

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

---

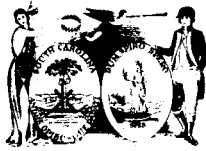
AUDITED FINANCIAL STATEMENTS

---

YEAR ENDED JUNE 30, 2003

WITH  
REPORT OF INDEPENDENT AUDITORS

State of South Carolina



Office of the State Auditor

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

THOMAS L. WAGNER, JR., CPA  
STATE AUDITOR

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

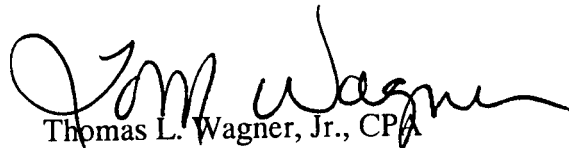
October 20, 2003

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, 2003, 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,

  
Thomas L. Wagner, Jr., CPA  
State Auditor

TLWjr/trb

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

---

AUDITED FINANCIAL STATEMENTS

---

YEAR ENDED JUNE 30, 2003

WITH

REPORT OF INDEPENDENT AUDITORS

**CONTENTS**

Report of Independent Auditors .....	1
Management's Discussion and Analysis .....	3
<b>Basic Financial Statements</b>	
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
<b>Independent Auditors' Report on Internal Control</b>	
Independent Auditors' Report on Internal Control.....	49

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

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

**REPORT OF INDEPENDENT AUDITORS**

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

We have audited the accompanying 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, 2003, 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, 2003 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.

The Fund has incurred significant decreases in net assets over the past two years. These losses have reduced the net assets of the Fund by approximately \$94 million resulting in net assets of \$88,094,444 at June 30, 2003.

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, 2003, 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.

We also audited the adjustments described in *Note 15* that were applied to restate the 2002 financial statements. In our opinion, such adjustment is appropriate and has been properly applied.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2003, 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.

*Rebeck & Williamson, L.L.P.*

September 26, 2003

## **Management's Discussion & 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, 2003. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

This is the second year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements and Managements Discussion and Analysis for State and Local Governments. The financial statement presentation required by GASB Statement 34 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, 2003 by \$88,094,444;
- IRF's net assets decreased by \$73,858,570 or 46.0 percent;
- IRF experienced an operating loss of \$40,864,622.

### **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, 2003 (in millions)**

	<b>June 30,</b>	
	<b>2003</b>	<b>2002</b>
Current assets	\$ 115.2	\$ 124.3
Non-current assets	209.8	250.8
Total assets	325.0	375.1
Current liabilities	236.7	212.9
Non-current liabilities	0.2	0.2
Total liabilities	236.9	213.1
Net assets:		
Investment in capital assets	0.1	0.1
Restricted for loan	20.0	20.0
Unrestricted	68.0	141.9
Total net assets	<u>\$ 88.1</u>	<u>\$ 162.0</u>

Net assets may serve over time as a useful indicator on an entity's financial position. Assets exceeded liabilities by \$161,953,014 at the close of the fiscal year ended June 30, 2002 and assets exceeded liabilities by \$88,094,444 at the close of fiscal year ended June 30, 2003.

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, 2003  
(in millions)**

	<b>For the Fiscal Year Ended June 30,</b>	
	<b>2003</b>	<b>2002</b>
Operating revenue		
Insurance premiums	\$ 66.4	\$ 58.4
Total operating revenue	66.4	58.4
Operating expenses		
Reinsurance premiums	30.0	23.3
Premiums	0.2	0.1
Claims	54.8	57.2
Administrative	22.3	19.5
Total operating expenses	107.3	100.1
Operating income (loss)	(40.9)	(41.7)
Non-operating revenue		
Income from deposits and investments	16.4	18.8
Notes receivable interest	1.4	1.6
Loss before transfers	(23.1)	(21.3)
Transfers (to) from State Agencies and other	(50.8)	0.8
Change in net assets	(73.9)	(20.5)
Net assets, beginning of the year	162.0	182.5
Net assets, end of the year	<u>\$ 88.1</u>	<u>\$ 162.0</u>

In Fiscal Year 01-02, IRF reduced premiums by implementing a significant rate decrease. Operating expenses for claims (and claims expenses) and reinsurance increased and non-operating income from deposits and investments decreased.

