

State of South Carolina



Office of the State Auditor

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

THOMAS L. WAGNER, JR., CPA
STATE AUDITOR

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

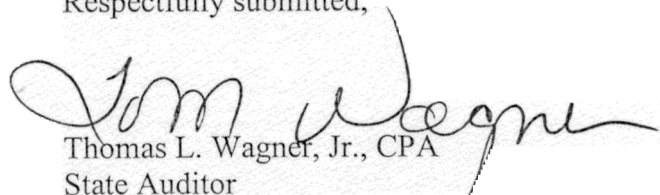
November 6, 2000

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

This report on the audit of the financial statements of the South Carolina State Budget and Control Board Office of Insurance Services for the fiscal years ended June 30, 2000 and 1999, was issued by Milhous, DeLoach & Williamson, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,


Thomas L. Wagner, Jr., CPA
State Auditor

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

YEARS ENDED JUNE 30, 2000 AND 1999

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, 2000 AND 1999

WITH

REPORT OF INDEPENDENT AUDITORS

CONTENTS

Report of Independent Auditors	1
--------------------------------------	---

Combined Financial Statements

Combined Balance Sheets	3
Combined Statements of Revenues, Expenses, and Changes in Retained Earnings	4
Combined Statements of Cash Flows	6
Notes to Combined Financial Statements (An Integral Part of the Financial Statements).....	7

Other Financial Information

Combining Balance Sheet - All Internal Service Funds	41
Combining Statement of Revenues, Expenses, and Changes in Retained Earnings - All Internal Service Funds	42
Combining Statement of Cash Flows - All Internal Service Funds	43

Independent Auditors' Report on Internal Control

Independent Auditors' Report on Internal Control.....	44
---	----

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, 2000 and 1999, 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 generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 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 15*, the Office is currently in violation of Section 1-11-710(A)(4) of the South Carolina Code of Laws, 1976, as amended. Additionally, the Office has incurred operating losses for the past four years which has resulted in a retained deficit in the Health, Life and Disability Insurance Reserve Fund. Managements analysis of these losses is more fully discussed in *Note 15*.

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, 2000 and 1999, and the results of operations and cash flows of its proprietary fund type for the years then ended in conformity with generally accepted accounting principles.

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.

September 22, 2000

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED BALANCE SHEETS

	Proprietary Fund Type	
	Internal Service	
	June 30,	
	2000	1999
Assets		
Current assets:		
Cash and cash equivalents	\$ 92,299,004	\$ 179,298,937
Premiums receivable	19,770,785	16,128,463
Reinsurance recovery receivable	3,644,087	2,887,884
Prescription Drug Rebate receivable	1,161,303	491,478
Current portion of notes receivable	1,556,018	2,025,551
Accrued interest	7,045,034	5,477,008
Due from South Carolina Division of Retirement	15,913,098	14,413,183
Prepaid insurance	2,118,094	2,167,973
Other assets	194,623	104,750
Total current assets	<u>143,702,046</u>	<u>222,995,227</u>
Non-current assets:		
Investments	269,536,712	233,770,052
Long-term notes receivable	23,254,956	24,186,712
Furniture and equipment, net of accumulated depreciation	719,248	913,988
Total non-current assets	<u>293,510,916</u>	<u>258,870,752</u>
Total assets	<u><u>\$ 437,212,962</u></u>	<u><u>\$ 481,865,979</u></u>
Liabilities and Fund Equity		
Current liabilities:		
Accounts payable	\$ 449,697	\$ 112,695
Accrued payroll	509,470	432,728
Claims payable	128,955,768	115,115,300
Deferred premium revenue	40,985,134	39,780,097
Claims incurred but not reported	179,632,638	152,589,966
Accrued compensated absences	647,053	603,912
Total current liabilities	<u>351,179,760</u>	<u>308,634,698</u>
Contingencies (<i>Note 13</i>)		
Fund equity:		
Contributed capital	<u>40,442</u>	<u>40,442</u>
Retained earnings:		
Reserved for:		
Installment Purchase Program	35,000,000	35,000,000
Savannah Valley Development Loans	20,000,000	20,000,000
Unreserved	30,992,760	118,190,839
Total retained earnings	<u>85,992,760</u>	<u>173,190,839</u>
Total fund equity	<u>86,033,202</u>	<u>173,231,281</u>
Total liabilities and fund equity	<u><u>\$ 437,212,962</u></u>	<u><u>\$ 481,865,979</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

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

YEARS ENDED JUNE 30, 2000 AND 1999

	Proprietary Fund Type	
	Internal Service	
	2000	1999
Operating Revenues		
Insurance premiums:		
Tort liability	\$ 26,220,269	\$ 28,111,228
Auto liability	16,308,557	15,910,544
Professional liability	5,678,783	5,686,782
Comprehensive and collision	2,245,419	2,207,260
School bus liability	3,512,769	3,516,351
Fire	6,932,650	6,885,871
Extended coverage	3,457,741	3,432,287
Inland Marine	2,615,386	2,631,194
Active employees:		
Health	541,261,482	478,262,791
Dental	39,443,117	38,098,794
Life	4,347,370	2,952,605
Long term disability	11,928,091	11,142,867
Dependent/optional life	21,331,102	19,253,685
HMO-point of service	5,092,262	1,615,563
Retirees:		
Health	36,403,894	32,010,038
Dental	2,458,281	2,258,082
Retiree surcharge	106,266,508	96,408,220
HMO-point of service	22,637	4,533
Other premium revenues	3,392,093	3,250,628
Prescription drug rebates	3,771,367	2,379,616
Income from deposits and investments	22,873,593	23,491,657
Notes receivable interest	1,867,687	2,451,755
Other	236,974	245,875
Contract dividend-Life	-	215,294
Contract dividend-LTD	—	1,085,708
Total operating revenues	867,668,032	783,509,228

