

**SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND**

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2008

**WITH
REPORT OF INDEPENDENT AUDITORS**

State of South Carolina



Office of the State Auditor

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October 3, 2008

The Honorable Mark Sanford, Governor
and
Members of the South Carolina State Budget and Control Board
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Budget and Control Board Office – Insurance Reserve Fund for the fiscal year ended June 30, 2008, was issued by DeLoach & Williamson, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard H. Gilbert Jr.", written in a cursive style.

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/trb

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CONTENTS

Report of Independent Auditors	1
Management's Discussion and Analysis	3
Basic Financial Statements	
Statement of Net Assets	8
Statement of Revenue, Expenses, and Changes in Net Assets	9
Statement of Cash Flows	11
Notes to Financial Statements.....	13
Independent Auditors' Report on Internal Control	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	44

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REPORT OF INDEPENDENT AUDITORS

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
Office of the State Auditor
Columbia, South Carolina

We have audited the accompanying basic financial statements of the governmental activities of the South Carolina State Budget and Control Board, Insurance Reserve Fund (the "Fund") as of and for the year ended June 30, 2008, 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, Insurance Reserve Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in *Note 1*, the accompanying financial statements of the South Carolina State Budget and Control Board, Insurance Reserve Fund 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 Insurance Reserve Fund of the South Carolina State Budget and Control Board. They do not purport to, and do not, present fairly the financial position of the State of South Carolina as of June 30, 2008 and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the South Carolina State Budget and Control Board, Insurance Reserve Fund, as of June 30, 2008, and the results of operations and cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 25, 2008, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's discussion and analysis is not a part of the basic financial statements, but is supplementary information required by the *Governmental Accounting Standards Board (GASB)*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Releach & Williamson, L.L.P.

September 25, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the South Carolina State Budget and Control Board, Insurance Reserve Fund (IRF) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of IRF's financial performance during the fiscal year ended June 30, 2008. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

The financial statement presentation required by current governmental accounting standards provides a comprehensive perspective of IRF's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

Financial Highlights:

- The assets of IRF exceeded its liabilities at June 30, 2008 by \$171,424,143;
- IRF's net assets increased by \$7,058,343 or 4.3 percent;
- IRF experienced an operating income of \$2,348,421.

Overview of Financial Statements:

IRF is engaged only in Business-Type Activities (BTA) that are financed in part by premiums charged to governmental entities for insurance policies. Accordingly, its activities are reported using the three financial statements required for proprietary funds: Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; and Statement of Cash Flows.

The Statement of Net Assets presents the financial position of IRF at the end of the fiscal year and requires classification of assets and liabilities into current and non-current categories. The difference between total assets and total liabilities is reflected in the net assets section, which displays net assets in three broad categories: invested capital assets, restricted and unrestricted. Net assets are one indicator of the current financial condition of IRF, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year.

The Statement of Revenues, Expenses, and Changes in Net Assets categorizes revenues as operating and non operating revenues and expenses as operating and non-operating expenses.

The Statement of Cash Flows will aid readers in identifying the sources and uses of cash by the categories of operating, non-capital financing, and investment activities.

Financial Analysis of IRF

This schedule is a condensed version of IRF's assets, liabilities, and net assets and is prepared from the Statement of Net Assets.

Net Assets As of June 30, 2008 (In millions)

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Assets		
Current assets	\$ 68.6	\$ 102.8
Noncurrent assets:	379.0	321.6
Total assets	<u>447.6</u>	<u>424.4</u>
Liabilities		
Current liabilities	276.0	259.9
Noncurrent liabilities	0.2	0.1
Total liabilities	<u>276.2</u>	<u>260.0</u>
Net assets		
Investment in capital assets	0.2	0.2
Restricted for loans	20.0	20.0
Unrestricted	151.2	144.2
Total net assets	<u>\$ 171.4</u>	<u>\$ 164.4</u>

Net assets may serve over time as a useful indicator on an entity's financial position. Assets exceeded liabilities by \$164,365,760 at the close of the fiscal year ended June 30, 2007 and assets exceeded liabilities by \$171,424,143 at the close of fiscal year ended June 30, 2008.

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

**Operating Results for the Fiscal Year Ended
June 30, 2008
(In millions)**

	<u>2008</u>	<u>2007</u>
Operating		
Operating revenue:		
Insurance premiums	\$ 109.8	\$ 98.6
Total operating revenue	<u>109.8</u>	<u>98.6</u>
Operating expenses:		
Reinsurance premiums	33.8	33.9
Premiums	0.3	0.2
Claims	45.7	20.4
Administrative	27.7	24.7
Total operating expenses	<u>107.5</u>	<u>79.2</u>
Net operating income (loss)	<u>2.3</u>	<u>19.4</u>
Non operating revenue:		
State appropriations	-	50.8
Income from deposits and investments	24.1	16.7
Notes receivable interest	0.6	0.5
Special items:		
Return of premium	(20.0)	-
Change in net assets	<u>7.0</u>	<u>87.4</u>
Net assets, beginning of the year	164.4	77.0
Net assets, end of the year	<u><u>\$ 171.4</u></u>	<u><u>\$ 164.4</u></u>

In Fiscal Year 02-03, IRF incurred a number of collapse claims involving Fire Resistive Treated Wood. These claims will exceed \$20 million.

