\$ (87,046,467)
Reclassify interest and investment income to investing activity	(18,757,337)	(4,606,299)	(23,363,636)	(24,741,279)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation expense	81,120	81,415	162,535	151,214
Change in fair value of long-term investments	(9,089,636)	(542,216)	(9,631,852)	5,584,733
Change in assets-(increase) decrease:				
Premiums receivable	9,168,009	(213,414)	8,954,595	(3,642,322)
Reinsurance recovery receivable	2,897,003	-	2,897,003	(756,203)
Due from South Carolina Division of Retirement	-	(5,031,665)	(5,031,665)	(1,499,914)
Prepaid insurance, prescription drug rebate receivable and other assets	(271,223)	70,078	(201,145)	(709,818)
Change in liabilities-increase (decrease):				
Accounts payable, accrued payroll and compensated absences	(14,998)	(51,900)	(66,898)	456,883
Deferred premium revenue	(10,819,545)	8,315	(10,811,230)	1,205,036
Claims payable and incurred but not reported	17,093,873	(16,410,091)	683,782	40,883,140
Total adjustments	9,044,603	(22,089,478)	(13,044,875)	41,672,749
Net cash provided by (used in) operating activities	4,929,116	(17,097,951)	(12,168,835)	(70,114,997)

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING STATEMENT OF CASH FLOWS-ALL INTERNAL SERVICE FUNDS

(CONTINUED)

	2001			2000
	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Totals	Restated Totals
Cash Flows from Capital and Related Financing Activities				
Purchase of fixed assets	\$ (86,105)	\$ (179,948)	\$ (266,053)	\$ (108,086)
Net cash used in capital and related financing activities	(86,105)	(179,948)	(266,053)	(108,086)
Cash Flows from Investing Activities:				
Principal payments received on notes receivable	6,649,862	-	6,649,862	2,625,551
Funds disbursed as notes receivable	(4,106,517)	-	(4,106,517)	(1,224,262)
Purchase of investments	(24,753,937)	(441,325)	(25,195,262)	(148,406,995)
Proceeds from sales and maturity of investments	38,215,491	1,069,950	39,285,441	107,055,602
Interest received-deposits and investments	17,319,152	5,058,948	22,378,100	21,305,567
Interest received-notes receivable	1,260,290	-	1,260,290	1,867,687
Net cash provided by (used in) investing activities	34,584,341	5,687,573	40,271,914	(16,776,850)
Net increase (decrease) in cash and cash equivalents	39,427,352	(11,590,326)	27,837,026	(86,999,933)
Cash and cash equivalents, beginning of year	53,011,581	39,287,423	92,299,004	179,298,937
Cash and cash equivalents, end of year	<u>\$ 92,438,933</u>	<u>\$ 27,697,097</u>	<u>\$ 120,136,030</u>	<u>\$ 92,299,004</u>
Supplemental Information				
Noncash capital and related financing activities:				
Disposal of purchased fixed assets (including depreciation \$86,317 and \$106,636 of accumulated depreciation for the years ended June 30, 2001 and 2000	\$ (49,098)	\$ (47,522)	\$ (96,620)	\$ (118,672)
Net (appreciation) /depreciation of investments	\$ (9,089,636)	\$ (542,216)	\$ (9,631,852)	\$ 5,584,733

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

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

Dear Mr. Wagner:

We have audited the combined financial statements of the South Carolina State Budget and Control Board, Office of Insurance Services (the "Office") as of and for the years ended June 30, 2001 and 2000, and have issued our report thereon dated September 21, 2001. These financial statements are the responsibility of the Office's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

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

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

In planning and performing our audit of the combined financial statements of the Office for the years ended June 30, 2001 and 2000, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and not to provide assurance on the internal control. Accordingly, we do not express such an opinion or provide such assurance. With respect to the internal control, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

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

During 2000/2001, the Health, Life and Disability Insurance Reserve Fund reported a net income of \$9,594,574. This income, along with losses in recent years, has resulted in a retained deficit of \$72,303,889 for the Fund at June 30, 2001. Additionally, Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended, stipulates that "a reserve equal to not less than an average of one and one-half months' claims must be maintained in the accounts and all funds in excess of the reserve must be used to reduce premium rates or expand benefits as funding permits." Under Proviso 63B.9 the reserve requirement was changed. The Proviso reads "Notwithstanding any other provision of law, the State Health Plan is only required to seek a twenty-two day reserve fund by the end of calendar year 2001." As of June 30, 2001, the HLDIRF does not have a twenty-two day reserve fund. Management of the HLDIRF has reviewed the above situations and offers their analysis below. Although certain changes in the funding and coverages have taken place, there is no guarantee that the HLDIRF will return to a surplus position or that cash will be adequate to cover claims and administrative costs. Additional funding sources, such as further rate increases, State appropriations, etc. may be necessary to provide for the costs of the continued existence of the Plan.

Management's analysis:

The State Health Plan continues to experience unprecedented claims expenditure growth. This is a result of continued dramatic increases in service volume and prescription drug costs. As was anticipated during calendar year 2000, State Health Plan expenditures exceeded income. Effective January 2001, a combination of increased funding and benefit payment reductions were enacted in an effort to improve the Plan's financial condition and restore Plan reserves. However, those measures were not sufficient to garner financial stability of the Plan. Further measures have been deemed necessary and additional funding increases and cost sharing initiatives have been enacted with an effective date of January 2002. These measures include a \$12 per month employee increase and an approximate average 9.5% increase in employer funding. In addition to increased funding, several cost sharing initiatives are slated for implementation. They

include a \$100 deductible for Emergency Room services (waived if admitted), a \$50 deductible for Outpatient services (waived for oncology, physical therapy and Emergency Room), a \$2 copayment increase for prescription drugs, a "pay the difference" generic substitution policy and a \$100/person increase in the out-of-pocket prescription drug maximum.

Additionally, beginning in 2002, the State Health Plan will be operating under a new Administrative Services Only contract with BCBSSC. This contract will allow for further cost savings initiatives for the Plan. Most notably, a nationwide network of hospitals and physicians, for which discounts will be made available to the Plan for members receiving services outside of South Carolina.

Management is and will be continually monitoring the financial condition of the State Health Plan, as well as keeping the Board and other interested parties updated as to the Plan's financial status.

* * * * *

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

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

DeLoach & W. H. Wilson, L.L.P.

September 21, 2001