IRF also experienced two property losses totaling \$1.3 million and two very unusual liability losses totaling approximately \$8 million during Fiscal Year 01-02.

In 1999, IRF amended the hourly rate paid to defense attorneys and this revised schedule was applicable to new cases. IRF has experienced a steady growth in legal defense costs over a three year period due to this revision of rates. By the end of Fiscal Year 01-02 nearly all cases were utilizing the amended schedule, therefore, the growth in legal defense costs due to this rate change has stabilized.

In Fiscal Year 02-03, IRF incurred a number of collapse claims involving Fire Resistive Treated Wood. These claims will exceed \$20 million. All Fire Resistive Treated Wood structures have been identified through a statewide inspection process and there should be no further claims. Subrogation is underway and prospects for some recovery are favorable.

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

**Statement of Cash Flows**  
(in millions)

	<b>Fiscal Year Ended June 30,</b>	
	<b>2003</b>	<b>2002</b>
Cash Flows from Operating Activities	\$ (49.5)	\$ (33.6)
Cash Flows from Noncapital Financing Activities	(22.9)	0.7
Cash Flows from Investing Activities	60.4	36.2
Net increase (decrease) in cash and cash equivalents	(12.0)	3.3
Cash and cash equivalents, beginning of year	95.7	92.4
Cash and cash equivalents, end of year	<u>\$ 83.7</u>	<u>\$ 95.7</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.

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

### **Reorganization**

In early 2002, the South Carolina Budget & Control Board reorganized the reporting authority of the Fund. This reorganization, however, did not become effective from an accounting and budgetary basis until July 1, 2002. In this reorganization, the IRF was transferred to the Division of Insurance and Grants Services.

### **Contact Information**

Questions related to the Management Discussion & Analysis and the accompanying financial statements should be directed to Rick Smith, Chief Financial Officer, @ 737-0020.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF NET ASSETS

JUNE 30, 2003

**Assets**

Current assets:

Cash and cash equivalents	\$ 83,698,102
Premiums receivable (Note 3)	11,859,704
Reinsurance recovery receivable	1,496,682
Current portion of notes receivable (Note 4)	3,856,760
Accrued interest	3,170,275
Prepaid insurance	11,118,172
Total current assets	<u>115,199,695</u>

Non-current assets:

Investments (Note 2)	191,082,064
Long-term notes receivable (Note 4)	18,579,131
Capital assets, net of accumulated depreciation (Note 5)	122,909
Total non-current assets	<u>209,784,104</u>

Total assets

324,983,799

**Liabilities**

Current liabilities:

Accounts payable	421,441
Accrued payroll	226,407
Claims payable	135,704,266
Deferred premium revenue	29,096,994
Claims incurred but not reported	71,180,325
Accrued compensated absences-current portion (Note 16)	47,591
Total current liabilities	<u>236,677,024</u>

Long term liabilities:

Contingencies (Note 12)	212,331
Accrued compensated absences-long term (Note 16)	212,331
Total long-term liabilities	<u>212,331</u>

Total liabilities

236,889,355

**Net assets**

Investment in capital assets	122,909
Restricted for:	
Savannah Valley Development Loans (Note 7)	20,000,000
Unrestricted	67,971,535
Total net assets	<u>\$ 88,094,444</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, 2003

**Operating Revenue**

Insurance premiums:

Tort liability	\$ 14,931,857
Auto, School Bus, and Inland Marine	9,317,290
Professional liability	4,367,931
Comprehensive and collision	2,074,499
Fire	4,206,648
Extended coverage	3,607,975
Premiums redirected to State General Fund	27,900,000

Total operating revenues

66,406,200

**Operating Expenses**

Reinsurance premiums	29,989,312
Premiums	206,606
Claims:	
Tort liability	21,079,910
Auto, School Bus, and Inland Marine	4,371,094
Fire	4,096,623
Extended coverage	15,373,469
Hospitals and physicians	9,058,139
Other	795,268
Salaries and benefits	3,026,617
Professional services	18,272,020
Telephone and utilities	47,576
Supplies	322,782
Other services	546,545
Printing and publication	14,826
Postage and shipping	22,990
Depreciation	47,045

Total operating expenses

107,270,822

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF REVENUE, EXPENSES,  
AND CHANGES IN NET ASSETS

(CONTINUED)