CONTINUED

**SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES**

**COMBINED STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN RETAINED EARNINGS**

CONTINUED

	Proprietary Fund Type	
	Internal Service	
	2000	1999
Operating Expenses		
Reinsurance premiums	22,622,105	22,396,813
Premiums	104,860,221	101,235,929
Claims:		
Tort liability	23,584,585	15,247,791
School bus liability	3,361,577	484,349
Fire	2,736,434	2,758,587
Extended coverage	8,027,996	741,845
Health	687,831,402	592,006,384
Dental	42,651,381	44,646,299
Life	1,391,664	203,131
Long term disability	5,661,042	4,191,100
HMO-point of service	4,345,992	1,100,798
Returned premium (from contract dividend)	—	1,063,742
Hospitals and physicians	(752,018)	(666,402)
Auto and Inland Marine	2,850,950	2,397,987
Other	34,495	56,362
Professional and administrative fees	34,461,944	30,831,838
Administrative and planning	930,800	1,140,702
Insurance Benefits Administration	5,980,585	5,842,069
Insurance Reserve Administration	4,272,920	4,171,797
Total operating expenses	954,854,075	829,851,121
Operating loss	(87,186,043)	(46,341,893)
Loss on disposal of assets	(12,036)	(7,873)
Net loss	(87,198,079)	(46,349,766)
Retained earnings, beginning of year	173,190,839	219,540,605
Retained earnings at end of year	\$ 85,992,760	\$173,190,839

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINED STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2000 AND 1999

	Proprietary Fund Type	
	Internal Service	
	2000	1999
Cash Flows from Operating Activities		
Operating loss	\$ (87,186,043)	\$ (46,341,893)
Reclassify interest and investment income to investing activity	(24,741,279)	(25,943,412)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	290,790	344,385
Change in fair values of long-term investments	5,584,733	5,324,890
Change in assets-(increase) decrease:		
Premiums receivable	(3,642,322)	(1,567,923)
Reinsurance recovery receivable	(756,203)	(1,217,113)
Due from South Carolina Division of Retirement	(1,499,914)	(598,000)
Prepaid insurance, prescription drug rebate receivable and other assets	(709,818)	30,463
Change in liabilities-increase (decrease):		
Accounts payable, accrued payroll and compensated absences	456,883	(76,826)
Deferred premium revenue	1,205,036	(899,331)
Claims payable and incurred but not reported	40,883,140	19,283,223
Total adjustments	41,812,325	20,623,768
Net cash used in operating activities	(70,114,997)	(51,661,537)
Cash Flows from Capital and Related Financing Activities		
Purchase of fixed assets	(108,086)	(259,733)
Net cash used in capital and related financing activities	(108,086)	(259,733)
Cash Flows from Investing Activities:		
Principal payments received on notes receivable	2,625,551	10,727,438
Funds disbursed as notes receivable	(1,224,262)	(2,423,517)
Purchases of investments	(148,406,995)	(107,855,855)
Proceeds from sales and maturity of investments	107,055,602	67,764,234
Interest received-deposits and investments	21,305,567	23,694,704
Interest received-notes receivable	1,867,687	2,451,755
Net cash used in investing activities	(16,776,850)	(5,641,241)
Net decrease in cash and cash equivalents	(86,999,933)	(57,562,511)
Cash and cash equivalents, beginning of year	179,298,937	236,861,448
Cash and cash equivalents, end of year	\$ 92,299,004	\$ 179,298,937
Supplemental Information		
Noncash capital and related financing activities:		
Disposal of contributed fixed assets	\$	\$ (5,532)
Disposal of purchased fixed assets (including \$106,636 and \$57,910 of accumulated depreciation for the years ended June 30, 2000 and 1999)	(118,672)	(71,411)

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

JUNE 30, 2000 AND 1999

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.

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.

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)

The South Carolina State Budget and Control Board, Office of Insurance Services, Insurance Reserve Fund and Health, Life, and Disability Insurance Reserve Fund 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.

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 Internal Service Funds presented include

Insurance Reserve Fund (IRF)

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

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 (Continued)

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.

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.

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.

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 Accounting (Continued)

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 the Proprietary Fund Type.

Description of Funds

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:

- (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 4*) 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 accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

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.

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.

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

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.

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. Although the cash management pool includes some long-term investments, it operates as a demand deposit account; therefore, for credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 2*.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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.

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)

The Office amortizes bond premiums and accretes bond discounts using the effective interest method from the date of purchase to maturity. Realized gains and losses on investments are recognized in the year of sale. Unrealized gains and losses in investments resulting from changes in fair value are recognized as investment income in the period of occurrence.

Interest 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

Prepaid Insurance Premiums

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 \$6,100,000 and \$5,600,000 as of June 30, 2000 and 1999, 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 5.50% for 2000 and 1999, compounded annually.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— 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.

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-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 Absence

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, 2000. 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.

