

SOUTH CAROLINA STATE ACCIDENT FUND

COLUMBIA, SOUTH CAROLINA

FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2003

State of South Carolina



Office of the State Auditor

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STATE AUDITOR

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October 23, 2003

The Honorable Mark Sanford, Governor
and
Mr. Irvin D. Parker, Director
South Carolina State Accident Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Accident Fund for the fiscal year ended June 30, 2003 was issued by Rogers & Laban, PA, 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,

A handwritten signature in black ink, appearing to read 'Tom Wagner'.

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/trb

SOUTH CAROLINA STATE ACCIDENT FUND

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YEAR ENDED JUNE 30, 2003**

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ROGERS & LABAN, PA

CERTIFIED PUBLIC ACCOUNTANTS AND FINANCIAL CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the South Carolina State Accident Fund (the Fund) as of and for the year ended June 30, 2003 as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the financial statements of the Fund are intended to present the financial position and results of operations of only that portion of the financial reporting entity of the State of South Carolina that is attributable to the transactions of the State Accident Fund. They do not purport to and do not present the financial position of the State of South Carolina as of June 30, 2003 and changes in its financial position or cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America, and do not include any other agencies, divisions or component units of the State of South Carolina.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2003, and the results of its operations and its cash flows of its proprietary fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 6 are not a required part of the basic financial statements but are supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Rogers & Laban PA

September 25, 2003



STATE ACCIDENT FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statements and Financial Analysis

The State Accident Fund presents a discussion and analysis of its financial statements for fiscal year 2003. The discussion includes an overview of the financial activity for the year. This report is prepared in accordance with Governmental Accounting Standards Board Statement 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. The new reporting model is expected to be more comprehensive but yet easily understood by it readers. This is the first year comparative analysis of the data has been presented. Three financial statements are presented: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. Please read in conjunction with the basic financial statements.

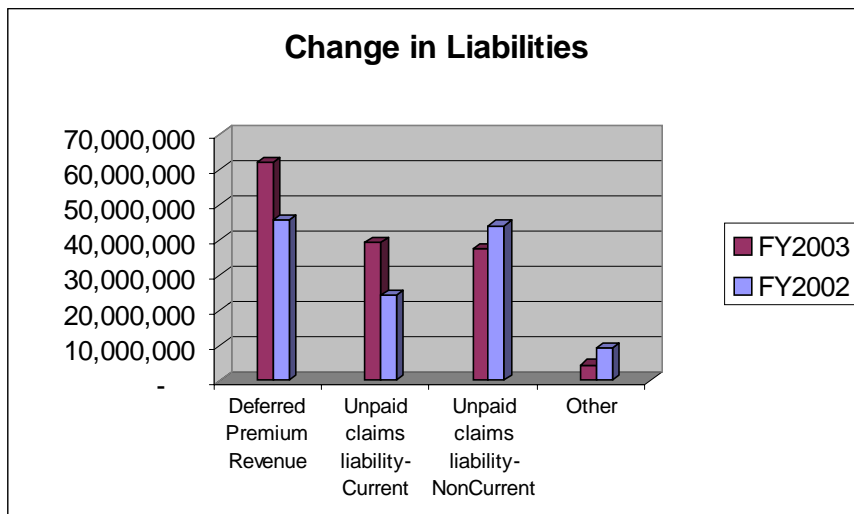
Statement of Net Assets

The Statement of Net Assets presents information reflecting the Fund's assets, liabilities, and net assets. This statement provides the reader with a snapshot view at a point in time. Net Assets represents the amount of total assets less liabilities. Assets and liabilities are shown as current and long term. Current assets and liabilities are those with immediate liquidity or which are collectible or due within twelve months of the statement date. The Statement of Net Assets indicates the funds available for the Fund's operation along with the liabilities that will come due during the next fiscal year.

Unpaid claim liabilities are a large part of the Fund's liabilities and have been separated into current (to be paid within one year) and long-term (to be paid after one year). Estimated unpaid claim liabilities, due within one year, increased by \$15m but unpaid claim liabilities, due after one year, decreased by \$6.5m. The overall increase was \$8.5m from the prior year. Another large part of the liabilities is deferred premium, which represents the amount of premium billed, but not yet earned, for the future period. Due to the rate increase of 24.7%, on January 1, 2003, deferred premium increased approximately \$16.4m from the prior year.

State Accident Fund
Condensed Statement of Net Assets
June 30, 2003

	FY2003	FY2002
ASSETS		
Current and other assets	\$ 75,614,200	\$ 69,606,512
Capital assets, net of accumulated depreciation	2,494,603	4,158,612
Other Noncurrent assets	1,115,857	1,144,768
Total assets	79,224,660	74,909,892
LIABILITIES		
Current liabilities	105,736,831	79,165,857
Noncurrent liabilities	37,681,792	44,142,443
Total liabilities	143,418,623	123,308,300
Net Assets		
Invested in capital assets	2,494,603	4,158,612
Unrestricted	(66,688,566)	(52,557,020)
Total net assets	\$ (64,193,963)	\$ (48,398,408)



The chart above shows the breakdown of liabilities and the change compared to the previous fiscal year.

