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

The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for generally accepted accounting principles for all State governmental entities. The accounting policies of the Office conform to generally accepted accounting principles applicable to governmental proprietary activities as prescribed by GASB. Accordingly, the Office applies all applicable GASB pronouncements and has elected to apply only those applicable standards issued by the Financial Accounting Standards Board on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents
For purposes of the statements of cash flows, the Office considers all highly liquid securities with a maturity of three months or less at the time of purchase to be cash equivalents. Because the State's internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Most State agencies participate in the internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds.

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

Cash and Cash Equivalents (Continued)
Most State agencies including the Office participate in the State's internal cash management pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 4*.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Deposits in the general deposit account are recorded and reported at cost. However, the Office reports its deposits in the special deposit accounts at fair value. Investments in the pool are recorded and reported at fair value. Interest earned by the agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total income receivable of the pool. Reported interest income includes interest earnings, realized gains/losses, and unrealized gains/losses on investments in the pool arising from changes in fair value. Realized gains and losses are allocated daily and are included in the accumulated income receivable. Unrealized gains and losses are allocated at year-end based on the Office's percentage ownership in the pool.

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

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

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

Investments (Continued)
Investment income consists of interest earned during the year, amortization of premiums and accretion of discounts, realized gains/losses on securities, and unrealized gains and losses resulting from changes in fair value. Earnings are posted to the agency's account at the end of each month. Securities and securities transactions are reflected in the financial statements on a trade-date basis.

Premium Revenue-Insurance Reserve Fund
Premiums billed to agencies (premiums receivable) for insurance coverage are deferred and amortized into income over the term of the insurance policy.

Premium Revenue-Health, Life, and Disability Insurance Reserve Fund
Premiums billed to employers, employees and retirees (premiums receivable) for insurance coverage are recorded as revenue when earned on a monthly basis. The retiree surcharge on employees is recognized as the liability is incurred by the various State agencies and school districts.

Deferred Premium Revenue
Premiums billed in advance of coverage, payments received in advance of coverage, or in excess of amounts billed and premiums collected but unearned are recorded as deferred premium revenue in the Insurance Reserve Fund and the Health, Life, and Disability Insurance Reserve Fund.

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

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

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

Fixed Assets

Fixed assets held in proprietary funds are capitalized at cost if purchased. Fixed assets contributed by other State agencies or funds are recorded at the State's original acquisition cost less accumulated depreciation from the purchase date. Assets donated by other parties are valued at fair market value at the date of gift. The Office has one class of fixed asset, equipment, which is depreciated on a straight-line basis over the estimated useful lives of 5-10 years.

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

Claims Liabilities Including Claims Incurred but not Reported (IBNR)

Losses are recorded at estimated amounts at the time they are reported and include a provision for expenses associated with claim settlements. Insurance claims are expensed as incurred over the period of coverage. The Office establishes an unpaid claim liability for claims in the process of review, and for IBNR claims. The liability for IBNR claims is actuarially estimated based on the most current historical claims experience of previous payments, changes in number of members and participants, inflation, award trends, and estimates of health care trend (cost, utilization and intensity of services) changes. Estimates of liabilities for incurred claims are continually reviewed and revised as changes in these factors occur and revisions are reflected in the current year's operating statement in the applicable claims expense. The liability is reported net of estimated receivables for salvage subrogation and reinsurance for the Insurance Reserve Fund. Claims payable and the related expense have been reduced by reinsurance recoveries receivable for claims paid and for estimated receivables for claims to be paid of approximately $4,200,000 and $6,100,000 as of June 30, 2001 and 2000, respectively. Amounts for allocated and unallocated claims adjustment expenses have been included in the calculation of IBNR.

Claim costs for basic group life and long-term disability coverages are actuarially calculated using the one-year term cost method; the cost of coverage is the present value of all benefit payments that will be made on expected claims incurred during the year following the valuation date. Claim liabilities are equal to the present value, as of the valuation date, of all future payments to be made for disabilities and deaths up to that date. Actuarial assumptions include an interest rate of 5.75% and 5.50% for 2001 and 2000, compounded annually.

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

Claims Payable-Insurance Reserve Fund

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

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

Claims payable in the Health, Life, and Disability Insurance Reserve Fund represents claims related to health claims, dental claims, and State Life and Long-Term Disability claims payable at June 30. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Health, Life, and Disability Insurance Reserve Fund.

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for unused sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances which commenced on or before June 30, 2001. The Office calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in each applicable internal service fund. The net change in the liability is recorded in the current year in the applicable fund's administration account.

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

Fund Equity

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

Budget Policy

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

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

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

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

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

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

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

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

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

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

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

- Phase 3 governments with total annual revenues less than $10 million should implement this Statement in financial statements for periods beginning after June 15, 2003.

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

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

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

2. Budgetary Reporting Basis

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

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

The following schedule reconciles the differences:

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

3. Other Budgeted Funds

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

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

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

4. Investments and Deposits

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

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

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

4. Investments and Deposits (Continued)

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

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

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

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

The accounts classified as investments in the financial statements comprise investments held for the Office and the State of South Carolina which are legally restricted and earnings thereon become revenue of the specific fund from which the investment was made. These investments are specific, identifiable investment securities, some of which may be included in one of the State Treasurer's investment pools.

4. Investments and Deposits (Continued)

The investment types listed above include all investment types in which monies were held as long-term investments throughout the fiscal year. For all investment classifications reported above, the balances therein fluctuated minimally in excess of the year-end balances throughout the years ended June 30, 2001 and 2000. As discussed in *Note 1*, GASB Statement Number 31 required investments reported at fair value. Therefore, gains and losses recognized due to market fluctuations are recognized as income on deposits and investments.

In accordance with State Law, the IRF and the HLDIRF may invest in a variety of instruments including obligations of the United States and its agencies and securities fully guaranteed by the United States, certain corporate obligations, certain shares of Federal savings and loan associations and State chartered savings and loan associations, and collateralized repurchase agreements. All investments are required to be insured or registered, or held by the State or its agent in the name of the State Treasurer as custodian.

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

(1) Insured or registered, or securities held by the government or its agent in the government's name.

(2) Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the government's name.

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

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

All deposits with financial institutions are required to be insured or collateralized with securities held by the State or its agent in the State Treasurer's name as custodian. At June 30, 2001 and 2000, all State Treasurer bank balances were fully insured or collateralized with securities held by the State or by its agents in the State's name.