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 is recorded in proprietary funds to reflect the net accumulated earnings of the fund.

Budget

The General Assembly enacts a budget for the Office within the Division of Operations budgetary unit of the State Budget and Control Board which includes only administrative activities and provides specific line-item appropriations by program within the budgetary unit. A statement of

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

budgeted versus actual expenditures by line-item is not required for internal service funds and therefore is not presented.

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)

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.

The Office will follow the implementation schedule for the State.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

2. Investments and Deposits

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

The following table presents the amortized cost and fair values of the long-term investments of the Office at June 30, 2000 and 1999.

	Amortized Cost		Fair Value	
	2000	1999	2000	1999
U.S. Treasury obligations	\$ 22,395,092	\$ 23,005,399	\$ 28,286,800	\$ 29,490,991
U.S. Government agencies and government-insured securities	27,749,485	56,590,680	28,438,030	57,006,747
Corporate bonds	119,210,938	46,515,580	118,111,876	46,636,220
Financial and other	95,480,664	100,873,139	94,700,006	100,636,094
Total	<u>\$ 264,836,179</u>	<u>\$ 226,984,798</u>	<u>\$ 269,536,712</u>	<u>\$ 233,770,052</u>

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

	Par Value	Unamortized Premiums	Unaccreted Discounts	Amortized Cost
U.S. Treasury obligations	\$ 23,285,000	\$ 28,698	\$ 918,606	\$ 22,395,092
U.S. Government agencies and government-insured 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>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

2. Investments and Deposits (Continued)

At June 30, 1999, 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	\$ 10,244	\$ 289,845	\$ 23,005,399
U.S. Government agencies and government-insured securities	57,265,062	576	674,958	56,590,680
Corporate Bonds	47,245,000	164,759	894,179	46,515,580
Financial and other	100,767,000	577,945	471,806	100,873,139
Total	<u>\$ 228,562,062</u>	<u>\$ 753,524</u>	<u>\$ 2,330,788</u>	<u>\$ 226,984,798</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.

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, 2000 and 1999. 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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.

2. Investments and Deposits (Continued)

- (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, 2000 and 1999, 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, 2000 and 1999, all State Treasurer bank balances were fully insured or collateralized with securities held by the State or by its agents in the State's name.

With respect to investments in the State's 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 2000 and 1999, the following amounts (which apply to all investments) were included in interest income:

	<u>2000</u>	<u>1999</u>
Discount accretion	\$ 583,751	\$ 167,464
Premium amortization	(336,840)	(191,457)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

Net accretion/amortization included in interest income	<u>\$ 246,911</u>	<u>\$ (23,993)</u>
--	-------------------	--------------------

Cash and cash equivalents whose amortized cost reported amounts approximate fair value at June 30, 2000 and 1999, were composed of the following:

	<u>June 30, 2000</u>		
	<u>Cash Deposits</u>	<u>Repurchase Agreements</u>	<u>Total</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>

2. Investments and Deposits (Continued)

	<u>June 30, 1999</u>		
	<u>Cash Deposits</u>	<u>Repurchase Agreements</u>	<u>Total</u>
IRF	\$ 12,244,195	\$ 66,100,000	\$ 78,344,195
HLDIRF	96,954,742	4,000,000	100,954,742
	<u>\$ 109,198,937</u>	<u>\$ 70,100,000</u>	<u>\$ 179,298,937</u>

At June 30, 2000 and 1999, the IRF bank balances totaled \$919,439 and \$909,141, respectively and the HLDIRF bank balances totaled \$31,383,135 and \$97,955,725, respectively. 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, 2000 and 1999. Short-term investments held during both fiscal year 2000 and 1999 consisted of U.S. Government agency and government-insured securities whose amortized cost reported amounts approximate fair value at June 30, 2000.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

The investment types listed above include all investment types in which monies were held throughout the year ended June 30, 2000 and 1999. 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, 2000 and 1999, were as follows:

	<u>2000</u>	<u>1999</u>
Short-term investments	<u>\$ 30,000,000</u>	<u>\$ 30,000,000</u>
Repurchase agreements	<u>\$ 71,000,000</u>	<u>\$ 71,000,000</u>

A summary of total investments is as follows:

	<u>2000</u>		<u>1999</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Long-term investments	\$ 264,836,179	\$ 269,536,712	\$ 226,984,798	\$ 233,770,052
Repurchase agreements	<u>61,430,112</u>	<u>61,430,112</u>	<u>70,100,000</u>	<u>70,100,000</u>
	<u>\$ 326,266,291</u>	<u>\$ 330,966,824</u>	<u>\$ 297,084,798</u>	<u>\$ 303,870,052</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

2. Investments and Deposits (Continued)

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

	<u>2000</u>	<u>1999</u>
IRF	\$ 251,098,185	\$ 212,065,678
HLDIRF	18,438,527	21,704,374
	<u>\$ 269,536,712</u>	<u>\$ 233,770,052</u>

3. Premiums Receivable

Premiums receivable at June 30, 2000 and 1999, consist of the following:

June 30, 2000:	Due to:		
Due From:	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Total
Local government	\$ 9,792,628	\$ 298,187	\$ 10,090,815
State government	9,215,404	8,418	9,223,822
Other	367,617	88,531	456,148
	<u>\$ 19,375,649</u>	<u>\$ 395,136</u>	<u>\$ 19,770,785</u>
June 30, 1999:	Due to:		

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

Due From:	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Total
Local government	\$ 6,356,732	\$ 48,411	\$ 6,405,143
State government	9,070,004	375,600	9,445,604
Other	261,728	15,988	277,716
	\$ 15,688,464	\$ 439,999	\$ 16,128,463

3. Premiums Receivable (Continued)

Premiums receivable and deferred premium revenue include approximately \$16,000,000 and \$14,700,000 attributable to premiums billed in advance of coverage as of June 30, 2000 and 1999, respectively.