In fiscal year 2004-2005, liability experience in the areas of Tort Liability and Medical Professional Liability declined somewhat which suggested that the unfortunate loss experience in fiscal year 2003 – 2004 was an anomaly.

In fiscal year 2005-2006, IRF experienced favorable claims development from several large liability losses, received some subrogation recoveries from the fire resistive treated wood losses, and increased operating revenue as a result of previous rate increases.

In fiscal year 2006-2007, IRF received subrogation recoveries on fire resistive treated wood losses, and increased operating revenue as a result of previous rate increases and increased rate of return on investments, and was appropriated approximately \$51 million by the General Fund.

In fiscal year 2007-2008, IRF assets and net assets grew beyond target levels and IRF returned \$20 million of premiums to participants.

A condensed version of the Statement of Cash Flows is presented as follows:

Condensed Statement of Cash Flows
(In millions)

	Fiscal Year Ended June 30 ,2008	Fiscal Year Ended June 30, 2007
Cash flows from operating activities	17.1	12.1
Cash flows from noncapital financing activities	(20.0)	50.8
Cash flows from investing activities	(33.6)	(102.1)
Net (decrease) increase in cash	(36.5)	(39.2)
Cash and cash equivalents, beginning of year	65.2	104.4
Cash and cash equivalents, end of year	<u>\$ 28.7</u>	<u>\$ 65.2</u>

Overview of IRF

The Insurance Reserve Fund is a self-insurance mechanism operated by the State of South Carolina. In many respects, IRF functions in the same way as a private insurance company. IRF issues policies, collects premiums, pays losses, and purchases reinsurance against swings in experience or catastrophic losses. As an insurance operation, the IRF files a National Association of Insurance Commissioners Annual Statement each year. The IRF is also subject to periodic audits by the South Carolina Department of Insurance. The IRF differs from private companies in that it does not market or pay marketing costs. Also, the IRF does not pay taxes or participate in any Guaranty Fund or Pool. As a self-insurance mechanism, IRF is responsible for funding fortuitous losses experienced by the government of South Carolina and offers very broad and, in some cases, unique coverage.

Economic Factors:

By statute, IRF assets are invested by the State Treasurer in repurchase agreements, bonds (US Treasury, US Government Agency, Governmental guaranteed mortgage backed, and Corporate), and financial paper. During Fiscal Year 01-02, interest rates fell and the decline in interest rates was reflected in a decline in non-operating revenue. The September 11, 2001 terrorist attack generated major losses in the reinsurance industry and the losses triggered a major contraction in the reinsurance industry. Although IRF has been able to maintain adequate reinsurance, there has been a substantial increase in reinsurance premiums. Reinsurance rates declined slightly in fiscal year 04 – 05. However, following the hurricane in 2005, property reinsurance premiums have increased. In fiscal year 06-07, IRF increased its reinsurance program from \$300 million per occurrence to \$400 million per occurrence.

The IRF has been impacted by two provisos as a part of the fiscal year 2002-2003 Appropriations Act. The first Proviso 72.98 directed the Fund to waive renewal premiums for all lines of insurance for all State agencies in the fiscal year 2002-2003. Proviso 72.97 instructed IRF to transfer \$22,937,800 of the Fund's assets to the General Fund. These provisos reduced net assets of almost \$51,000,000. The results of these two provisos had a significant financial impact on the Fund during fiscal year 2002-2003, 2003-2004, 2004-2005 and 2005-2006.

The reduction in assets caused by Provisos 72.97 and 72.98 reduced the amount available to invest in fiscal year 2003-2004 and this reduced investment income. The effect continued fiscal year 2005-2006. In fiscal year 2006-2007, the General Fund of the State of South Carolina returned those funds by appropriating approximately \$51 million to the Insurance Reserve Fund.

The rate increases which were taken in previous years were fully earned by the end of fiscal year 2006-2007, generating increased premium income. Fire Resistive Treated Wood recoveries are now virtually complete with approximately \$3.5 million in recoveries in fiscal year 2006-2007. The return of \$51 million in fiscal year 2006-2007 increased IRF assets, IRF net assets, and investment income.

Rate levels from previous years, combined with the return of money from the General Fund and fire resistive treated wood recoveries allowed IRF to return \$20 million to participants in fiscal year 2007-2008.

Contact Information

Questions related to the Management Discussion & Analysis and the accompanying financial statements should be directed to Stephen Waterhouse, Chief Financial Officer, at (803) 737-3827.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF NET ASSETS

JUNE 30, 2008

Assets

Current assets:

Cash and cash equivalents	\$ 28,717,809
Premiums receivable	17,555,003
Reinsurance recovery receivable	290,607
Current portion of notes receivable	2,095,231
Accrued interest	4,309,536
Due from other funds	1,235,000
Prepaid insurance	14,347,831
Total current assets	<u>68,551,017</u>

Non-current assets:

Investments	369,853,267
Long-term notes receivable	9,043,780
Capital assets, net of accumulated depreciation	158,342
Total non-current assets	<u>379,055,389</u>
Total assets	<u>447,606,406</u>

Liabilities

Current liabilities:

Accounts payable	792,024
Accrued payroll	283,837
Claims payable	125,505,648
Deferred premium revenue	58,840,001
Claims incurred but not reported	90,396,627
Accrued compensated absences-current portion	168,455
Total current liabilities	<u>275,986,592</u>

Long term liabilities:

Contingencies (<i>Note 13</i>)	
Accrued compensated absences - long term	195,671
Total long-term liabilities	<u>195,671</u>