Statement of Revenue, Expenses, and Changes in Net Assets

This statement represents operating revenues and expenses, as well as the non-operating revenues and expenses during the operating year. The purpose of this statement is to present the reader with information relating to monies received and expenses paid during the year. The Fund's major revenue

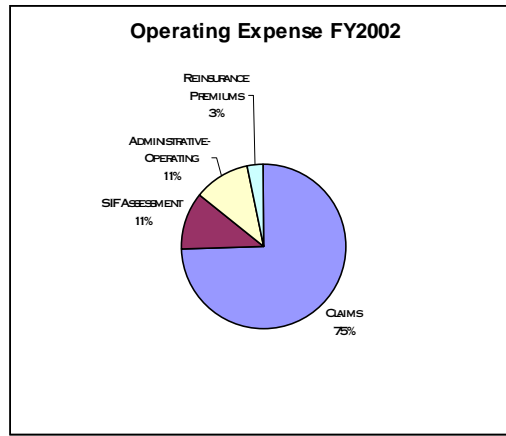
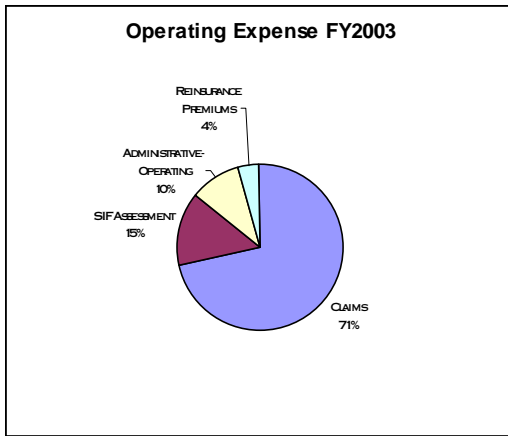
comes from premium income for workers' compensation insurance coverage. The major expenses are from incurred claim liabilities, which include medical cost and lost wages to injured workers and the change in anticipated future payments. Though the Fund is a state agency its normal operation is similar to that of other property and casualty insurance companies.

The Fund is a proprietary fund entity therefore; the statement of Revenues, Expenses, and Changes in Net Assets has been prepared on the accrual basis. Statements prepared using the accrual basis recognize revenues when earned and expenses when incurred.

The expenses presented in this statement include both administrative expenses and claims paid during the year. The administrative cost ratio for FY2003 was 13.3% compared to 16% in FY2002. The administrative cost ratio, means 13.3% of premium dollars, was used to operate the Fund during the fiscal year. Other expenses for the Fund were the transfer of \$1,791,269 to the General Fund in FY2003 and \$4,408 during FY2002.

**Condensed Statement of Revenues, Expenses, and Changes in Net Assets
for the year ended June 30, 2003**

	2003	2002
Operating revenues	\$ 55,599,482	\$ 45,274,268
Operating expenses	<u>70,726,493</u>	<u>65,073,872</u>
Operating loss	(15,127,011)	(19,799,604)
Nonoperating revenues and expenses	<u>1,122,725</u>	<u>1,389,866</u>
Income (Loss) before transfers	(14,004,286)	(18,409,738)
Transfer to General Fund of the state	<u>(1,791,269)</u>	<u>(4,408)</u>
Increase (Decrease) in net assets	(15,795,555)	(18,414,146)
Nets assets - beginning of year, as reported previously	(48,398,408)	(29,857,917)
Cumulative effect of changes in accounting principles	<u>-</u>	<u>(126,345)</u>
Net assets - beginning of year, as restated	<u>(48,398,408)</u>	<u>(29,984,262)</u>
Net assets at end of year	<u><u>\$ (64,193,963)</u></u>	<u><u>\$ (48,398,408)</u></u>



The charts above show that during the past two fiscal year 71-75% of expenses have been paid directly to injured workers or to medical providers on behalf of the injured worker.

Statement of Cash Flows

The statement of cash flows gives a detailed look at the Fund's cash flow from operating, capital and investing activities. The statement gives a summary of operating cash flows and operating activity for the year. Non-operating revenues include investment income received from cash held and invested by the State Treasurer's Office.

The change in cash and cash equivalents at year-end for FY2003 compared to FY2002 is due primarily to the increase of over \$3m in the Second Injury Fund assessment, increase in claim expense of \$2m and the transfer of \$1.8m to the state's General Fund.

	2003	2002
Cash provided (used by):		
Operating activities	\$ (6,576,830)	\$ (3,904,550)
Non-capital and related financing activities	(3,007,629)	411,257
Capital and related financing activities	(17,049)	(82,613)
Investing activities	1,179,914	1,415,990
Net change in cash	(8,421,594)	(2,159,916)
Cash and cash equivalents - beginning of year	23,253,496	25,413,412
Cash and cash equivalents - end of year	<u>\$ 14,831,902</u>	<u>\$ 23,253,496</u>

Capital Asset and Debt Activity

Capital assets increased by \$17,049 for the purchase of two additional tape drives that were added to an existing tape library during the fiscal year. There were no other significant additions to capital assets. The Fund had no changes in credit rating or debt limitations that may affect future financing.

Economic Outlook

The Fund incurred an operating loss of \$15.8m during the fiscal year ending June 30, 2003. In order to recover from this operating loss, effective January 1, 2003, rate changes were made to increase premium revenue. Additional premium revenue of approximately \$0.5m was also created from 27 new policyholders during fiscal year 2003. During FY2003 the Fund policy retention ratio was 92.99%. Due to the hardening of the workers' compensation market we expect to continue to attract new policyholders.

The National Council on Compensation Insurance estimates that medical and indemnity costs will continue to rise. Even though the Fund's average claim costs remain below the industry average the following cost containment efforts are being made:

- The managed comp program implemented during FY2002 to reduce medical and indemnity cost was expanded to include additional vendors.
- Reinsurance coverage was purchased to recover costs exceeding \$350,000 per claim through 11/14/02 and \$500,000 per claim effective 11/15/02.
- A Request for Proposal (RFP) for vendors who offer a third part subrogation program has been submitted to the Materials Management Office. The bid process should be completed and the program implemented in the new fiscal year.