4. Due from South Carolina Division of Retirement

\$15,913,098 and \$14,413,183 (\$15,322,911 and \$13,914,400 from South Carolina Retirement System and \$590,187 and \$498,783 from Police Officers Retirement System) were due from the South Carolina Retirement Systems at June 30, 2000 and 1999, 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 1.95% from July 1, 1999 to December 31, 1999 and 2.16% from January 1, 2000 to June 30, 2000 and 2.03% for fiscal year 1999. 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 —

5. Notes Receivable

Amounts due from notes receivable in the Insurance Reserve Fund at June 30, 2000 and 1999, consist of the following:

	<u>2000</u>	<u>1999</u>
Due from State Agencies		
Six and twelve 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; range of maturity 1999 to 2006.	\$ 6,160,099	\$ 7,599,201
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 2005.	1,787,393	2,373,841
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.	976,892	1,576,893
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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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

5. Notes Receivable (Continued)

	<u>2000</u>	<u>1999</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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

One note in the principal amount of \$1,224,262 with interest at 8%; maturity date is January 31, 2030.	1,224,262	—
Total	24,810,974	26,212,263
Less current portion	(1,556,018)	(2,025,551)
Total	<u>\$ 23,254,956</u>	<u>\$ 24,186,712</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

6. 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, 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>

	Balance June 30, 1998	Additions	Deletions	Balance June 30, 1999
Furniture and Equipment	<u>\$1,997,809</u>	<u>\$ 259,732</u>	<u>\$ 71,411</u>	<u>\$2,186,130</u>

A summary of fixed assets by fund at June 30, 2000 and 1999, is as follows:

June 30, 2000	Furniture and Equipment	Accumulated Depreciation	Net Book Value
Insurance Reserve Fund	\$ 925,910	\$ 684,971	\$ 240,939
Health, Life and Disability Insurance Reserve Fund	<u>1,249,634</u>	<u>771,325</u>	<u>478,309</u>
Total	<u>\$ 2,175,544</u>	<u>\$ 1,456,296</u>	<u>\$ 719,248</u>

June 30, 1999	Furniture and Equipment	Accumulated Depreciation	Net Book Value
Insurance Reserve Fund	\$ 938,326	\$ 571,208	\$ 367,118

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

Health, Life and Disability Insurance Reserve			
Fund	<u>1,247,804</u>	<u>700,934</u>	<u>546,870</u>
Total	<u>\$ 2,186,130</u>	<u>\$ 1,272,142</u>	<u>\$ 913,988</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

6. Fixed Assets and Contributed Capital (Continued)

Depreciation expense for the years ended June 30, 2000 and 1999, was \$290,790 and \$344,385, respectively.

The following is a schedule of changes in contributed capital for the years ended June 30, 2000 and 1999.

	Health, Life, and Disability Insurance Reserve Fund
Balance, June 30, 1998	\$ 45,974
Donated assets-year ended June 30, 1999	—
Disposal of assets-year ended June 30, 1999	<u>(5,532)</u>
Balance, June 30, 1999	40,442
Donated assets-year ended June 30, 2000	—
Disposal of assets-year ended June 30, 2000	<u>—</u>
Balance, June 30, 2000	<u><u>\$ 40,442</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

7. Lease Obligations

The Office leases office space accounted for as an operating lease. The office space lease was amended effective May 1, 1997, and now expires June 30, 2002. Rental expense under this lease for the years ended June 30, 2000 and 1999, was \$791,107 and \$669,055. The lease payments are fixed for the remaining life of the lease. The lease contains a renewal option which expires June 30, 2002.

The following schedule summarizes the Office's obligations under operating leases having remaining terms in excess of one year as of June 30, 2000:

<u>Fiscal Year</u> <u>Ending June 30,</u>	<u>Total</u>
2001	\$ 791,107
2002	791,107
Total	<u><u>\$ 1,582,214</u></u>

The Office has also entered into a number of operating leases which expire in various years from 2001 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, 2000 and 1999, expenses under these leases were approximately \$26,550 and \$37,000, respectively.

8. 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, 2000 and

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

1999, \$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, 2000 and 1999, was \$6,160,099 and \$7,599,201, respectively.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

8. Retained Earnings-Reserved (Continued)

Savannah Valley Development Program-At June 30, 2000 and 1999, \$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, 2000 and 1999, \$16,863,482 and \$16,239,222, respectively, was outstanding.

9. Pension Plans

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.

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.

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 30 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 15 years credited

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

service. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service. A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

9. Pension Plans (Continued)

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, 2000, 1999 and 1998 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 \$473,000, \$427,000 and \$398,000, 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, 2000, 1999 and 1998.

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).

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.