Operating loss	(40,864,622)
Non-operating revenue (expense):	
Income from deposits and investments <i>(Note 2)</i>	16,402,005
Notes receivable interest	1,440,183
Other non-operating revenue	1,050
Loss on disposal of assets	<u>(216)</u>
Loss before transfers	(23,021,600)
Transfers to other State Agencies <i>(Note 11)</i>	<u>(50,836,970)</u>
Change in net assets	(73,858,570)
Net assets, beginning of year, as restated <i>(Note 15)</i>	<u>161,953,014</u>
Net assets, end of year	<u><u>\$ 88,094,444</u></u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2003

**Cash Flows from Operating Activities**

Insurance premiums from customers	\$ 35,586,876
Payments to employees	(2,816,269)
Payments to suppliers/claimants	(82,275,605)
Net cash flows used in operating activities	<u>(49,504,998)</u>

**Cash Flows from Capital and Related Financing Activities**

Purchase of fixed assets	(24,269)
Proceeds from disposal of fixed assets	5
Net cash used in capital and related financing activities	<u>(24,264)</u>

**Cash Flows from Non-Capital Financing Activities**

Transfers to other state agencies	(22,936,970)
Other non-operating receipts	1,050
Net cash used in non-capital financing activities	<u>(22,935,920)</u>

**Cash Flows from Investing Activities**

Principal payments received on notes receivable	958,875
Funds disbursed as notes receivable	(1,339,175)
Purchases of investments	(103,620,082)
Proceeds from sales and maturity of investments	148,803,719
Interest received-deposits and investments	14,162,991
Interest received-notes receivable	1,411,941
Net cash provided by investing activities	<u>60,378,269</u>

Net decrease in cash and cash equivalents	(12,086,913)
Cash and cash equivalents, beginning of year	95,785,015
Cash and cash equivalents, end of year	<u>\$ 83,698,102</u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

(CONTINUED)

**Reconciliation of operating loss to net cash**

**used in operating activities**

Operating loss	\$ (40,864,622)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	47,045
Premiums redirected to State General Fund	(27,900,000)
Change in assets-(increase) decrease:	
Premiums receivable	(5,222,241)
Reinsurance recovery receivable	1,359,414
Prepaid insurance	(675,760)
Change in liabilities-increase (decrease):	
Accounts payable, accrued payroll and compensated absences	(432,299)
Deferred premium revenue	2,302,917
Claims payable and claims incurred but not reported	21,880,548
Net cash used in operating activities	<u><u>\$ (49,504,998)</u></u>

**Supplemental Information**

Transfer of premium revenue to other State Agency	<u><u>\$ 27,900,000</u></u>
Reduction in investments for amortization and accretion	<u><u>\$ 127,718</u></u>
Net (appreciation)/depreciation of investments	<u><u>\$ (4,456,340)</u></u>
Disposal of fixed assets	<u><u>\$ 216</u></u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003

**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. Effective July 1, 2002, 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, automobile liability insurance, and medical professional liability insurance. The Insurance Reserve Fund collects premiums from participating entities, issues policies, and pays claims incurred under the policies from accumulated premiums and earnings on investments and notes receivable. The premium rates are determined actuarially and approved by the South Carolina Budget and Control Board. The Insurance Reserve Fund allocates the costs of providing claims servicing and claims payments by charging each participant a premium. Interest income is considered in the premium rate setting process.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
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 are 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 2-10 years. A full year of depreciation is taken the year the asset is placed in service and no depreciation is taken in the year of disposition. 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 \$5,100,000 as of June 30, 2003. 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 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. 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.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**2. Investments and Deposits (Continued)**

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

- (1) Insured or registered in the agency's name, or securities held by the agency or its agent in the agency's name.
- (2) Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the agency's name.
- (3) Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the agency's name.

At June 30, 2003, all of the Fund's long-term investments were in Category (1).

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, 2003.

