

October 1, 1998

The Honorable David M. Beasley, Governor
and
Mr. Douglas P. Crossman, Director
South Carolina Second Injury Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Second Injury Fund for the fiscal year ended June 30, 1998, was issued by Wilkes & Company, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

Thomas L. Wagner, Jr., CPA
State Auditor

TLW/trb

**SOUTH CAROLINA SECOND INJURY FUND
COLUMBIA, SOUTH CAROLINA**

FINANCIAL STATEMENTS

June 30, 1998

SOUTH CAROLINA SECOND INJURY FUND
COLUMBIA, SOUTH CAROLINA

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the South Carolina Second Injury Fund as of and for the year ended June 30, 1998, 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 financial statements based on our audit.

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

As described in Note 1, the financial statements of the South Carolina Second Injury Fund are intended to present the financial position, and the results of operations, and cash flows of its proprietary fund type of only that portion of the funds and accounts groups of the State of South Carolina that is attributable to the transactions of the South Carolina Second Injury Fund.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Carolina Second Injury Fund as of June 30, 1998, and the results of its operations and the cash flows of its proprietary fund type for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 11 to the financial statements, the Fund changed its method of accounting for unrealized gains in internal investment pools as required by the provisions of Governmental Accounting Board (GASB) Statement No. 31.

Columbia, South Carolina
September 15, 1998

FINANCIAL STATEMENTS

SOUTH CAROLINA SECOND INJURY FUND

**COMBINED BALANCE SHEET -
ALL FUND TYPES AND ACCOUNT GROUPS**
JUNE 30, 1998

	GOVERNMENTAL FUND TYPE	PROPRIETARY FUND TYPE	ACCOUNT GROUP	TOTAL (MEMORANDUM ONLY)
	SPECIAL REVENUE	ENTERPRISE	GENERAL LONG-TERM DEBT	
<u>ASSETS</u>				
Cash and Cash Equivalents	\$ 290,938	\$ 151,353	\$ -	\$ 442,291
Cash and Cash Equivalents - Restricted	-	50,990,877	-	50,990,877
Interest Receivable - Restricted	-	675,477	-	675,477
Equipment, Net of Accumulated Depreciation of \$131,341	-	84,484	-	84,484
Amount to be Provided for Retirement of General Long-Term Debt	-	-	5,132,144	5,132,144
Total Assets	<u>\$ 290,938</u>	<u>\$ 51,902,191</u>	<u>\$ 5,132,144</u>	<u>\$ 57,325,273</u>
<u>LIABILITIES AND FUND EQUITY</u>				
Liabilities:				
Accounts Payable	\$ -	\$ 6,214	\$ -	\$ 6,214
Claims Payable From Restricted Assets	-	51,666,355	-	51,666,355
Accrued Payroll	-	71,327	-	71,327
Claims and Awards:				
Reported	-	-	2,366,720	2,366,720
Incurred But Not Reported	-	-	2,765,424	2,765,424
Accrued Compensated Absences	-	73,811	-	73,811
Total Liabilities	-	51,817,707	5,132,144	56,949,851
Fund Equity:				
Retained earnings	-	84,484	-	84,484
Fund balance:				
Reserved for workers' compensation uninsured employers claims	290,938	-	-	290,938
Total Fund Equity	290,938	84,484	-	375,422
Total Liabilities and Fund Equity	<u>\$ 290,938</u>	<u>\$ 51,902,191</u>	<u>\$ 5,132,144</u>	<u>\$ 57,325,273</u>

THE ACCOMPANYING NOTES
ARE AN INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA SECOND INJURY FUND

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE - GOVERNMENTAL FUND TYPE
FOR THE YEAR ENDED JUNE 30, 1998**

Revenues:

Allocation from South Carolina Workers' Compensation Commission	\$ 248,820
Allocation from South Carolina Department of Insurance	1,951,180
Recoupment of claims paid	671,444
Miscellaneous	<u>133</u>
Total Revenues	<u>2,871,577</u>

Expenditures:

Workers' Compensation Uninsured Employers' Fund claims and awards	2,746,281
Claims adjustment expenditures	<u>223,026</u>
Total Expenditures	<u>2,969,307</u>