Total liabilities	<u>276,182,263</u>
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Net assets

Investment in capital assets	158,342
Restricted for:	
Savannah Valley Development Loans	20,000,000
Unrestricted	151,265,801
Total net assets	<u><u>\$ 171,424,143</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2008

Operating Revenues

Insurance premiums:	
Tort liability	\$ 42,021,328
Auto, school bus, and inland marine	26,024,060
Professional liability	13,353,130
Comprehensive and collision	4,082,754
Fire	12,630,377
Extended coverage	11,657,869
Total operating revenues	<hr/> 109,769,518 <hr/>

Operating Expenses

Reinsurance premiums	33,848,634
Premiums	291,472
Claims:	
Tort liability	21,524,035
Auto, school bus, and inland marine	5,081,809
Fire	4,183,385
Extended coverage	3,203,789
Hospitals and physicians	11,106,306
Other	638,670
Salaries and benefits	3,723,046
Professional services	22,448,482
Telephone and utilities	55,802
Supplies	309,780
Other services	916,234
Printing and publication	16,050
Postage and shipping	21,170
Depreciation	52,433
Total operating expenses	<hr/> 107,421,097 <hr/>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2008

(CONTINUED)

Operating income	<u>2,348,421</u>
Non-operating revenue (expense):	
Income from deposits and investments	24,081,871
Notes receivable interest	616,954
Other non-operating revenue	<u>11,137</u>
Total non-operating revenue (expense):	<u>24,709,962</u>
Special items:	
Return of premium (<i>Note 11</i>)	<u>(20,000,000)</u>
Change in net assets	7,058,383
Net assets, beginning of year	<u>164,365,760</u>
Net assets, end of year	<u><u>\$ 171,424,143</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2008

Cash Flows from Operating Activities

Insurance premiums from customers	\$ 108,073,144
Payments to employees	(3,523,806)
Payments to suppliers/claimants	(87,380,128)
Net cash flows provided by operating activities	<u>17,169,210</u>

Cash Flows from Capital and Related Financing Activities

Purchase of fixed assets	(27,003)
Net cash used by capital and related financing activities	<u>(27,003)</u>

Cash Flows from Non-Capital Financing Activities

Special refund to participants (<i>Note 11</i>)	(20,000,000)
Net cash used by non-capital financing activities	<u>(20,000,000)</u>

Cash Flows from Investing Activities

Principal payments received on notes receivable	1,356,361
Purchases of investments	(748,739,439)
Proceeds from sales and maturity of investments	687,596,462
Interest received-deposits and investments	27,286,359
Interest received-notes receivable	(1,095,140)
Net cash used by investing activities	<u>(33,595,397)</u>

Net decrease in cash and cash equivalents	(36,453,190)
Cash and cash equivalents, beginning of year	65,170,999
Cash and cash equivalents, end of year	<u><u>\$ 28,717,809</u></u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2008

-CONTINUED-

**Reconciliation of operating income to net cash
provided by operating activities**

Operating income	\$ 2,348,421
Adjustments to reconcile operating income to net cash flows provided by operating activities:	
Depreciation expense	52,433
Change in assets:	
Premiums receivable	(2,746,061)
Reinsurance recovery receivable	24,259
Prepaid insurance	2,564,814
Change in liabilities:	
Accounts payable, accrued payroll and compensated absences	391,352
Deferred premium revenue	1,049,686
Due from others	(1,235,000)
Claims payable and claims incurred but not reported	14,719,306
Net cash provided by operating activities	<u><u>\$ 17,169,210</u></u>

Supplemental Information

Reduction in investments for amortization and accretion	<u><u>\$ (138,223)</u></u>
Net (appreciation) depreciation of investments	<u><u>\$ (2,199,082)</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008

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, Insurance Reserve 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 Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Fund's accounting policies are described below.

Reporting Entity

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In turn component units may have component units.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity.

The primary government or entity is financially accountable if it appoints a voting majority of the organization's governing body including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally dependent on the primary entity that holds one or more of the following powers:

- (1) Determine its budget without another government's having the authority to approve and modify that budget.
- (2) Levy taxes or set rates or charges without approval by another government.
- (3) Issue bond debt without approval by another government.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Reporting Entity (Continued)

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

The South Carolina State Budget and Control Board, Insurance Reserve Fund is a fund of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. This report contains only the Fund and no other Offices or funds of the South Carolina State Budget and Control Board or any other part of the State of South Carolina primary government are included. The Insurance Reserve Fund is under the control of the Division of Insurance and Grant Services 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 of the Budget and Control Board are included in the Comprehensive Annual Financial Report of the State of South Carolina.

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The Insurance Reserve Fund was created by the Budget and Control Board on June 5, 1989 to manage insurance programs provided by the State for its agencies, institutions, and political subdivisions. The Fund was formed as a section from the Office of General Services.

Programs managed by the Fund 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 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, and automobile 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
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Basis of Presentation

The financial statements present the funds of the South Carolina State Budget and Control Board, Insurance Reserve Fund.

The financial statement presentation for the Fund meets the requirements of Governmental Accounting Standards Board (“GASB”) Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*. As an internal service fund, the Fund in its stand-alone financial statements is considered a proprietary fund under the guidance of GASB Statement No. 34. However, the guidance requires internal service funds included in the basic financial statements of the primary government to be reported as part of the governmental activity. Therefore, presentation in the Comprehensive Annual Financial Report of the State of South Carolina will include this fund as a governmental activity. The financial statement presentation provides a comprehensive, entity-wide perspective of the Fund’s net assets, revenue, expenses and changes in net assets and cash flows that replaces the fund-group perspective previously required.