An Act passed in the last General Assembly session which had not been signed by the Governor as of June 30, 2000 will amend Chapter 1, Title 9 of the 1976 Code of Laws, relating to the South Carolina Retirement System effective July 1, 2000, with some provisions effective January

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

1, 2001. The amendment will enact the Teacher and Employee Retention Incentive Program, reduce from thirty to twenty-eight the years of creditable service required to retire at any age without penalty and make other changes to the South Carolina Retirement System.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

10. Post-Employment and Other Employee Benefits

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the 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.

The Office recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$332,000, \$288,000 and \$267,000 for the years ended June 30, 2000, 1999 and 1998, respectively. As discussed in *Note 9*, the Office paid approximately \$94,000, \$91,000 and \$81,000 for the years ended June 30, 2000, 1999 and 1998, respectively, applicable to the surcharge included with the employer contributions for retirement benefits (1.95% for 2000, 2.03% for 1999 and 1.916% for 1998).

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

11. 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.

The State appropriated funds from unspent fiscal year 1998-1999 general fund appropriations above the ten percent set aside, for contributions to 401(k) accounts of eligible state employees. The appropriated 401(k) match is limited to \$300. To be eligible, an employee must meet the following eligibility requirements:

1. The employee must be a permanent full-time State employee for 24 continuous months as of July 1, 1999 and be employed on the date of distribution and
2. Must have established a 401(k) account with annual contributions equal to the match (this requirement is not required for employees earning less than \$20,000).

In April, 2000 the State contributed \$118 to the 401(k) accounts of each eligible State employee.

12. 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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.

12. Transactions with State Entities (Continued)

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

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 \$9,223,822 and \$9,445,604 at June 30, 2000 and 1999, 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, 2000 and 1999:

	<u>2000</u>	<u>1999</u>
Tort liability	\$ 13,928,475	\$ 16,345,043
Auto liability	5,228,448	5,204,589
Professional liability	5,138,563	4,961,915
Comprehensive and collision	223,177	231,602
School bus liability	31,107	3,081,442
Fire	3,292,996	2,911,845
Extended coverage	1,642,421	1,451,420
Inland Marine	915,687	826,848
Active employees:		
Health	221,770,332	202,756,215

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

Dental	16,376,868	16,283,948
Life	2,096,207	1,461,615
Long-term disability	5,091,545	4,794,235
Dependent/optional life	10,468,539	9,520,305
HMO-point of service	5,092,262	1,615,563
Retirees:		
Health	15,814,628	14,366,111
Dental	1,112,711	1,047,586
Retiree surcharge	46,612,711	39,255,882
HMO-point of service	22,637	4,533
Other premium revenues	1,628,281	1,453,271
	<u>\$ 356,487,595</u>	<u>\$ 327,573,968</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

12. 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 2000 and 1999 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, 2000 and 1999, \$1,969,841 and \$1,886,549, respectively was collected from state agencies and disbursed to the State Life and Long-Term Disability carrier.

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

The 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.

13. Contingencies

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

14. 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).

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:

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

14. Risk Management/Reinsurance (Continued)

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, 2000 or 1999, based on the requirements of GASB 10 because information at June 30 did not indicate that an asset had been impaired or a liability had been incurred. GASB 10 states that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30 and the amount of loss is reasonably estimable.

The 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

14. Risk Management/Reinsurance (Continued)

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

15. Discussion of Net Loss in FY 1999-2000

During 1999/2000, the Health, Life and Disability Insurance Reserve Fund reported a net loss of \$91,797,766. This loss, along with other losses in recent years, has resulted in a retained deficit of \$82,024,522 for the Fund at June 30, 2000. 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.” Due to the above loss and the resulting decrease in cash reserves, the HLDIRF is not in compliance with the above statute.

Management has reviewed the above situations and offers the following analysis:

State Health Plan claims expenditures during the fiscal year continued to grow at a pace unprecedented in recent years. Contribution rates for Calendar Year 1999 were thought to be adequate at the time they were established in August 1998. Subsequent claims experience proved that not to be the case. Because of this excessive growth in claims, primarily the result of additional service volume, an “emergency” increase in the employer contribution was enacted in June 1999 for a January 2000 effective date. It was understood at that time that expenditures would exceed income for Calendar Year 2000; the contribution increase was established with the intent of generating sufficient revenue, in combination with cash reserves, to pay claims throughout Plan Year 2000.

Office of Insurance Services staff spent a considerable amount of time briefing representatives of the executive and legislative branches as to the Plan’s financial condition from the time the critical situation was known late last spring through the 2000 legislative session. A standard presentation was prepared and constantly updated with detailed information concerning the

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

causes of the situation and projections as to short-term financial outcomes. Quarterly reports were distributed to Board members and other interested parties noting the declining cash balance in the State Health Plan's reserve account. The General Assembly recognized the unique nature of the current financial situation by enacting a temporary proviso reducing the cash reserve requirement for Plan Year 2001 by half: from the statutory 1 1/2 claim months to 22 days.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

15. Discussion of Net Loss in FY 1999-2000 (Continued)

Another factor contributing to the operating deficit during the fiscal year is the change in the prescription drug benefit methodology effective January 2000. The Plan went from a system in which prescription drugs were payable after filing of a paper claim by the patient to one in which prescriptions are electronically filed by the pharmacy. This change, estimated to be cost neutral over the course of a year, nonetheless resulted in an acceleration of drug claims payments, such that during the first half of Calendar 2000, the Plan was paying substantially for both 1999 and 2000 drug claims incurrals.