Deficit of Revenues Over (Under) Expenditures (97,730)

Fund Balance - July 1 388,668

Fund Balance - June 30 \$ 290,938

THE ACCOMPANYING NOTES
ARE AN INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA SECOND INJURY FUND

**STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN RETAINED EARNINGS-PROPRIETARY FUND TYPE
FOR THE YEAR ENDED JUNE 30, 1998**

Operating Revenue:	
Assessments	\$ <u>1,232,269</u>
Operating Expenses:	
Administration:	
Personal services	751,767
Employer contributions	176,152
Contractual services	101,059
Supplies	26,726
Fixed charges and contributions	98,075
Travel	52,400
Minor uncapitalized equipment	2,102
Library books	9,817
Depreciation	<u>25,753</u>
Total Operating Expenses	<u>1,243,851</u>
Operating Income (Loss)	<u>(11,582)</u>
Net Income (Loss)	(11,582)
Retained Earnings - July 1	<u>96,066</u>
Retained Earnings - June 30	<u>\$ 84,484</u>

THE ACCOMPANYING NOTES
ARE AN INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA SECOND INJURY FUND

STATEMENT OF CASH FLOWS
PROPRIETARY FUND TYPE
FOR THE YEAR ENDED JUNE 30, 1998

Cash Flows From Operating Activities:	
Operating Income (Loss)	\$ (11,582)
Adjustments to Reconcile Net Income (Loss)	
to Net Cash Provided by Operating Activities:	
Depreciation	25,753
Assessments and other income received	
restricted for payment of claims	61,767,711
Claims paid	(59,411,828)
(Increase) Decrease in Assets:	
Accounts receivable	5,488
Increase (Decrease) in Liabilities:	
Accounts payable	(13,234)
Accrued payroll	3,052
Accrued compensated absences	<u>(784)</u>
Total Adjustments	<u>2,376,158</u>
Net Cash Provided (Used) by Operating Activities	<u>2,364,576</u>
 Cash Flows From Capital and Related Financing	
Activities:	
Acquisition of equipment	<u>(14,172)</u>
Net Cash Used by Capital and Related	
Financing Activities	<u>(14,172)</u>
 Cash Flows from Investing Activities:	
Investment income restricted for payment of claims	<u>4,514,749</u>
Net Cash Provided by Investing Activities	<u>4,514,749</u>
Net Increase (Decrease) in Cash and Cash Equivalents	6,865,153
Cash and Cash Equivalents, Beginning of Year	<u>44,277,077</u>
Cash and Cash Equivalents, End of Year	<u>\$ 51,142,230</u>

THE ACCOMPANYING NOTES ARE AN
INTEGRAL PART OF THIS FINANCIAL STATEMENT

SOUTH CAROLINA SECOND INJURY FUND

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by generally accepted accounting principles, the financial reporting entity includes both the primary government and all its component units. Component units are legally separate organizations for which the elected officials or 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 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 bonded debt without approval by another government.

Based on the application of the above criteria, no component units are included in the reporting entity.

Prior to July 1, 1993, the Second Injury Fund was considered to be a component unit of the State of South Carolina. Effective July 1, 1993, the Fund was considered part of the State of South Carolina's primary government and is included in the State of South Carolina's Comprehensive Annual Financial Report as such. This is based on guidance provided by GASB Statement 14 *The Financial Reporting Entity*. The South Carolina Second Injury Fund was established by Section 42-7-310 of the Code of Laws of South Carolina. The funds and account groups of the Fund are included in the Comprehensive Annual Financial Report of the State of South Carolina.

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

The Fund is administered by a Director appointed by the State Budget and Control Board. The reporting entity is part of the State primary government unit. The accompanying financial statements present the financial position, results of operations and cash flows solely of the South Carolina Second Injury Fund and do not include any other funds of the State of South Carolina. The Second Injury Fund does not have any component units.