During the 2003 legislative session the General Assembly decided again to exercise its authority to redirect money held in trust funds. According to Proviso 73.2, the Fund must transfer during FY2004 a total of \$11,585,710 to the state's general fund in addition to the \$1,791,269 transferred during FY2003.

SOUTH CAROLINA STATE ACCIDENT FUND

STATEMENT OF NET ASSETS

JUNE 30, 2003

ASSETS

Current Assets:

Cash and cash equivalents	\$ 14,831,902
Premiums receivable	59,417,129
Claims recoveries and reimbursement receivables	757,440
Recoverable under reinsurance annuity contract	120,364
Accrued interest receivable	209,719
Prepaid expenses	277,646
Total current assets	<u>75,614,200</u>

Noncurrent Assets:

Capital assets, net of accumulated depreciation	2,494,603
Prepaid expenses	7,526
Recoverable under reinsurance annuity contract	165,148
Investment in reinsurance annuity contract, net of accumulated amortization of \$339,111	943,183
Total noncurrent assets	<u>3,610,460</u>
Total assets	<u><u>\$ 79,224,660</u></u>

LIABILITIES AND NET ASSETS

Current Liabilities:

Accounts payable	1,170,174
Accrued compensated absences and related benefits	255,405
Accrued payroll and related liabilities	308,912
Accrued refundable premiums	2,614,469
Deferred premium revenue	62,139,371
Unpaid claims liability and claims adjustment expenses payable within one year - net	39,248,500
Total current liabilities	<u>105,736,831</u>

Noncurrent Liabilities:

Accrued compensated absences and related benefits	82,292
Unpaid claims liability and claims adjustment expenses payable beyond one year - net	37,599,500
Total noncurrent liabilities	<u>37,681,792</u>

Total liabilities	143,418,623
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Net assets

Invested in capital assets	2,494,603
Unrestricted deficit	<u>(66,688,566)</u>
Total net assets	<u>(64,193,963)</u>
Total liabilities and net assets	<u><u>\$ 79,224,660</u></u>

See accompanying Notes to Financial Statements.

SOUTH CAROLINA STATE ACCIDENT FUND

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2003**

OPERATING REVENUES

Premiums	\$ 55,599,482
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OPERATING EXPENSES

Claims	50,281,181
Second Injury Fund assessment	10,459,344
Administrative:	
Personal services and employee benefits	3,893,385
Contractual services	851,459
Rent and insurance	342,497
Supplies and materials	110,602
Depreciation	1,681,058
Amortization expense - reinsurance annuity contract premium	75,358
Reinsurance premiums	2,868,181
Other expenses	142,428
Actuarial fee	21,000
Total administrative expenses	9,985,968
Total operating expenses	70,726,493

OPERATING INCOME (LOSS)	(15,127,011)
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NONOPERATING REVENUES (EXPENSES)

Interest/investment income	1,120,644
Other revenues	2,081

INCOME (LOSS) BEFORE TRANSFERS	(14,004,286)
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TRANSFER TO GENERAL FUND OF THE STATE	(1,791,269)
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CHANGE IN NET ASSETS	(15,795,555)
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NET ASSETS (DEFICIT), AT BEGINNING OF YEAR	(48,398,408)
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NET ASSETS (DEFICIT), AT END OF YEAR	\$ (64,193,963)
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See accompanying Notes to Financial Statements.

SOUTH CAROLINA STATE ACCIDENT FUND

**STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2003**

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received for premiums from state agencies	\$ 41,350,711
Cash received for premiums from other entities	13,311,338
Cash received for reimbursements of claims expense from state agencies	10,948,079
Cash received for reimbursements of claims expense from other entities	1,597,513
Payments for claims	(55,716,597)
Payments for salaries and related benefits	(3,869,763)
Payment of second injury fund assessment to other state agency	(10,459,344)
Payments for other administrative expenses to other state agencies	(117,506)
Payments for other administrative expenses to other entities	(3,621,261)
Net cash used by operating activities	<u>(6,576,830)</u>

CASH FLOWS FROM NON-CAPITAL AND RELATED FINANCING ACTIVITIES:

Other receipts	2,081
Transfer to General Fund of the State	(1,791,269)
Repay cash overdraft	(1,218,441)
Net cash provided by non-capital and related financing activities:	<u>(3,007,629)</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Acquisition of capital assets	<u>(17,049)</u>
Net cash used by capital and related financing activities	<u>(17,049)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest/investment income received	<u>1,179,914</u>
Net cash provided by investing activities	<u>1,179,914</u>

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (8,421,594)

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 23,253,496

CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 14,831,902

SOUTH CAROLINA STATE ACCIDENT FUND

STATEMENT OF CASH FLOWS (CONTINUED)
YEAR ENDED JUNE 30, 2003

**Reconciliation of net operating revenues (expenses)
to net cash provided (used) by operating activities:**

Operating income (loss)	\$ (15,127,011)
Adjustments to reconcile operating income (loss) to net cash used by operating activities:	
Depreciation and amortization	1,756,416
Changes in assets and liabilities:	
(Increase) decrease in premiums receivable	(14,293,749)
(Increase) decrease in claims recoveries and reimbursement receivables	(153,016)
(Increase) decrease in prepaid expenses	(34,261)
(Increase) decrease in recoverable under reinsurance annuity contract	(53,973)
Increase (decrease) in accounts payable	631,661
Increase (decrease) in accrued compensated absences and related benefits	13,342
Increase (decrease) in accrued payroll and related liabilities	10,280
Increase (decrease) in accrued refundable premiums	(4,263,556)
Increase (decrease) in deferred premium revenue	16,410,037
Increase (decrease) in estimate of unpaid claims liability	8,527,000
Total adjustments	<u>8,550,181</u>
Net cash (used) by operating activities	<u>\$ (6,576,830)</u>

Noncash capital and related financing activities:

The Fund disposed of equipment with a cost of \$41,696 and accumulated depreciation of \$41,696 during the year.