Financial Statements

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

Basis of Accounting

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

The Fund uses the accrual basis of accounting. Revenue is recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable. The Fund reports claims liabilities when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The accounting policies of the Fund conform to accounting principles generally accepted in the United States of America applicable to governmental proprietary activities as prescribed by GASB. Accordingly, the Fund applies all applicable GASB pronouncements and those applicable standards issued by the Financial Accounting Standards Board, and its predecessors on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Fund considers all highly liquid securities with a maturity of three months or less at the time of purchase to be cash equivalents. Most State agencies including the Fund participate in the State's internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 2*. 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.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Deposits in the general deposit account are recorded and reported at cost. However, the Fund reports its deposits in the special deposit accounts at fair value. Investments in the pool are recorded and reported at fair value. Interest earned by the agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total income receivable of the pool.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The amounts shown in the financial statements as “cash and cash equivalents” represent cash on deposit with the State Treasurer as a part of the State’s internal cash management pool, and cash invested in various short-term instruments by the State Treasurer and held in separate agency accounts.

Investments

Investments, in accordance with Governmental Accounting Standards Board (GASB) Statement Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price.

Investment income consists of interest earned during the year, amortization of premiums and accretion of discounts, realized gains/losses on securities, and unrealized gains and losses resulting from changes in fair value. Earnings are posted to the agency’s account at the end of each month. Securities and securities transactions are reflected in the financial statements on a trade-date basis. Realized gains/losses are calculated independent of the change in fair value therefore amounts reported as realized gain/loss in the current year may have been included as unrealized gains/losses in prior years.

Premium Revenue

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

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.

Reinsurance Recovery Receivable

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Prepaid Insurance

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

Capital Assets

Capital assets are capitalized at cost if purchased. Capital assets contributed by other State agencies or funds are recorded at the State's original acquisition cost less accumulated depreciation from the purchase date. Assets donated by other parties are valued at fair market value at the date of gift. The Fund has one class of capital asset, equipment, which is depreciated on a straight-line basis over the estimated useful lives of 3-10 years. The capitalization dollar threshold limit for capital assets is \$5,000.

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 Fund establishes an unpaid claim liability for claims in the process of review, and for IBNR claims. The liability for IBNR claims is actuarially estimated based on the most current historical claims experience of previous payments, changes in number of members and participants, inflation, and award trends. 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. Claims payable and the related expense have been reduced by estimated reinsurance recoveries receivable for claims to be paid of approximately \$290,000 as of June 30, 2008. Amounts for allocated and unallocated claims adjustment expenses have been included in the calculation of IBNR.

Claims Payable

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
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least twenty hours per workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for unused sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances. The Fund calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in the fund.

Net Assets

Net assets are reported in three categories:

Investment in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets which do not meet the definition of restricted net assets or investment in capital assets, net of related debt.

The Fund applies expenses that can be used for both restricted and unrestricted resources against restricted resources first.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Classification of Revenue

The Fund has established the following criteria for reporting operating revenue or nonoperating revenue:

Operating revenue generally results from exchange transactions to provide the services authorized by State statute. These revenue include (1) premiums for insurance coverage, (2) administrative fees, and (3) other receipts arising from services provided.

Nonoperating revenue include activities that have the characteristics of nonexchange transactions. These revenue include appropriations, investment income, and contract revenue not classified as operating revenue or restricted by the provider to be used exclusively for capital purposes.

2. Investments and Deposits

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

Investments

In accordance with State Law, the Fund may invest in a variety of instruments including obligations of the United States and its agencies and securities fully guaranteed by the United States, certain corporate obligations, certain shares of Federal savings and loan associations and State chartered savings and loan associations, and collateralized repurchase agreements.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

The following table presents the amortized cost and fair values of the investments of the Fund at June 30, 2008:

	Amortized Cost	Unrealized Gains	Losses	Fair Value
U. S. Treasury obligations	\$ 299,208	\$ -	\$ (3,829)	\$ 295,379
U. S. Government agencies securities	8,607,500	374,150	-	8,981,650
Collateralized mortgage- backed obligations	95,510,558	402,968	(400,512)	95,513,014
Other Governmental guaranteed investments	1,516,012	18,140	-	1,534,152
SC State political subdivision bonds	110,165,230	661,976	(730,283)	110,096,923
Repurchase agreement	23,875,000	-	-	23,875,000
Corporate bonds	117,529,208	1,182,526	(916,951)	117,794,783
Corporate asset-backed securities	6,405,615	76,249	-	6,481,864
Financial paper	29,681,207	182,365	(708,070)	29,155,502
Total	<u>\$ 393,589,538</u>	<u>\$ 2,898,374</u>	<u>\$ (2,759,645)</u>	<u>\$ 393,728,267</u>

At June 30, 2008, the amortized cost of the above investments was comprised of the following:

	Par Value	Unamortized Premiums	Unaccreted Discounts	Amortized Cost
U. S. Treasury obligations	\$ 292,000	\$ 7,208	\$ -	\$ 299,208
U. S. Government agencies securities	20,000,000	-	(11,392,500)	8,607,500
Collateralized mortgage- backed obligations	96,005,747	-	(495,189)	95,510,558
Other Governmental guaranteed investments	1,546,951	-	(30,939)	1,516,012
SC State political subdivision bonds	110,686,676	-	(521,446)	110,165,230
Repurchase agreement	23,875,000	-	-	23,875,000
Corporate bonds	118,100,714	445,889	(1,017,395)	117,529,208
Corporate asset-backed securities	6,479,707	-	(74,092)	6,405,615
Financial paper	29,936,818	45,030	(300,641)	29,681,207
Total	<u>\$ 406,923,613</u>	<u>\$ 498,127</u>	<u>\$ (13,832,202)</u>	<u>\$ 393,589,538</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

Deposits

For cash and cash equivalents, the fair values are equal to the bank balances, which approximate the carrying amount. The cash and cash equivalents reported consist of the following as of June 30, 2008:

Deposits held by Third Party Administrators	\$ 69,820
Cash held by the South Carolina Treasurer's Office	4,772,989
	<u>\$ 4,842,809</u>

Balances held by the third party administrator are exposed to custodial credit risk. In the case of deposits, this is the risk that in the event of a bank failure, the Fund's deposits may not be returned. The Fund does not have a deposit policy for custodial credit risk. As of June 30, 2008, \$69,820 of the Fund's bank balance was uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the Fund's name.

Balances held by the South Carolina State Treasurer's Office are classified by risk category in the Comprehensive Annual Financial Report of the State of South Carolina. Information about the classification of a portion of its pooled funds is not available.

The following schedule reconciles investments and deposits as reported in the statement of net assets to disclosures included in this note.

	<u>Statements</u>	<u>Note Disclosure</u>
Cash and cash equivalents	\$ 28,717,809	\$ -
Deposits held by Third Party Administrators	-	69,820
Held by the State Treasurer:		
Cash	-	4,772,989
Specifically identified investments	-	393,728,267
Investments	369,853,267	-
Total	<u>\$ 398,571,076</u>	<u>\$ 398,571,076</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

During the year, the following amounts (which apply to all investments) were included in investment earnings:

Interest earned	\$ 26,419,176
Accretion of discount	(1,369,670)
Amortization of premium	1,231,447
Change in unrealized gains (losses)	(2,199,082)
	<hr/>
	\$ 24,081,871

3. Premiums Receivable

Premiums receivable at June 30, 2008, consist of the following:

Local government	\$ 10,156,840
State government (<i>Note 12</i>)	7,043,006
Other	355,157
	<hr/>
	\$ 17,555,003

Premiums receivable and deferred premium revenue include approximately \$12,800,919 attributable to premiums billed in advance of coverage as of June 30, 2008.

As of June 30, 2008, all of the receivables are deemed by management to be collectible. Therefore, no allowance for doubtful accounts has been recognized. In addition, the Fund has applied no discounts to its receivables as of June 30, 2008.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Notes Receivable

Amounts due from notes receivable in the Insurance Reserve Fund at June 30, 2008, consist of the following:

**Due from Engineering Services Section of the
Office of General Services**

One note in the original principal amount of \$1,500,000 with interest at 5.50%; maturity date is June 1, 2009. \$ 105,994

**Due from Savannah Valley Development Division of the
Department of Commerce**

One note in the original principal amount of \$14,983,215 with interest at 8.00%; maturity date is January 31, 2031. 9,033,017

Due from Senate

One note in the principal amount of \$1,000,000 with a maturity date of July 1 of the second fiscal year following final disposition of certain litigation settlement (Abbeville County School District). 1,000,000

Due from the House of Representatives

One note with an available line of credit of \$1,000,000 with a maturity date of July 1 of the second fiscal year following final disposition of the litigation settlement (Abbeville County School District). 1,000,000

Total 11,139,011

Less current portion (2,095,231)

Long-term notes receivable \$ 9,043,780

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

5. Capital Assets

The following summarizes the changes in capital assets for the year.

	Balance July 1, 2007	Additions	Deletions	Balance June 30, 2008
Furniture and equipment	\$ 348,936	\$ 27,003	\$ -	\$ 375,939
Accumulated depreciation	(165,164)	(52,433)	-	(217,597)
Capital assets, net	<u>\$ 183,772</u>	<u>\$ (25,430)</u>	<u>\$ -</u>	<u>\$ 158,342</u>

Depreciation expense for the year ended June 30, 2008, was \$52,433.

6. Lease Obligations

The Fund leases office space from a party outside of State government and this lease is accounted for as an operating lease. The office space lease was amended effective July 1, 2005, and now expires June 30, 2010. Rental expense under this lease for the year ended June 30, 2008 was \$283,859.

The Fund has also entered into an operating lease from a party outside the state government, for office equipment, which contains a cancellation provision and is subject to annual appropriation. In the normal course of business, operating leases are generally renewed or replaced by other leases. Operating leases are generally payable on a monthly basis. For the year ended June 30, 2008, expenses under these leases were approximately \$23,655.

The following schedule summarizes the Fund's obligations under non-cancelable operating leases having remaining terms in excess of one year as of June 30, 2008:

Fiscal Year Ending June 30,	Total
2009	\$ 283,859
2010	283,859
	<u>\$ 567,718</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

7. Restricted Net Assets – Savannah Valley Development Program

At June 30, 2008, \$20,000,000 of the Fund's net assets is restricted 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, 2008, \$9,033,017 was outstanding on loans made under this program.