The Second Injury Fund, per Code of Laws Section 42-9-400, established the guidelines by which to pay compensation claims in those cases where an individual having an existing permanent physical impairment incurs a subsequent disability from injury by accident arising out of and in the course of employment. Funding for payment of compensation awards and for Fund operating costs is provided by equitable assessments upon all workman's compensation insurance carriers, self-insurers, and the South Carolina State Accident Fund (approximately 325 entities). Participation is mandatory as required by State law. Participants of the fund are responsible for the fund's liabilities. Payments of claims and awards are made directly to the carriers and self insurers. The State of South Carolina will not be responsible for any expense or liabilities of the fund, except the State Accident Fund, who is a participant in the fund.

Per Code of Laws Section 42-7-200(a), as amended, the Second Injury Fund is responsible for administering the Workers' Compensation Uninsured Employers' Fund. The Fund issues payment of awards of workers' compensation benefits which are unpaid because of employers' who fail to acquire necessary coverage for employees. Funding for payment of awards is provided from collections of the tax on insurance carriers and self-insured persons in an amount sufficient to maintain the fund. The monies are transferred from the South Carolina Department of Insurance and the South Carolina Workers' Compensation Commission.

Fund Accounting

The government uses funds and account groups to report its financial position, results of operations and cash flows. 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. Separate accounts are maintained for each fund. An account group, on the other hand, is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources. Funds are classified into two categories: governmental and proprietary. Each category, in turn, is divided into separate "fund types."

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

Governmental funds are those through which most governmental functions typically are financed and are used to account for all or most of a government's general activities, including the collection and disbursement of earmarked monies (special revenue fund). Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; and the differences between assets and liabilities is fund balance.

Special Revenue Fund - accounts for the proceeds of specific revenue sources requiring separate accounting because of legal or regulatory provisions or administrative action. The Workers' Compensation Uninsured Employers Fund is considered a special revenue fund. The Fund receives revenues from the collections of the tax on insurance carriers and self-insured persons in an amount sufficient to maintain the Uninsured Employers' Fund at a level of not less than two hundred thousand dollars. These monies, which are transferred to the fund from the South Carolina Department of Insurance and the South Carolina Workers' Compensation Commission, are utilized to pay claims.

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Generally, when services from such activities are provided primarily to outside parties, the funds are classified as enterprise funds.

Enterprise Fund - accounts for activities that are self-sustaining, primarily through user charges, or are used when management wants to control or measure costs of services. The Second Injury fund is considered to be an enterprise fund.

General Long-Term Debt Account Group

Long-term debt or liabilities expected to be financed from governmental funds are accounted for in the general long-term debt account group, not in the governmental funds. Actuarially computed liabilities for awards and claims for the Workers' Compensation Uninsured Employers' Fund are included in this account group.

Basis of Accounting

All governmental funds are accounted for using a current financial resources measurement focus whereby only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases and decreases in net current assets.

All governmental funds use the modified accrual basis of accounting. Their revenues are recognized when they become available and measurable. The allocations from the South Carolina Insurance Commission and the South Carolina Workers' Compensation Commission are recorded when received in cash because they are not considered revenue until the Fund requests the transfer of funds. The

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

request from the Fund is the event that is considered necessary to trigger the recognition of revenue.

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

Expenditures of governmental funds are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred. Expenditure recognition is limited to exclude amounts represented by noncurrent liabilities since they do not effect net current assets. They are instead reported as liabilities in the General Long-term Debt Account Group.

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Proprietary fund type operating statements present increases and decreases in total assets.

Proprietary fund type revenues and expenses are recognized on the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for generally accepted accounting principles applicable to governmental proprietary activities. The Fund applies all applicable Government Accounting Standards Board (GASB) pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with (GASB) pronouncements. In accordance with GASB Statement 20, the Fund has elected not to implement FASB Statements 103 and after.

Budget Policy

The South Carolina Second Injury Fund is granted an annual appropriation for administrative operating purposes by the General Assembly to be funded from the Second Injury Fund's participants assessments. The appropriation as enacted becomes the legal operating budget for the Fund for its budgeted activities. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The Total Funds column in the Appropriations Act for each individual budgetary unit authorizes expenditures from all budgeted resources. A revenue budget is not adopted for individual budgetary units. The agency receives no State General Funds Appropriations. The General Assembly enacts the budget through passage of 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 budgetary 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 authority or by the agency as set forth in Appropriation Act Proviso 72.9 as follows: Agencies are authorized to transfer appropriations within programs and

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

within the agency with notification to the Division of Budget and Analysis 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.