See accompanying Notes to Financial Statements.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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

Reporting Entity

The South Carolina State Accident Fund, a primary entity, is part of the primary government of the State of South Carolina and is included in the Comprehensive Annual Financial Report of the State of South Carolina. The Fund was established by Section 42-7-10 of the Code of Laws of South Carolina, as amended, to provide worker's compensation insurance coverage to State entities. Although the State of South Carolina is the Fund's predominant participant, counties, municipalities, and other political subdivisions of the State may elect to participate. The State assumes the full risk for the covered claims. The Fund is responsible for investigating, adjusting and paying worker's compensation claims as awarded by the Worker's Compensation Commission for job related accidental injury, disease, or death to employees of participants.

The Fund is administered by a director, appointed by the Governor, with the advice and consent of the Senate, for a term of six years. The accompanying financial statements present the financial position, results of operations, and cash flows solely of the Fund and do not include any other departments, institutions, component units, etc. of the State of South Carolina.

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.

A 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 government or entity that holds one or more of the following powers:

- (1) Determines its budget without another government's having the Fund to approve and modify that budget.
- (2) Levies taxes or set rates or charges without approval by another government.
- (3) Issues bonded debt without approval by another government.

The organization is fiscally independent if it holds all three of those powers. Based on the criteria, the Fund has determined it is not a component of another entity and it has no component units.

The budget, personnel, procurement, and other laws of the State and the policies and procedures for State agencies are applicable to the activities of the Fund.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

Fund Accounting

The South Carolina state government uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

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

The South Carolina State Accident Fund is an internal service fund of the proprietary fund types of the State of South Carolina. Such funds account for the financing of goods and services.

Basis of Accounting

The accounting policies of the Fund conform to generally accepted accounting principles (GAAP) applicable to proprietary activities as prescribed by the Governmental Accounting Standards Board (GASB), the recognized standard-setting body for GAAP for all state governmental entities. Proprietary fund entities use the accrual basis of accounting. If measurable, revenues are recognized when earned and expenses when incurred. In accordance with GASB Statement 20, the Fund has elected to apply all applicable GASB pronouncements as well as all applicable FASB pronouncements issued on or before November 30, 1989 not in conflict with GASB standards.

Cash and Cash Equivalents

The amount shown in the financial statements as "cash and cash equivalents" represents cash on deposit with the State's Treasurer, cash in banks, and cash invested in various instruments by the State Treasurer as part of the State's internal cash management pool and short-term investments not held by the State Treasurer's Office and having a maturity at purchase of three months or less.

Because the internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, certain corporate bonds.

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. Investments held by the pool are carried at fair value. Interest earned on the agency's special deposit account is posted to the agency's account at the end of each month and is retained by the agency. The Fund records and reports its deposits in the general deposit account at cost. The Fund reports its deposits in the special deposit accounts at fair value. Interest earnings are allocated based on the percentage of the Fund's accumulated daily income receivable to the total interest receivable of the pool. Reported investment 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 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 cash management pool, see the deposits disclosures in Note 3.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

Capital Assets

Capital assets are recorded at cost at the date of acquisition. The Fund follows capitalization guidelines established by the State of South Carolina. All land is capitalized, regardless of cost. The Fund capitalizes movable personal property with a unit value in excess of \$5,000 and a useful life in excess of two years and intangible assets including software costing in excess of \$100,000. Routine repairs and maintenance are charged to operating expenses in the year in which the expense was incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 3 to 10 years.

Unpaid Claims Liability

The Fund establishes unpaid claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. The amount accrued includes estimated specific incremental claims adjustment expenses but not administrative expenses. Estimated amounts of salvage and subrogation and reinsurance recoverable, if any, on both settled and unsettled claims have been deducted from the liability for unpaid claims to the extent reasonably estimable. In addition, to the extent reasonably estimable, the liability for unpaid claims has been adjusted for amounts to be recovered or reimbursed from participants who retain the risk of loss for specific periods. This includes amounts recoverable from the State of South Carolina for state agency claims prior to July 1, 1986. See Note 7 for further explanation. Claims liabilities for DOT claims prior to January 1, 1994, are not included in the State Accident Fund's claims liability. See below and Note 4 for further information. Because actual claims costs depend on such complex factors as inflation, changes in doctrine of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed annually as of fiscal year end using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. While management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided.

The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in current earnings. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

Prior to July 1, 1998 the Fund acted as a claims service with respect to claims incurred by the Department of Transportation prior to January 1, 1994 and the Department of Public Safety prior to August 1, 1993. For the year ended June 30, 1999 the General Assembly required the State Accident Fund to purchase an annuity for the purpose of funding the future obligation for workers compensation claims filed prior to restructuring by Department of Highways and Public Transportation employees. After June 30, 1998 workers compensation claims from these agencies are be paid from funds received from the annuity purchased. Risk of loss on these claims became the responsibility of the State Accident Fund.

Reinsurance

The fund has obtained reinsurance coverage to reduce its exposure to losses on insured events. Losses in excess of \$500,000 from an insured event are covered up to limits based on the type of injury as set by the workmen's compensation statutes of the South Carolina Code of Laws, with the Fund retaining the risk for the first \$500,000 of loss. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Fund as direct

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

insurer of the risks reinsured. The Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by reinsurers. The new coverage period runs from November 15, 2002 to November 14, 2003, the reinsurance coverage also reduces its exposure to losses on insured events related to State owned aircrafts in excess of \$1,000,000 per occurrence up to the limit of \$9,000,000.