The Plan's critical funding situation has been addressed with a series of major actions that will become effective January 2001. The employer contribution will increase by 20% for Calendar Year 2001, and benefit payments will be reduced in the form of a hike in the annual deductible of \$50/person, \$100/family, and an increase in the patient share of coinsurance by 5%. In addition, enrollee contribution rates will increase by \$5/month regardless of level of coverage. Management is hopeful that these actions will result in positive movement toward restoration of Plan reserves and correction of the Plan's deficit financial position.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

16. 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 funds.

	Insurance Reserve Fund		Health, Life, and Disability Insurance Reserve Fund	
	2000	1999	2000	1999
	(In thousands)		(In thousands)	
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 138,899	\$ 146,778	\$ 128,806	\$ 101,644
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current fiscal year	36,860	38,515	666,644	476,306
Increases (decreases) in provision for insured events of prior fiscal years	2,984	(17,494)	75,238	165,842
Total incurred claims and claim adjustment expenses	39,844	21,021	741,882	642,148
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	7,422	10,785	566,987	405,982
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	20,172	18,115	146,262	209,004
Total payments	27,594	28,900	713,249	614,986
Total unpaid claims and claim adjustment expenses at end of the fiscal year	\$ 151,149	\$ 138,899	\$ 157,439	\$ 128,806

The above totals are comprised of the following:

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

NOTES TO COMBINED FINANCIAL STATEMENTS

— CONTINUED —

Claims payable	\$ 89,916	\$ 87,881	\$ 39,039	\$ 27,234
Claims incurred but not reported	<u>61,233</u>	<u>51,018</u>	<u>118,400</u>	<u>101,572</u>
Total	<u>\$ 151,149</u>	<u>\$ 138,899</u>	<u>\$ 157,439</u>	<u>\$ 128,806</u>

The HMO self-insured managed care plan liability at June 30, 2000 was \$906,774 and is included in the claims liability of HLDIRF listed above.

17. Demutualization-Contract Dividend

During fiscal year 1999, the Office's State Life and LTD carrier converted from a mutual ownership company to a stock ownership company. This conversion has no effect on the plans offered to employees and coverage for the insureds. The conversion resulted in a return of premium to the Office of \$1,085,708 and of \$215,294 for the LTD and the State Life contracts respectively. The Office disbursed \$1,063,742 as a return of premium, of the LTD funds to its insureds. The balance of the LTD funds was held to cover administrative expenses. As the State Life premiums were paid by the State, those funds will be held in the HLDIRF.

OTHER FINANCIAL INFORMATION

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING BALANCE SHEET - ALL INTERNAL SERVICE FUNDS

JUNE 30, 2000
(With comparative totals for June 30, 1999)

	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Totals	1999 Totals
Assets				
Current assets:				
Cash and cash equivalents	\$ 53,011,581	\$ 39,287,423	\$ 92,299,004	\$ 179,298,937
Premiums receivable	19,375,649	395,136	19,770,785	16,128,463
Reinsurance recovery receivable	3,644,087	—	3,644,087	2,887,884
Prescription Drug Rebate receivable	—	1,161,303	1,161,303	491,478
Current portion of notes receivable	1,556,018	—	1,556,018	2,025,551
Accrued interest	5,812,793	1,232,241	7,045,034	5,477,008
Due from South Carolina Division of Retirement	—	15,913,098	15,913,098	14,413,183
Prepaid insurance	2,118,094	—	2,118,094	2,167,973
Other assets	192,892	1,731	194,623	104,750
Total current assets	<u>85,711,114</u>	<u>57,990,932</u>	<u>143,702,046</u>	<u>222,995,227</u>
Non-current assets:				
Investments	251,098,185	18,438,527	269,536,712	233,770,052
Long-term notes receivable	23,254,956	—	23,254,956	24,186,712
Furniture and equipment, net of accumulated depreciation	240,939	478,309	719,248	913,988
Total non-current assets	<u>274,594,080</u>	<u>18,916,836</u>	<u>293,510,916</u>	<u>258,870,752</u>
Total assets	<u>\$ 360,305,194</u>	<u>\$ 76,907,768</u>	<u>\$ 437,212,962</u>	<u>\$ 481,865,979</u>
Liabilities and Fund Equity				
Current liabilities:				
Accounts payable	\$ 247,644	\$ 202,053	\$ 449,697	\$ 112,695
Accrued payroll	209,652	299,818	509,470	432,728
Claims payable	89,916,449	39,039,319	128,955,768	115,115,300
Deferred premium revenue	40,412,508	572,626	40,985,134	39,780,097
Claims incurred but not reported	61,232,562	118,400,076	179,632,638	152,589,966
Accrued compensated absences	269,097	377,956	647,053	603,912
Total current liabilities	<u>192,287,912</u>	<u>158,891,848</u>	<u>351,179,760</u>	<u>308,634,698</u>
Fund equity:				
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	113,017,282	(82,024,522)	30,992,760	118,190,839
Total retained earnings	<u>168,017,282</u>	<u>(82,024,522)</u>	<u>85,992,760</u>	<u>173,190,839</u>
Total fund equity	<u>168,017,282</u>	<u>(81,984,080)</u>	<u>86,033,202</u>	<u>173,231,281</u>
Total liabilities and fund equity	<u>\$ 360,305,194</u>	<u>\$ 76,907,768</u>	<u>\$ 437,212,962</u>	<u>\$ 481,865,979</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN RETAINED EARNINGS - ALL INTERNAL SERVICE FUNDS