8. Pension Plans

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the South Carolina Retirement Division, Post Office Box 11960, Columbia, South Carolina 29211-1960. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees. The State Optional Retirement Program (ORP) is a defined contribution plan that is offered as an alternative to certain state, public school, and higher education employees. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. The SCRS assumes no liability for State ORP benefits, as they are the liability of the investment providers. New employees have the option of choosing the State Optional Retirement Program.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. Pension Plans (Continued)

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 5 years credited service. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service (this requirement does not apply if the disability is the result of a job-related injury). A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (TERI) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period. TERI participants with an effective TERI date prior to July 1, 2005 do not make employee contributions to SCRS. TERI participants with an effective TERI date on or after July 1, 2005 make employee contributions to SCRS. All TERI participants do not earn service credit and are ineligible to receive group life insurance benefits and are not eligible for disability retirement benefits.

Beginning July 1, 2006, employees participating in the SCRS have been required to contribute 6.50 percent of all compensation. For the year ended June 30, 2008, the employer contribution rate was 9.06 percent (before a surcharge to fund retiree health and dental insurance coverage). For the year ended June 30, 2006, this rate was 7.55 percent and for the year ended 2007, this rate was 8.05 percent. The Fund's actual contributions to the SCRS for the years ended June 30, 2008, 2007 and 2006 were approximately \$360,717, \$317,583 and \$307,405 respectively and equaled the required contributions (excluding the surcharge) in the percentages outlined above. Also, the Fund paid employer group-life insurance contributions at the rate of .15 percent of compensation for each of the years ended June 30, 2008, 2007 and 2006.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. Pension Plans (Continued)

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

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

The SCRS does not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Fund's liability under the pension plans is limited to the amounts 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 the plans.

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

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.

The required retirement contribution rates will increase by 0.26% as of July 1, 2008.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Post-Employment and Other Employee Benefits

Post Employment Benefits

The State provides post employment health and dental benefits to retired employees and their covered dependents through a plan which has been determined to be a cost-sharing multiple-employer defined benefit post employment healthcare plan by the Comptroller General's Office of the State of South Carolina. The State Budget and Control Board (SBCB) is the Trustee and the plan is administered by the Employee Insurance Program (EIP), a part of the State Budget and Control Board. A retiree's eligibility for the health and dental benefits is based on his hire date and years of earned retirement service credit. Generally, ten years of service credit with the SC Retirement System is required for full funding of employees enrolled in the system prior to May 2, 2008. For all others who may become enrolled, eligibility requires fifteen years of service for partial funding and twenty-five years for full funding.

In addition the State provides long-term disability benefits to active employees through the Long-Term Disability Plan which has been determined to be a cost sharing multiple-employer plan by the Comptroller General's Office of the State of South Carolina. The State Budget and Control Board is the Trustee and the plan is administered by the Employee Insurance Program (EIP), a part of the State Budget and Control Board (SBCB). Benefits under this plan are provided to the employee upon approval of the disability by the South Carolina Retirement System.

Section 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended, requires the post-employment benefits be funded through annually established employer's contribution rates, also known as the pension surcharge. Funding for the employer's payment of the surcharge is provided through General Appropriations from the State and other sources. Effective May 1, 2008 through Act 195, the State established the South Carolina Retiree Health Insurance Trust Fund and the Long-Term Disability Insurance Trust Fund for the purpose of funding and accounting for the employer costs of retiree health and dental insurance benefits and employee long-term disability benefits. The Retiree Health Insurance Trust Fund is primarily funded through the payroll surcharge. Other sources of funding may include additional State appropriated dollars, accumulated EIP reserves, and income generated from investments. The Fund's actual contribution to this trust fund for the fiscal year ended June 30, 2008 was \$98,117, which equaled the required contribution rate of 3.42%. The Long-Term Disability Insurance Trust Fund is funded through a per person premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee contributed to the trust was \$3.23 for the fiscal year ended June 30, 2008.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

By state law, the State is liable for the employer share of retiree premiums. Accordingly, an annual required contribution and related liability for the Fund, as employer, is not included in the accompanying financial statements.

Audited financial statements of the trust funds may be obtained by written request to Employee Insurance Program, SC Budget and Control Board, 1201 Main Street, Suite 360, Columbia, South Carolina 29201.

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 all permanent full-time and certain permanent part-time employees of the Fund. These benefits are provided on a reimbursement basis by the employer agency based on rates established at the beginning of the service period by the Employee Insurance Program within the SC Budget and Control Board.

The Fund recorded benefit expenses for these insurance benefits for active employees in the amount of \$217,534 for the year ended June 30, 2008.

10. Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Fund have elected to participate.

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

This Fund made no contributions for the fiscal year ending June 30, 2008.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Return of Premium

The transfer of investment income to the General Fund and the “Rate Holiday” in FY 2002-2003 created a substantial decline in Fund assets and equity. IRF increased rates over several years in order to rebuild both assets and equity. In FY 2006-2007, the Appropriations Act transferred approximately \$52,000,000 (\$52 million) from the General Fund to the Insurance Reserve Fund. The combination of the cumulative rate increases and the transfer of monies back to the Fund generated assets and equity in excess of the Fund’s needs. The insurance industry uses several ratios to measure the financial strength and adequacy of capitalization for insurance companies. The ratio, which is published in the Budget and Control Board Accountability Report, is the ratio of Loss and Loss Expense Reserves to Policyholder Equity. The target range is between 1.25 and 1.5. It was apparent that the combination of the rate increases and the transfer from the General Fund would raise the Fund’s assets and equity to the point where the actual loss reserve to equity ratio would fall below the target range. Accordingly, the Fund returned \$20,000,000 to its policyholders as a refund of premium. The return for each policyholder was calculated by calculating the percentage that the policyholder’s annual premium bore to the total of the Fund annual premium.