During the fiscal year-end close-out period in July, agencies may continue to charge vendor, interagency, and interfund payments for the fiscal year to that fiscal year's appropriation. For the Fund, any unexpended funds as of June 30, automatically carry over to the ensuing fiscal year. State law does not require the use of encumbrance accounting.

State law does not precisely define the budgetary basis of accounting. The current Appropriation Act states that the General Assembly intends to appropriate all State funds and to authorize and/or appropriate the use of all other 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 disbursements basis for payroll expenditures.

The budget and actual comparison in Note 2 presents actual expenditures on the budgetary basis of accounting compared to the legally adopted and modified budget on a line-item expenditure basis for the Fund's administrative costs. The level of legal control for each agency is reported in a publication of the State Comptroller General's Office titled *A Detailed Report of Appropriations and Expenditures* for each fiscal year.

Fixed Assets

Equipment acquisitions require the use of fund financial resources and are capitalized at cost in the fund upon acquisition. Purchases of equipment in excess of \$400 and for electronic equipment in excess of \$300 are capitalized. Depreciation of equipment is charged as an expense against operations, and accumulated depreciation is reported on the Funds' balance sheet. Depreciation has been provided over the estimated useful lives of five to ten years using the straight line method of depreciation.

There are no fixed asset purchases by the Workers' Compensation Uninsured Employers Fund. As mentioned in this note, all administrative expenses are paid by the Second Injury Fund.

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's workweek are entitled to accrue and carry forward at calendar year-end a maximum of 180 days sick leave and 45 days annual vacation leave, except that faculty members do not accrue annual leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum of 45 days, but are not

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

entitled to any payment for unused sick leave. The South Carolina Second Injury 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 as a current liability. The net change in the liability is recorded in the current year in the applicable administrative expense categories.

Cash and Cash Equivalents

The amounts shown in the financial statements as "*cash and cash equivalents*" represent cash on hand with the State Treasurer, and cash invested in various instruments by the State Treasurer as part of the State's cash management pool.

Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The pool includes some long-term investments such as obligations of the United States and certain agencies of the of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Most State agencies participate in the cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. For those accounts, cash equivalents included investments in short-term, highly liquid securities having a maturity of three months or less.

The State's 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 in the pool are recorded at fair value. Amortization of premiums and discounts is allocated and reported as interest income. 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 income receivable to the total income receivable of the pool.

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 agency's percentage ownership in the pool.

Although the cash management pool includes some long-term investments, it operates as a demand deposit account; therefore, for credit risk information pertaining to the cash management pool, see the deposits disclosures in Note 3.

Unpaid Claims Liabilities

It has been determined that the Second Injury Fund did not fall within GASB 10's definition of a public entity risk pool (PERP), because there is no actual transfer of risk to the Fund, and also the majority of the entities serviced by the fund are not

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

governmental entities. Assessments for the current year are recognized only to the extent actually assessed to the participants. The assessments are recognized as revenues only to the extent they are used to cover the funds administrative expenses and capital outlay. Claims are recognized as a liability only to the extent that assets are available to liquidate these liabilities. Based on the fund operations and prior actuarial studies, it was determined that the liabilities far exceed the available assets, however since the participants are ultimately responsible for paying these liabilities and there is no transfer of risk, a liability is recognized only to the availability of assets to pay claims. Therefore the balance sheet does not include any additional claims reported to the Second Injury Fund as a claims service or an estimate of IBNR claims which are the responsibility of the participants. The payments of claims are not considered an operating expense of the fund. These are only shown on the statement of cash flows.