YEAR ENDED JUNE 30, 2000

(With comparative totals for the year ended June 30, 1999)

	2000			1999
	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Totals	Totals
Operating Revenues				
Insurance premiums:				
Tort liability	\$ 26,220,269	\$ —	\$ 26,220,269	\$ 28,111,228
Auto liability	16,308,557	—	16,308,557	15,910,544
Professional liability	5,678,783	—	5,678,783	5,686,782
Comprehensive and collision	2,245,419	—	2,245,419	2,207,260
School bus liability	3,512,769	—	3,512,769	3,516,351
Fire	6,932,650	—	6,932,650	6,885,871
Extended coverage	3,457,741	—	3,457,741	3,432,287
Inland Marine	2,615,386	—	2,615,386	2,631,194
Active employees:				
Health	—	541,261,482	541,261,482	478,262,791
Dental	—	39,443,117	39,443,117	38,098,794
Life	—	4,347,370	4,347,370	2,952,605
Long term disability	—	11,928,091	11,928,091	11,142,867
Dependent/optional life	—	21,331,102	21,331,102	19,253,685
HMO-point of service	—	5,092,262	5,092,262	1,615,563
Retirees:				
Health	—	36,403,894	36,403,894	32,010,038
Dental	—	2,458,281	2,458,281	2,258,082
Retiree surcharge	—	106,266,508	106,266,508	96,408,220
HMO-point of service	—	22,637	22,637	4,533
Other premium revenues	2,581,672	810,421	3,392,093	3,250,628
Prescription drug rebates	—	3,771,367	3,771,367	2,379,616
Income from deposits and investments	15,463,744	7,409,849	22,873,593	23,491,657
Notes receivable interest	1,867,687	—	1,867,687	2,451,755
Other	10,827	226,147	236,974	245,875
Contract dividend-life	—	—	—	215,294
Contract dividend-LTD	—	—	—	1,085,708
Total operating revenues	86,895,504	780,772,528	867,668,032	783,509,228
Operating Expenses				
Reinsurance premiums	22,622,105	—	22,622,105	22,396,813
Premiums	1,439,471	103,420,750	104,860,221	101,235,929
Claims:				
Tort liability	23,584,585	—	23,584,585	15,247,791
School bus liability	3,361,577	—	3,361,577	484,349
Fire	2,736,434	—	2,736,434	2,758,587
Extended coverage	8,027,996	—	8,027,996	741,845
Health	—	687,831,402	687,831,402	592,006,384
Dental	—	42,651,381	42,651,381	44,646,299
Life	—	1,391,664	1,391,664	203,131
Long term disability	—	5,661,042	5,661,042	4,191,100
HMO-point of service	—	4,345,992	4,345,992	1,100,798
Return of premium (from contract dividend)	—	—	—	1,063,742
Hospitals and physicians	(752,018)	—	(752,018)	(666,402)
Auto and Inland Marine	2,850,950	—	2,850,950	2,397,987
Other	34,495	—	34,495	56,362
Professional and administrative fees	13,646,769	20,815,175	34,461,944	30,831,838
Administrative and planning	465,400	465,400	930,800	1,140,702
Insurance Benefits Administration	—	5,980,585	5,980,585	5,842,069
Insurance Reserve Administration	4,272,920	—	4,272,920	4,171,797
Total operating expenses	82,290,684	872,563,391	954,854,075	829,851,121
Operating income (loss)	4,604,820	(91,790,863)	(87,186,043)	(46,341,893)
Loss on disposal of assets	(5,133)	(6,903)	(12,036)	(7,873)
Net income (loss)	4,599,687	(91,797,766)	(87,198,079)	(46,349,766)
Retained earnings, beginning of year	163,417,595	9,773,244	173,190,839	219,540,605
Retained earnings (deficit) at end of year	\$ 168,017,282	\$ (82,024,522)	\$ 85,992,760	\$ 173,190,839

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
OFFICE OF INSURANCE SERVICES

COMBINING STATEMENT OF CASH FLOWS - ALL INTERNAL SERVICE FUNDS

YEAR ENDED JUNE 30, 2000

(With comparative totals for the year ended June 30, 1999)