Recognition of Premium Revenue, Receivables and Deferred Revenue

Premiums are recognized as revenue on a pro rata basis over the policy term. Policies are billed and issued on both the fiscal year and calendar year basis. Premiums are based on an actuarial method and are currently adjusted so that over a reasonable period of time expected revenues, including investment income, and anticipated expenses will be approximately equal. In addition premium revenue includes accrued premium adjustments for additional premiums owed by policyholders as determined based on actual payrolls for the policy period which are in excess of estimated premiums billed which were based on estimated payroll costs. Revenue is reduced for refunds payable. Estimated premiums receivables and refund payables are recorded as of year-end for future anticipated premium adjustments for the policy years which end within the fund's fiscal year. A receivable is recorded at the time the annual estimated premium is billed even though some/all of the amount may not be currently due. Deferred revenue is recognized to the extent that the premiums billed and not yet received are for future periods. In addition, deferred revenue is recognized for unearned premiums received.

Budget Policy

The Fund is granted an annual appropriation for operating purposes by the General Assembly (to be funded by workers' compensation premiums and interest earned thereon). The appropriation as enacted becomes the legal operating budget for the Fund. The General Assembly enacts the budget through passage of specific line-item appropriations by program within budgetary unit, within budgetary fund category, State General Fund or other budgeted funds. Budgetary control is maintained at the line-item level of the entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist.

Transfers of funds may be approved by the State Budget and Control Board under its Fund or by the agency as set forth in the 2003 Appropriations Act proviso 72.14 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

Agencies may charge vendor, interagency, and interfund payments for fiscal year 2003 to 2004 appropriations in July. Any unexpended appropriations as of June 30 automatically lapse on July 31 unless authorization is received from the General Assembly to carry over the funds to the ensuing fiscal year. State law does not precisely define the budgetary basis of accounting. For each fiscal year, the level of legal control for each agency is reported in a publication by the State Comptroller General. The current Appropriations Act states that the General Assembly intends to appropriate all monies to operate State government for the current fiscal year. The State's annual budget is prepared primarily on the modified accrual basis of accounting with several exceptions, principally the cash basis for payroll expenses and certain non-State appropriations revenue.

The Fund's budget includes administrative expenses and specifically excludes claims expense and the Second Injury Fund assessment. Amounts to be expended for capital assets are also budgeted. Expenses prepared on the accrual basis do not vary significantly from the budgetary basis. In accordance generally accepted accounting principles applicable to business type activities, a comparison of actual revenues and expenses to the budgeted amounts has not been presented.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

Statement of Cash Flows

For purposes of cash flows, the Fund considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The State's internal cash management pool is included in this definition of cash equivalents.

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the Fund'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 and compensatory holiday and overtime leave earned for which the employees are entitled to paid time off or payment at termination. The Fund calculates the compensated absences liability based on recorded balances of unused leave for which the employer expects to compensate employees through paid time off or cash payments at termination. That liability is determined by using fiscal year-end current salary costs and the cost of the salary-related benefit payments. The net change in the liability is recorded in the current year in the applicable personal services and employee benefits expense category.

Operating and Nonoperating Revenues and Expenses

The Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with a proprietary fund's principal ongoing operations. The Fund's primary operating revenues are from premium revenues. Operating expenses include the cost of sales or services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Net Assets

Net assets are categorized as follows:

Invested in capital assets: This represents the Fund's total investment in capital assets, net of outstanding debt obligations, if any, related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Unrestricted net assets: Unrestricted net assets (deficit) represent the remainder of the Fund's liabilities in excess of assets excluding those net assets reported in other categories.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Such estimates include the unpaid claims liability.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

Investment in Reinsurance Annuity Contract

As more fully explained in Note 4 under the 1993 Restructuring Act, the Department of Transportation and the Department of Public Safety were created and were charged with responsibilities of the former Department of Highways and Public Transportation effective July 1, 1993. Proviso 44.4 of the 1998-1999 Appropriation Act passed by the General Assembly required the State Accident Fund to purchase an annuity for the purpose of funding the future obligation for workers' compensation claims filed prior to restructuring by the Department of Highways and Public Transportation employees using funds from the Workers' Compensation Trust Fund. This annuity is being amortized over the life of the contract in proportion to annuity proceeds received.

NOTE 2 RISK MANAGEMENT:

Insurance Coverage

The Fund, an administrative agency, is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks. 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 prior years except for the increase in the base before reinsurance is received as discussed in Note 1. The cost of settled claims and claim losses have not exceeded this coverage in any of the past three years. The Fund pays insurance premiums to itself and certain other State agencies 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 accordance 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 type of claims:

1. Claims of State employees for unemployment compensation benefits. This type of claim is handled through the South Carolina Employment Security Commission;
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries. This type of claim is handled by the State Accident Fund;
3. Claims of covered public employees for health and dental insurance benefits. This type of claim is handled by the Office of Insurance Services; and
4. Claims of covered public employees for long-term disability and group-life insurance benefits. This type of claim is handled through the 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.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

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

1. Theft of, damage to, or destruction of assets – building contents;
2. General tort claims; and
3. Data processing equipment.

The IRF is a self-insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of property insurance. Also, the IRF purchases reinsurance for catastrophic property insurance. Reinsurance permits partial recovery of losses from reinsurers, but the IRF remains primarily liable. The IRF's rates are determined actuarially.