Prior to July 1, 1995, the Workers' Compensation Uninsured Employers' Fund was determined to be covered by GASB Statement 10 as an activity other than a public entity risk pool (PERP) which, however, does involve risk financing activities. The primary difference between a PERP and a non-PERP entity is that in a non-PERP entity the government does not transfer or pool its risks. Effective July 1, 1995, it has been determined that the Fund is a state benefit program that should follow GASB 10's guidance for measurement and recognition of claims liabilities. However, the Fund is not required to present additional disclosures, such as the claims reconciliation table required by GASB 10. GASB 10 allows the selection of fund type based upon characteristics of the fund. This activity is classified as a special revenue fund with the liability for the actuarially computed claims payable recorded in the general long-term debt account group. The Fund actuarially establishes claims liabilities based on estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the coverage involved. Because actual claims costs depend on such complex factors as medical technology, changes in doctrines 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 using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. 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 reflects 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 the general long term debt group of accounts. The non-current portion is included in the long term debt group of accounts. The first actuarial study for this fund was done as of June 30, 1990. Claims are reported as expenditures of the special revenue fund when they are paid. In August 1998, an actuarial study was done for the year ended June 30, 1998.

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

Assessment Revenues

Second Injury Fund assessments are recognized as enterprise fund revenues only to the extent which they are needed for administrative expenses and capital outlay of the fund, less depreciation and loss on disposal of asset recorded by the Fund.

Total Columns on Combined Statement

Total columns on the combined statement is captioned "*Memorandum Only*" to indicate that it is presented only to facilitate financial analysis. Data in this column does not present financial position in conformity with generally accepted accounting principles. Neither is such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

Restricted Assets and Claims Payable from Restricted Assets

Cash which is not required to pay administrative liabilities is restricted for payment of claims. The sources of funds to pay restricted claims are assessments, interest earned on deposits and other income. Also interest receivable is restricted for payment of claims. A payable of claims is recorded only to the extent of the assets available to pay claims.

Administration Expenses

The Second Injury Fund does not allocate any administrative expenses to the Uninsured Employers Fund because by State law the Uninsured Employers' Fund cannot pay administrative expenses. The fund only pays claims and those direct costs associated with payment of the claims.

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.

NOTE 2 - BUDGET COMPARISON TO ACTUAL

The Administration expenses shown in the statement of revenue, expenses, and changes in retained earnings are reported on the accrual basis of accounting which differs from the legally enacted budgetary basis for the year ended June 30, 1998. Adjustments of the GAAP basis of accounting to the budgetary basis consist of reversals of payroll and compensated absences accruals and the related fringe benefits, and of reflecting equipment acquisitions as expenses.

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

Administration expenses per statement	\$ 1,243,851
Adjustments to Budgetary Basis:	
Depreciation	(25,753)
Net Accruals:	
Personal services	(1,711)
Employer contributions	(557)
Equipment purchased	<u>14,172</u>
Total Actual on Budgetary Basis	<u>\$ 1,230,002</u>

The Administration expenditures shown below are presented on the budgetary basis compared to the legally adopted and modified budget by object code category.

<u>Fiscal Year 1998</u>	<u>Legal Basis Budget</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Personal Services	\$ 761,479	\$ 750,056	\$ 11,423
Employer Contributions	179,305	175,595	3,710
Other Operating Expenses	<u>355,183</u>	<u>304,351</u>	<u>50,832</u>
Total	<u>\$ 1,295,967</u>	<u>\$ 1,230,002</u>	<u>\$ 65,965</u>

NOTE 3 - DEPOSITS AND INVESTMENTS

All deposits and investments of the agency are under the control of the State Treasurer who, by law, has sole authority for investing State funds.

Deposits Held by State Treasurer

State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days. At June 30, 1998, all State Treasurer bank balances were fully insured or collateralized with securities held by the State or by its agents in the State's name.

With respect to investments in the State's 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 agent 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.

NOTE 4 - LONG-TERM DEBT

The following is a summary of changes in General Long Term Debt of the Workers' Compensation Uninsured Employers' Fund:

SOUTH CAROLINA SECOND INJURY FUND

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998**

(Continued)

	<u>July 1, 1997</u>	<u>Increase</u>	<u>Decrease</u>	<u>June 30, 1998</u>
Claims and Awards:				
Reported	\$ 2,415,994	\$ 2,920,033	\$ 2,969,307	\$ 2,366,720
Incurred but not reported	<u>3,375,962</u>	<u>-</u>	<u>610,538</u>	<u>2,765,424</u>
Total	<u>\$ 5,791,956</u>	<u>\$ 2,920,033</u>	<u>\$ 3,579,845</u>	<u>\$ 5,132,144</u>

NOTE 5 - RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS

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.