The Fund has also decreased rates for several lines of insurance effective July 1, 2008 in an effort to slow the growth in assets and equity.

12. Transactions with State Entities

The Fund has significant transactions with the State of South Carolina and various State agencies.

The property and liability coverage is provided for a fee to various State agencies and within the South Carolina State Budget and Control Board. The fees are recorded as revenues in the financial statements for the Fund.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

The following details the insurance premiums received by the Fund from other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2008:

Adjutant General of South Carolina	\$ 431,626
Administrative Law Court	2,787
Agriculture Department	76,901
Aiken Technical College	37,002
Alcohol and Other Drug Abuse Services	8,228
Appellate Defense Commission	11,520
Archives and History Department	5,877
Arts Commission	15,826
Attorney General's Office	26,788
Beckman Center for Mental Health	4,884
Commission for the Blind	26,830
Board of Magistrates	80,261
Budget and Control Board	1,641,263
Central Carolina Technical College	39
Citadel University	566,061
Clemson University	2,105,740
Coastal Carolina University	503,958
College of Charleston	1,179,820
Commerce Department	99,469
Commission on Higher Education	20,578
Commission Prosecution Coordinators	12,383
Comptroller General	13,533
Consumer Affairs	4,351
Denmark Technical College	31,039
Department of Corrections	3,432,830
Department of Juvenile Justice	480,734
Department of Natural Resources	765,660
Department of Health and Environmental Control	1,333,221

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

Department of Motor Vehicles	130,191
Disabilities and Special Needs Department	550,121
Department of Social Services	543,985
Education Department	4,537,365
Education Oversight Commission	4,789
Educational Television	499,361
Election Commission	22,349
Employment Security Commission	160,522
Ethics Commission	3,352
State Board of Financial Institute	10,569
Florence-Darlington Technical College	109,435
Forestry Commission	264,022
Francis Marion University	319,596
Governor's Office	176,898
Governor's Office - Mansion and Grounds	52,246
Greenville Technical College	145,880
Health and Human Services Finance	181,797
Higher Education Tuition Grants Commission	11,154
Horry - Georgetown Technical College	62,339
House of Representatives	79,866
Commission on Human Affairs	14,826
Jobs and Economic Development Authority	5,670
John De La Howe School	67,400
Lander University	235,630
Legislative Audit Council	5,842
Legislative Department - Codification of Laws and Legislative Council	3,723
Legislative Printing	10,891
South Carolina State Library	44,389
Lieutenant Governors Office	12,686
Labor, Licensing and Regulations	170,123

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

Medical Malpractice Patients	35
Medical University of South Carolina	6,548,591
Midlands Technical College	12,996
Northeastern Technical College	38,263
Office of Regulatory Staff	14,732
Parks Recreation and Tourism	617,171
Patriots Point Development Authority	86,086
Piedmont Technical College	80,054
Probation, Parole and Pardon Services	254,491
Public Safety Department	878,202
Public Service Authority	372,412
Public Service Commission	9,697
Retirement System Investment Commission	9,277
Revenue and Taxation Department	113,448
Department of Insurance	16,856
South Carolina State University	333,706
Department of Mental Health	120,944
School for the Deaf and Blind	215,631
Transportation Infrastructure Bank	4,475
Worker's Compensation Commission	18,885
Sea Grant Consortium, South Carolina	7,951
Second Injury Fund	5,521
Secretary of State	9,350
Senate	31,559
South Carolina Law Enforcement Division	420,334
South Carolina Conservation Bank	5,363
State Accident Fund	10,215
State Auditor's Office	9,312
State Commission Minority Affairs	6,889

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

State Housing Finance and Development Authority	32,248
State Museum Commission	40,749
State Board for Technical and Comprehensive Education	1,111,151
Technical College of Lowcountry	37,374
Tobacco Settlement Revenue Management	2,925
Transportation Department	7,071,380
State Treasurer's Office	17,427
Tri-County Technical College	70,464
Trident Technical College	204,642
University of South Carolina	3,830,117
University of South Carolina - Beaufort Campus	64,102
University of South Carolina - Lancaster Campus	30,141
University of South Carolina - Salkehatchie Campus	42,350
University of South Carolina - Spartanburg Campus	214,984
University of South Carolina - Sumter Campus	29,240
Vocational Rehabilitation Department	326,681
Wil Lou Gray Opportunity School	42,460
Williamsburg Technical College	11,474
Winthrop University	568,486
York Technical College	78,255
	<u>\$ 45,435,322</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

Premiums owed from these entities at June 30, 2008 were:

Adjutant General of South Carolina	\$ 213,207
South Carolina Budget and Control Board	66,184
Citadel University	33,414
Clemson University	49,553
Coastal Carolina University	327
College of Charleston	125
Consumer Affairs	1
Department of Corrections	1,676,471
Department of Juvenile Justice	489,350
Department of Natural Resources	6
Department of Health and Environmental Control	1,224
Department of Motor Vehicles	130,991
Disabilities and Special Needs Department	36,475
Educational Department	8,536
Educational Television	246,782
Ethics Commission	3,352
Health and Human Services	181,797
Lander University	235,158
South Carolina State Library	19,897
Medical University of South Carolina	4,397
Mental Health Department	27,850
Office of Regulatory Staff	14,732
Parks Recreation and Tourism	338
Patriots Point Development Authority	86,086
Piedmont Technical College	16
South Carolina State University	1,760
Criminal Justice Academy	81,340
Sea Grant Consortium, South Carolina	3,715
South Carolina Law Enforcement Division	339,362
Spartanburg Community College	15,691
State Auditor's Office	9,312

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Transactions with State Entities (Continued)

State Museum Commission	40,749
Technical and Comprehensive Education Board	220,065
Transportation Department	699
University of South Carolina	2,688,208
University of South Carolina - Spartanburg Campus	110,460
York County Registration	5,376
	<hr/>
	\$ 7,043,006
	<hr/>

The Fund 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, 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 2008 expenses applicable to related party transactions not disclosed elsewhere are approximately:

South Carolina Budget and Control Board-Internal Operations	\$ 267,522
South Carolina Budget and Control Board-Legal Services	190,000
South Carolina Employment Commission	3,287
South Carolina Accident Fund	12,073
	<hr/>
	\$ 472,882
	<hr/>

In addition, the Fund was owed \$1,235,000 from the South Carolina Budget and Control Board as of June 30, 2008 for reimbursed expenses.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

13. Contingencies

By the nature of its operations and responsibilities as an insurer, the Fund has been named in a number of lawsuits, many of which are pending. A provision has been made in the financial statements for the payment of routine claims. Management is not aware of any other claims that, in their opinion, would have a material effect on the financial statements and, therefore, no liability has been recorded.

As a result of the 2004-2005 Appropriations Act Proviso 63.47, the Fund is to provide funds to cover legal defense costs of the State associated with the Abbeville School Funding litigation case. During the year ended June 30, 2008, the Fund incurred \$284,788.41 of legal defense costs associated with the case. However, the amount of this liability is not known as of the date of our report.

As a result of the 2007-2008 Appropriations Act, the Fund is to provide funds to cover legal defense costs of the State associated with the S. C. Citizens for Responsible Government litigation case. During the year ended June 30, 2008, the Fund incurred \$48,136.21 of legal defense costs associated with the case. However, the amount of this liability is not known as of the date of our report.

14. Risk Management/Reinsurance

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks except for certain types of risks for which it is self-insured (these risks are further described herein). Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage in the prior year other than the Fund did not renew reinsurance for Medical Professional Liability. Settled claims have not exceeded this coverage in any of the past three years.

The Fund 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

14. Risk Management/Reinsurance (Continued)

State management believes it is more economical to manage certain risks internally and set aside assets for claim settlement. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

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

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 Fund issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following Fund assets, activities, and/or events:

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

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

The Fund obtains coverage of up to \$750,000 per loss through a commercial carrier for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation.

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

14. Risk Management/Reinsurance (Continued)

The Fund has not transferred the portion of the risk of loss related to insurance policy deductibles and limits. The Fund has not reported an estimated claims loss expense, and the related liability at June 30, 2008, 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), 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 Insurance Reserve Fund self insures Tort Liability Insurance, Automobile Physical Damage Insurance, Medical Professional Liability and the self insured retention for Property, and Boiler and Machinery Insurance.

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

Property - \$10,000,000 per occurrence

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

15. Reconciliation of Claims Liabilities by Fund

The schedule below presents the changes in claims liabilities for the past two years for the Fund.

	2008 (in thousands)	2007 (in thousands)
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 201,183	\$ 214,651
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	43,630	41,278
Increases (decreases) in provision for insured events of prior fiscal years	2,108	(20,760)
Total incurred claims and claim adjustment expenses	45,738	20,518
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	11,688	9,126
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	19,330	24,860
Total payments	31,018	33,986
Total unpaid claims and claim adjustment expenses at end of the fiscal year	<u>\$ 215,903</u>	<u>\$ 201,183</u>
The above totals are comprised of the following:		
Claims payable	\$ 125,506	\$ 117,473
Claims incurred but not reported	90,397	83,710
Total	<u>\$ 215,903</u>	<u>\$ 201,183</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

16. Changes in Long-Term Liabilities

Changes in long-term obligations for the year ended June 30, 2008 were as follows:

	Beginning Balance July 1, 2007	Increases	Decreases	Ending Balance June 30, 2008	Due Within 1 Year
Compensated absences payable	<u>\$ 383,619</u>	<u>\$ 187,489</u>	<u>\$ (206,982)</u>	<u>\$ 364,126</u>	<u>\$ 168,455</u>

DELOACH & WILLIAMSON, L.L.P.

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

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
Office of the State Auditor
Columbia, South Carolina

Dear Mr. Gilbert:

We have audited the financial statements of the South Carolina State Budget and Control Board, Insurance Reserve Fund (the "Fund") as of and for the year ended June 30, 2008, and have issued our report thereon dated September 25, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Fund's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Fund's financial statements that is more than inconsequential will not be prevented or detected by the Fund's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Fund's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

* * * * *

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

Releach & Williamson, L.L.P.

September 25, 2008