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

The Fund obtains coverage of up to \$25,000 per occurrence through a commercial insurer for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation. The Fund has not transferred the portion of the risk of loss related to insurance policy deductibles for its property contents, general torts, and fidelity bond coverage's to a State or commercial insurer. There were no expenses incurred for the year ended June 30, 2003 for actual claim payments related to such retained risk of loss.

The Fund has not reported an estimated claims loss expense and the related liability at June 30, 2003, based on the requirements of GASB Statements No. 10 and No. 30, which state 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, 2003, and the amount of loss is reasonably estimable.

In management's opinion, claims losses in excess of insurance coverage, if any, are unlikely and, if incurred, would be insignificant to the Fund's financial position. Furthermore, there is no evidence of asset impairment or other information to indicate that a loss should be recorded. Therefore, no loss accrual has been recorded.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE 3 DEPOSITS AND INVESTMENTS:

Cash and cash equivalents consist of deposits under the control of the State Treasurer, who by law, has sole Fund for investing State funds and deposits under the control of the State Accident Fund. However, as authorized by the State Treasurer's office, certain funds used to pay claims are deposited with financial institutions.

The following schedule reconciles deposits within the footnotes to the statement of net asset amounts:

<u>Statement of Net Assets</u>		<u>Footnotes</u>	
Cash and cash equivalents	\$ 14,831,902	Deposits Held by State Treasurer	\$ 14,782,026
		Other Deposits	49,876
	<u>\$ 14,831,902</u>		<u>\$ 14,831,902</u>

Deposits

State law requires full collateralization of all State Treasurer's bank balances. The State Treasurer must correct any deficiencies in collateral within seven days. With respect to investments in the State's cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agents in the State's name. Information pertaining to the carrying amounts, market values, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

Investments

Legally authorized investments include obligations of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, certain corporate bonds, and commercial paper.

All of the Fund's investments are stated at fair value except those meeting certain specific requirements. Purchases and sales are accounted for on the trade date. Unrealized gains and losses on investments have been recorded. Realized gains and losses on securities transactions are recorded on the accrual basis. Earnings are recorded on the accrual basis.

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

1. Insured or registered, or for which the securities are held by the government or its agent in the government's name.
2. Uninsured and unregistered, with securities held by the counter-party's trust department or agent in the government's name.
3. Uninsured and unregistered, with securities held by the counter-party, or by its trust department or agent but not in the government's name.

During the year, the Fund had repurchase agreements as investments. All investments were in the first category of credit risk.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

NOTE 4 INVESTMENT IN REINSURANCE ANNUITY CONTRACT:

Under the 1993 Restructuring Act, the Department of Transportation and the Department of Public Safety were created and were charged with responsibilities of the former Department of Highways and Public Transportation effective July 1, 1993. Proviso 44.4 of the 1998-1999 Appropriation Act passed by the General Assembly required the State Accident Fund to purchase an annuity for the purpose of funding the future obligation for workers' compensation claims filed prior to restructuring by the Department of Highways and Public Transportation employees using funds from the Workers' Compensation Trust Fund.

While the State believes the annuity will provide funding adequate to cover this liability, the Fund has ultimate responsibility to pay these claims should the annuity funding be inadequate. On March 11, 1999 the State Accident Fund purchased a type one annuity that will pay a fixed amount quarterly for a period of forty years. The annuity was effective as of January 1, 1999. The Fund received its first quarterly annuity payment on April 5, 1999. For the year ended June 30, 2003, the Fund paid \$174,337 of Department of Transportation claims covered by this annuity. They received reimbursement of \$120,364 under this contract for the year ended June 30, 2003. The amount of \$285,512, shown on the statement of net assets as recoverable under reinsurance annuity contract, represents amounts due under the annuity that will be collected in the future for cumulative claims payments in excess of cumulative annuity receipts. The estimated future claims is \$796,000 which is not included in the unpaid claims liability and claims adjustment expenses payable on the statement of net assets. Under the terms of the annuity the Fund will receive 160 quarterly payments. For the first forty payments the Fund will receive \$30,091 per quarter, the next forty payments will be for \$15,022, the next forty payments will be for \$3,726, and the last forty will be for \$2,364. Total amount to be received under the annuity will be \$2,048,120. The total price of the annuity was \$1,282,294 and was paid in a single premium. The amount of the annuity to purchase was determined actuarially.

The liability for these claims is not reported by either the State Accident Fund or the Department of Transportation because the State of South Carolina feels that the proceeds from the annuity contract will provide adequate funding to pay these claims and the risk of loss is remote. The annuity is being amortized over the life of the annuity in proportion to annuity proceeds received. The amount of amortization charged for the year ended June 30, 2003 was \$75,358 and is included as amortization expense in the statement of revenues, expenses, and changes in net assets.