Substantially all employees of the South Carolina Second Injury 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.

Under SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 30 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 15 years credited service. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service. A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6.0 percent of all compensation. Effective July 1, 1997, the employer contribution rate became 9.466 percent which included a 1.916 percent surcharge to fund retiree health and dental insurance coverage. The Fund's actual contributions to the SCRS for the fiscal year ended June 30, 1998 were \$56,153, and equaled the

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

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required contributions of 7.55 percent (excluding the surcharge) for the year. Employer contributions for fiscal year 1997 were \$52,444 and for fiscal year 1996 were \$48,761. Also, the Fund paid employer group-life insurance contributions of \$1,116 in the current fiscal year at the rate of .15 percent of compensation.

The amounts paid by the South Carolina Second Injury Fund for pension and group-life benefits are reported as employer contributions below.

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, 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 System does not make separate measurements of assets and pension liabilities for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plan is limited to the amounts 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 plan is limited to the contribution requirements for the applicable year from amounts appropriated therefor 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 plan.

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

Post-Retirement 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 active and certain retired State employees and certain surviving dependents of retirees. All permanent full-time employees of the South Carolina Second Injury Fund are eligible to receive these benefits. The State provides post employment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirement, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits. These benefits are provided through the Fund's applicable revenue sources for active employees and the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable revenue sources of the

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

South Carolina Second Injury Fund for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Currently, approximately 18,500 State retirees meet these eligibility requirements.

The South Carolina Second Injury Fund recorded employer contribution expenses for these insurance benefits for active employees in the amount of \$43,205 for the year ended June 30, 1998. As discussed above, the Fund paid \$14,250 applicable to the 1.916% surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Division of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to the South Carolina Second Injury Fund retirees is not available. By State law, Fund has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from System's earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS benefits.

Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the agency have elected to participate. The multiple-employer plans, created under Internal revenue code sections 457, 401(k), and 403(b) are accounted for as agency funds of the State and included in the Comprehensive Annual Financial Report of the State of South Carolina. Employees may withdraw the current value of their contributions prior to termination if they meet requirements specified by the applicable plan.

Compensation deferred under the Section 401(k) and 403(b) plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Under the Section 457 plan, all deferred compensation plan amounts and earnings remain assets of the employer (the State) subject to the claims of the employer's general creditors, one of whom is the employee participant. It is unlikely, however, that the State would ever use plan assets to satisfy claims of the State's general creditors. The portion of assets of the Section 457 plan to which the State has access is disclosed in its annual financial report.

On August 20, 1996, the provisions of Internal Revenue Code Section 457 were amended by adding subsection (g). That subsection provides that new plans will not be considered eligible plans unless all assets and income of the plans are held in trust

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

for the exclusive benefit of the participants and their beneficiaries. Existing plans also must comply with this requirement by January 1, 1999. South Carolina's plan adopted this change effective July 24, 1998.

NOTE 6 - OPERATING LEASE

The Second Injury Fund paid \$90,482 in fiscal year 1998 for rental of office space under an operating lease. The lease expires in October 2000.

The Fund is obligated under this lease as follows:

<u>Year Ending</u> <u>June 30</u>	<u>Amounts</u>
1999	\$ 86,640
2000	86,640
2001	<u>36,100</u>
Total Minimum Payments Required	<u>\$ 209,380</u>

NOTE 7 - RESERVED FUND BALANCE

A reservation of fund balance indicates that it is not appropriable or available for expenditure except for the purpose that it is reserved. The fund balance of the Uninsured Employers' Fund which totaled \$290,938 at June 30, 1998 is reserved per Section 42-7-200 of the Code of Laws of South Carolina, for payment of worker's compensation claims which are unpaid because employers failed to acquire necessary coverage.

NOTE 8 - RELATED PARTY TRANSACTIONS

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 and check preparation, banking and investment functions from the State Treasurer.

Other services received at no cost from the various divisions of the State Budget and Control Board include retirement and health plan administration, personnel management, assistance in the preparation of the State Budget, review and approval of certain budget amendments, procurement services and other centralized functions.