	2000			1999
	Insurance Reserve Fund	Health, Life, and Disability Insurance Reserve Fund	Totals	Totals
Cash Flows from Operating Activities				
Operating income (loss)	\$ 4,604,820	\$ (91,790,863)	\$(87,186,043)	\$ (46,341,893)
Reclassify interest and investment income to investing activity	(17,331,430)	(7,409,849)	(24,741,279)	(25,943,412)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation expense	144,605	146,185	290,790	344,385
Change in fair value of long-term investments	4,736,014	848,719	5,584,733	5,324,890
Change in assets-(increase) decrease:				
Premiums receivable	(3,687,185)	44,863	(3,642,322)	(1,567,923)
Reinsurance recovery receivable	(756,203)	—	(756,203)	(1,217,113)
Due from South Carolina Division of Retirement	—	(1,499,914)	(1,499,914)	(598,000)
Prepaid insurance, prescription drug rebate receivable and other assets	(39,994)	(669,824)	(709,818)	30,463
Change in liabilities-increase (decrease):				
Accounts payable, accrued payroll and compensated absences	178,897	277,986	456,883	(76,826)
Deferred premium revenue	1,394,271	(189,235)	1,205,036	(899,331)
Claims payable and incurred but not reported	12,250,353	28,632,787	40,883,140	19,283,223
Total adjustments	14,220,758	27,591,567	41,812,325	20,623,768
Net cash provided by (used in) operating activities	1,494,148	(71,609,145)	(70,114,997)	(51,661,537)
Cash Flows from Capital and Related Financing Activities				
Purchase of fixed assets	(23,559)	(84,527)	(108,086)	(259,733)
Net cash used in capital and related financing activities	(23,559)	(84,527)	(108,086)	(259,733)
Cash Flows from Investing Activities:				
Principal payments received on notes receivable	2,625,551	—	2,625,551	10,727,438
Funds disbursed as notes receivable	(1,224,262)	—	(1,224,262)	(2,423,517)
Purchase of investments	(147,296,997)	(1,109,998)	(148,406,995)	(107,855,855)
Proceeds from sales and maturity of investments	103,528,476	3,527,126	107,055,602	67,764,234
Interest received-deposits and investments	13,696,342	7,609,225	21,305,567	23,694,704
Interest received-notes receivable	1,867,687	—	1,867,687	2,451,755
Net cash provided by (used in) investing activities	(26,803,203)	10,026,353	(16,776,850)	(5,641,241)
Net decrease in cash and cash equivalents	(25,332,614)	(61,667,319)	(86,999,933)	(57,562,511)
Cash and cash equivalents, beginning of year	78,344,195	100,954,742	179,298,937	236,861,448
Cash and cash equivalents, end of year	\$ 53,011,581	\$ 39,287,423	\$ 92,299,004	\$ 179,298,937
Supplemental Information				
Noncash capital and related financing activities:				
Disposal of contributed fixed assets	\$	\$	\$	\$ (5,532)
Disposal of purchased fixed assets (including \$106,636 and \$57,910 of accumulated depreciation for the years ended June 30, 2000 and 1999)	(35,975)	(82,696)	(118,672)	(71,411)

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

MILHOUS, DeLOACH & WILLIAMSON, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
1401 MAIN STREET, SUITE 660
COLUMBIA, SOUTH CAROLINA 29201

PHONE: (803) 771-8855
FAX: (803) 771-6001

Robert E. Milhous, CPA
Harry D. DeLoach, CPA
Ray L. Williamson, CPA

MAILING ADDRESS:

POST OFFICE BOX 1445
COLUMBIA, SOUTH CAROLINA 29202

Members
American Institute of
Certified Public Accountants
S. C. Association of
Certified Public Accountants

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, 2000 and 1999, and have issued our report thereon dated September 22, 2000. 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, 2000 and 1999, 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 1999/2000, the Health, Life and Disability Insurance Reserve Fund reported a net loss of \$91,797,766. This loss, along with other losses in recent years, has resulted in a retained deficit of \$82,024,522 for the Fund at June 30, 2000. 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.” Due to the above loss and the resulting decrease in cash reserves, the HLDIRF is not in compliance with the above statute.

We recommend that management of the Office continue to monitor this situation and make the necessary changes to return to profitable operations.

Management has reviewed the above situations and offers the following analysis:

State Health Plan claims expenditures during the fiscal year continued to grow at a pace unprecedented in recent years. Contribution rates for Calendar Year 1999 were thought to be adequate at the time they were established in August 1998. Subsequent claims experience proved that not to be the case. Because of this excessive growth in claims, primarily the result of additional service volume, an “emergency” increase in the employer contribution was enacted in June 1999 for a January 2000 effective date. It was understood at that time that expenditures would exceed income for Calendar Year 2000; the contribution increase was established with the intent of generating sufficient revenue, in combination with cash reserves, to pay claims throughout Plan Year 2000.

Office of Insurance Services staff spent a considerable amount of time briefing representatives of the executive and legislative branches as to the Plan’s financial condition from the time the critical situation was known late last spring through the 2000 legislative session. A standard presentation was prepared and constantly updated with detailed information concerning the causes of the situation and projections as to short-term financial outcomes. Quarterly reports were distributed to Board members and other interested parties noting the declining cash balance in the State Health Plan’s reserve account. The General Assembly recognized the unique nature of the current financial situation by enacting a temporary proviso reducing the cash reserve requirement for Plan Year 2001 by half: from the statutory 1 1/2 claim months to 22 days.

Another factor contributing to the operating deficit during the fiscal year is the change in the prescription drug benefit methodology effective January 2000. The Plan went from a system in which prescription drugs were payable after filing of a paper claim by the patient to one in which prescriptions are electronically filed by the pharmacy. This change, estimated to be cost neutral over the course of a year, nonetheless resulted in an acceleration of drug claims payments, such that during the first half of Calendar 2000, the Plan was paying substantially for both 1999 and 2000 drug claims incurrals.

The Plan's critical funding situation has been addressed with a series of major actions that will become effective January 2001. The employer contribution will increase by 20% for Calendar Year 2001, and benefit payments will be reduced in the form of a hike in the annual deductible of \$50/person, \$100/family, and an increase in the patient share of coinsurance by 5%. In addition, enrollee contribution rates will increase by \$5/month regardless of level of coverage. Management is hopeful that these actions will result in positive movement toward restoration of Plan reserves and correction of the Plan's deficit financial position.

* * * * *

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.

Milliano, DeLoach & Williamson, L.L.P.

September 22, 2000