NOTE 5 PREMIUMS RECEIVABLE:

Premiums receivable consist of amounts receivable from the following:

County and Municipal Governments and Agencies	\$ 4,633,345
State Agencies	54,783,784
	<u>\$59,417,129</u>

Included in premium receivable and premium revenue is \$721,575 receivable from state agencies and \$197 from county and municipal governments and agencies for estimated additional premium adjustments not processed as of June 30, 2003. The majority of premiums receivable represent billings for future periods which have not been earned as of fiscal year-end.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE 6 CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2003 is summarized as follows:

	Beginning Balance July 1, 2002	Increases	Decreases	Ending Balance June 30, 2003
Equipment and furniture	\$ 876,629	\$ 17,049	\$ (41,696)	\$ 851,982
Software	8,152,000			8,152,000
Total capital assets at historical cost	<u>9,028,629</u>	<u>17,049</u>	<u>(41,696)</u>	<u>9,003,982</u>
Less accumulated depreciation for:				
Equipment and furniture	(562,823)	(158,899)	41,696	(680,026)
Software	(4,307,194)	(1,522,159)		(5,829,353)
Total accumulated depreciation	<u>(4,870,017)</u>	<u>(1,681,058)</u>	<u>41,696</u>	<u>(6,509,379)</u>
Capital assets, net of accumulated depreciation	<u>\$ 4,158,612</u>	<u>\$ (1,664,009)</u>	<u>\$ -</u>	<u>\$ 2,494,603</u>

NOTE 7 ACCRUED REFUNDABLE PREMIUMS:

Policyholders are billed annually for estimated premiums based on the policyholder's estimated payroll. After the policy period ends, policyholders submit the details of the actual salaries paid and the Fund adjusts the premium based on the actual payroll and a rating modifier based on claims experience. The amounts the Fund owed policyholders for estimated premiums in excess of actual adjusted premiums at June 30, 2003 was \$203,413 for those county and municipal policyholders. An additional \$2,411,056 was due to State agencies.

Included in refunds payable is \$13,130 estimated due to county and municipal governments and agencies and \$2,331,741 estimated due to State agencies for estimated premium adjustments not processed as of June 30, 2003.

NOTE 8 UNPAID CLAIMS LIABILITY AND CLAIMS ADJUSTMENT EXPENSES:

The amount accrued for unpaid claims liability and claims adjustment expenses is an actuarially determined amount, based on the Fund's historical claims expenses adjusted for current factors, for the estimated ultimate cost of settling claims for events which occurred on or before year-end but were unpaid at the end of the year. To the extent claims were incurred on behalf of state agencies prior to July 1, 1986, reimbursement will be due from the State of South Carolina when the claims are paid. Estimated amounts recoverable from subrogation have been deducted from the claims liability.

The estimated reimbursement due from the State for claims prior to July 1, 1986 is as follows:

Due within one year	\$ 172,500
Due after one year	517,500
Total	<u>\$ 690,000</u>

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

The amounts accrued for unpaid claims liability and claims adjustment expenses, net of amounts recoverable from the State, for the past two years are as follows:

	2003	2002
Unpaid claims liability and claim adjustment expenses at beginning of year	\$ 68,321,000	\$ 56,318,634
Current year claims and changes in estimates	58,808,181	60,404,903
Claims payments	(50,281,181)	(48,402,537)
Total unpaid claims liability and claim adjustment expenses at the end of year	<u>\$ 76,848,000</u>	<u>\$ 68,321,000</u>
This claims liability is further categorized as follows:		
State Agencies	\$ 58,406,000	
Counties and Municipalities	18,442,000	
Total	<u>\$ 76,848,000</u>	

NOTE 9 SECOND INJURY FUND ASSESSMENT:

The Fund is required to pay an annual assessment to the Second Injury Fund of the State of South Carolina. The assessment is usually billed in the first quarter of the fiscal year and is based on a specified percentage of total claims paid by the Second Injury Fund during the previous calendar year. The Second Injury Fund handles claims for workers who have permanent physical impairments and incur subsequent disability from injury by accidents arising out of and in the course of employment. The assessment for fiscal year 2003 was \$10,459,344. The Fund receives reimbursements of claims expense from the Second Injury Fund. The total amount received during fiscal year 2003 was approximately \$10,878,000 which is reported as a reduction of claims expense.

NOTE 10 PENSION PLAN:

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

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division, 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.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

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

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

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6.0 percent of all compensation. Effective July 1, 2002 the employer contribution rate became 10.70 percent which included a 3.15 percent surcharge to fund retiree health and dental insurance coverage. The Fund's actual contributions to the SCRS for the most recent fiscal years ended June 30, 2003, 2002 and 2001 were approximately \$228,000, \$234,000 and \$235,000, respectively, and equaled the required contributions of 7.55% (excluding the surcharge) for each year. Also, the Fund paid employer group life insurance contributions of approximately \$4,500 for the current fiscal year at the rate of .15% of compensation.

The amounts paid by the Fund for pension, group-life, and post-retirement benefits are included as personal services expenses.

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

The Systems do not make separate measurements of assets and pension liabilities obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Fund's liability under the pension plans is limited to the contribution requirements for the applicable year from amounts appropriated therefore in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Fund recognizes no contingent liability for unfunded costs associated with participation in plans. At retirement, employees participating in the SCRS may receive additional service credit (at a rate of 20 days equal to one month of service) for up to 90 days for accumulated unused sick leave.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE 11 POSTEMPLOYMENT AND OTHER EMPLOYEE BENEFITS:

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the Fund are eligible to receive these benefits. The State provides postemployment 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 these State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

These benefits are provided through annual appropriations by the General Assembly to the Fund for its active employees and to the State Budget and Control Board for all participating State retirees except the portions funded through the pension surcharge and provided from other applicable fund sources of the Fund for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Approximately 24,000 State retirees met these eligibility requirements as of June 30, 2002.

The Fund recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of approximately \$276,000 for the year ended June 30, 2003. As discussed in Note 10, the Fund paid approximately \$95,000 applicable to the 3.15 percent surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Office of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to Fund retirees is not available. By State law, the Fund has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements. In addition, the South Carolina General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from the System's earnings; however, a portion of the required amount is appropriated from the South Carolina General Fund annually.

NOTE 12 DEFERRED COMPENSATION PLANS:

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Fund have elected to participate. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401 (k), and 403 (b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employees.