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

The Fund had financial transactions with various State agencies during the fiscal year. Significant payments were made to divisions of the State Budget and Control Board for retirement and insurance plans contributions, vehicle rental, insurance coverage, office supplies, printing, telephone, and interagency mail. Significant payments were also made for unemployment and workers' compensation coverage for employees. The amounts of 1998 expenses applicable to related party transactions are not readily available. The fund collected assessments from the State Accident Fund in the amount of \$5,794,617.

The Fund provided no services free of charge to other state agencies during the fiscal year.

NOTE 9 - ASSESSMENTS

The Second Injury Fund assesses all insurance carriers, self-insurers (including the State Accident Fund). Each carrier, under regulation prescribed by the Workers' Compensation Commission, shall make payments to the Fund in an amount equal to that proportion of one hundred seventy-five percent of the total disbursement made from the Fund during the preceding fiscal year less the amount of net assets in the Fund as of June thirtieth of the preceding fiscal year which the total benefits paid by such carrier bore to the total benefits paid by all carriers funding the preceding calendar year. An employer who has ceased to be a self insurer shall continue to be liable for any assessments into the Fund on account of any benefits paid by him during such calendar year. Any assessment levied or established in accordance with this section constitutes a personal debt of every employer or insurance carrier so assessed and is due and payable to the Second Injury Fund when payment is called for by the Fund. Assessments are done in September of each year and substantially collected by December of each year.

NOTE 10 - RISK MANAGEMENT

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for certain risks. Management believes such coverage is sufficient to preclude any significant uninsured losses to the Fund. The Fund has not had any claims in the past three years. There were no significant reductions in insurance coverage from coverage in the prior year. The Fund pays insurance premiums to certain other State agencies and commercial insurers to cover risk that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered premium losses sustained during the policy period in accord with the insurance policy and benefit program limits. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of covered employees for health and dental insurance benefits (Office of Insurance Services); and

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

2. Claims of covered public employees for long-term disability and group-life insurance benefits (Office of Insurance Service).

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
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(Continued)

3. Claims of covered public employees for workers' compensation insurance benefits (State Accident Fund).
4. Claims of covered public employees for unemployment compensation insurance benefits (Employment Security Commission).

The Fund and other entities pay premiums to the states Insurance Reserve Fund (IRF) which issues policies, accumulate 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. Personal property and equipment - Eighty percent of each loss is covered by the IRF. Losses are subject to a \$250 deductible.
2. Data processing equipment - Coverage is up to \$300,000 per loss with a \$250 deductible.
3. Torts - General tort liability up to \$1,000,000 per occurrence.

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, boiler and machinery, and automobile liability. The IRF's rates are determined actuarially.

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

The Fund purchases insurance through a private carrier for employee fidelity bond insurance coverage for all employees to cover losses of up to \$50,000 arising from theft or misappropriations. Management believes based on exposure and likelihood of loss that this coverage is sufficient.

The Fund has not recorded an estimated claims expense related to insurance policy deductibles and policy limits because there is no evidence of asset impairment or other information to indicate a loss should be recorded as of June 30, 1998.

NOTE 11 - ACCOUNTING CHANGES AND PRIOR PERIOD ADJUSTMENTS

Effective July 1, 1997, the Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement requires that most investments of governmental entities be stated at fair value rather than at cost. For internal (and external) investment pools, this statement requires the equity position of each fund that sponsors the pool to be reported as assets in those funds. The agency has restated its beginning cash and cash equivalents balances and claims payable from restricted assets balances by an increase of \$20,000 as of July 1, 1997, for changes resulting from adoption of Statement No. 31. This change had no effect

SOUTH CAROLINA SECOND INJURY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 1998

(Continued)

on fund balances since claims payable are recorded to the extent of available assets. Therefore, the increase in available assets was offset by a corresponding increase in claims payable. Included in cash and cash equivalents at June 30, 1998 is \$345,180 of unrealized gains allocated to the Fund by the State Treasurers office as the Fund's portion of unrealized gains in the entire investment pool. Included in investment income for 1998 is \$325,180 for the current year change in unrealized gain.