The State has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

NOTE 13 OPERATING LEASES:

The Fund leases its office space and computer from an external party. The lease for the rental of office space expires June 30, 2007. The lease contains a renewal option for up to five years at the same terms and conditions, except that the rental rate shall be negotiated. During fiscal year 2003, the Fund leased computers for 2 years period with a renewed option for an additional two years with the lessor to provide new equipment. It also leases office equipment and vehicles under short-term and/or cancelable operating leases. 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. Minimum future rental obligations under the noncancelable lease with a remaining term in excess of one year are as follows:

Fiscal Year Ending June 30,	Amount
2004	\$ 339,712
2005	317,210
2006	281,042
2007	281,042
Totals	<u>\$ 1,219,006</u>

Operating lease expenses for the fiscal year ended June 30, 2003, was approximately \$281,000 for office space and approximately \$26,000 for office equipment. Approximately \$23,000 for vehicle rental was paid to the South Carolina State Budget and Control Board.

NOTE 14 LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2003 was as follows:

	June 30, 2002	Additions	Reductions	June 30, 2003	Due w ithin One year
Accrued compensated absences and related benefits	\$ 324,355	\$ 268,747	\$ (255,405)	\$ 337,697	\$ 255,405

NOTE 15 TRANSACTIONS WITH STATE ENTITIES:

The Fund has significant transactions with the State of South Carolina and various State agencies. Services received at no cost from State Agencies include maintenance of certain accounting records and payroll and disbursement processing from the Comptroller General's office; check preparation, banking, and investment functions from the State Treasurer; legal services from the Attorney General's office; and record storage for the Department of Archives and History.

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

The Fund had financial transactions with various State Agencies during the year ended June 30, 2003. Significant payments were made to divisions of the State Budget and Control Board for pension and insurance plan contributions, vehicle rental, insurance coverage, office supplies, printing, telephone, interagency mail, and data processing services. Payments were also made for unemployment coverage for employees to the Employment Security Commission. The amount of expenses applicable to these transactions are not readily determinable.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

The Fund provided no services free of charge to other State Agencies during the year ended June 30, 2003.

Total revenues from other State agencies based on the agency classification chart prepared by the South Carolina Comptroller General's Office is as follows:

General Government	\$ 1,236,361
Administration of Justice	10,477,363
Education	5,585,425
Higher Education	8,093,002
Health and Environment	9,540,605
Housing Authority	33,351
Resource and Economic Development	1,167,639
Social Services	1,402,512
Transportation	5,192,882
Unemployment Compensation	115,287
Other Business Types	<u>16,832</u>
	<u>\$42,861,259</u>

The Fund recorded \$68,025 in the fiscal year as reimbursements of claims expense from the State of South Carolina for claims prior to 1986. \$21,862 was billed subsequent to June 30, 2003 for the last quarter billing report of fiscal year 2003 and is included in the claims recoveries and reimbursement receivables account on the balance sheet.

The Fund recorded \$46,042 in the fiscal year as reimbursements of claims expense from the South Carolina Adjutant General's Office. \$22,792 of this amount is included in the claims recoveries and reimbursement receivables account on the balance sheet.

The Fund was required to remit \$1,791,269 to the General Fund of the State pursuant to Proviso 72.97 of the 2003 Appropriations Act.

NOTE 16 NET LOSS/NET ASSETS DEFICIT:

The statement of revenues, expenses, and changes in net assets shows a net loss of approximately \$15,800,000 for the year ended June 30, 2003. The Fund has a deficit retained earnings deficit of approximately \$64,194,000. The loss for the year was due primarily to an increase in liability for future losses based on the recommendation of the Fund's actuary and an increase in administrative expenses. In addition, investment earnings decreased. The deficit includes lost interest earnings through 1995.

Prior to 1990, all investment income earnings of the Fund were credited to the General Fund of the State. For fiscal years 1991 and 1992, the Fund received one-third and two-thirds of the investment income. Section 42-7-75 of the South Carolina Code of Laws require the State Treasurer to deposit in the Fund's trust account monthly sufficient funds to pay expenses and claims required by law to be paid with the amount limited to the amount of investment income which the Fund would have earned since its inception if all investment earnings had been credited to the Fund. Estimates prepared by management in 1995 estimated that limit to be approximately \$12,300,000 assuming an interest rate of 4% to approximately \$20,600,000 using an interest rate of 6%.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003

To reduce the deficit, the Fund purchased excess of loss reinsurance for accidents that occur on and after July 1, 2000. Claim costs in excess of \$350,000 were reinsured with the amount increasing to \$500,000 as of November 15, 2002. Effective January 1, 2003, the overall premium rate was increased by 24.7%. The Fund implemented a medical management cost containment program in 2001 that is expected to reduce claim costs significantly. Increases in medical costs have stabilized for those agencies utilizing this program.

Management is hopeful that these actions along with a rate modification in January 2004 will result in positive movement toward elimination of the Fund financial deficit.

NOTE 17 CONCENTRATIONS OF CREDIT RISK AND OTHER CONCENTRATIONS:

The Fund has reinsurance contracts with providers which share or limit the Fund's exposure to losses. However, should the reinsurance providers be unable to meet their obligations settlement of these amounts will ultimately be the responsibility of the South Carolina State Accident Fund. The Fund provides services to South Carolina governmental entities. The limited make-up of the membership group, as well as the limited geographic region in which the Fund operates, increases the Fund's exposure to business concentrations.

NOTE 18 SUBSEQUENT EVENTS

The Fund will be required to remit approximately \$11,586,000 to the General Fund of the State during the year ended June 30, 2004 pursuant to Proviso 73.2 of the 2004 Appropriations Act.