	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value
U. S. Treasury obligations	\$ 19,870,903	\$ 6,467,441	\$ -	\$ 26,338,344
U. S. Government agencies securities	27,838,936	566,388	-	28,405,324
Collateralized mortgage-backed obligations	3,683,880	261,082	-	3,944,962
SC State political subdivision bonds	7,959,460	200,852	-	8,160,312
Repurchase agreement	83,965,000	-	-	83,965,000
Corporate bonds	64,447,194	5,455,610	(118,314)	69,784,490
Financial paper	52,135,959	2,312,673	-	54,448,632
Total	<u>\$ 259,901,332</u>	<u>\$ 15,264,046</u>	<u>\$ (118,314)</u>	<u>\$ 275,047,064</u>

At June 30, 2003, the amortized cost of the above investments was comprised of the following:

	Par Value	Unamortized Premiums	Unaccreted Discounts	Amortized Cost
U. S. Treasury obligations	\$ 20,285,000	\$ 13,087	\$ (427,184)	\$ 19,870,903
U. S. Government agencies securities	28,100,000	113,296	(374,360)	27,838,936
Collateralized mortgage-backed obligations	3,772,131	-	(88,252)	3,683,879
SC State political subdivision bonds	7,959,916	-	(456)	7,959,460
Repurchase agreement	83,965,000	-	-	83,965,000
Corporate bonds	64,785,479	522,560	(860,844)	64,447,195
Financial paper	51,814,307	632,929	(311,277)	52,135,959
Total	<u>\$ 260,681,833</u>	<u>\$ 1,281,872</u>	<u>\$ (2,062,373)</u>	<u>\$ 259,901,332</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**2. Investments and Deposits (Continued)**

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

The investment types listed above include all investment types in which monies were held as long-term investments throughout the fiscal year. For all investment classifications reported above, the balances therein fluctuated minimally in excess of the year-end balances throughout the year ended June 30, 2003. 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. The Fund held no short-term investments at June 30, 2003. Short-term investments held during the fiscal year 2003 consisted of U.S. Government agency and government-insured securities whose amortized cost approximates fair value at June 30, 2003.

The investment types listed above include all investment types in which monies were held throughout the year ended June 30, 2003. Due to higher cash flows at certain times during the year, the Fund's investment in repurchase agreements and short-term investments fluctuated significantly. The maximum amounts held in these classifications during the year ended June 30, 2003, were as follows:

Short-term investments	<u>\$ 19,000,000</u>
Repurchase agreements	<u><u>\$ 95,120,000</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**2. Investments and Deposits (Continued)**

Deposits

The Fund's deposits are categorized to give an indication of the level of risk assumed by the Fund 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 deposits if the depository financial institution fails or to recover the value of collateral securities that are in the possession of an outside party if the counterparty to the deposit transaction fails. The three categories of credit risk are:

1. Insured or collateralized with securities held by the agency or by its agent in the agency's name.
2. Collateralized with securities held by the pledging financial institution's trust department or agent in the agency's name.
3. Uncollateralized or collateralized with securities held by the pledging financial institution's trust department or agent but not in the agency's name.

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, 2003.

Deposits held by Third Party Administrators	\$ 203,854
Cash held by the South Carolina State Treasurer's Office	<u>(470,752)</u>
	<u><u>\$ (266,898)</u></u>

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 deposits held by third party administrators are classified at June 30, 2003 as category 3.

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:

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

Interest earned	\$ 12,771,383
Accretion of discount	808,626
Amortization of premium	(936,344)
Realized gains (losses)	(698,000)
Change in unrealized gains (losses)	4,456,340
	<u>\$ 16,402,005</u>

	<u>Statements</u>	<u>Note Disclosure</u>
Cash and cash equivalents	\$ 83,698,102	\$ -
Deposits held by Third Party Administrator	-	203,854
Held by the State Treasurer:		
Cash	-	(470,752)
Specifically identified investments	-	275,047,064
Investments	191,082,064	-
Total	<u>\$ 274,780,166</u>	<u>\$ 274,780,166</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**3. Premiums Receivable**

Premiums receivable at June 30, 2003, consist of the following:

Local government	\$ 8,093,030
State government ( <i>Note 11</i> )	3,235,856
Other	530,818
	<hr/> <u>\$ 11,859,704</u>

Premiums receivable and deferred premium revenue include approximately \$8,475,000 attributable to premiums billed in advance of coverage as of June 30, 2003.

As of June 30, 2003, 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, 2003.

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, 2003, consist of the following:

**Due from Department of Commerce**

One note in the principal amount of \$3,500,000 with an unstated interest rate; maturity date is March 1, 2004.	\$ 3,500,000
---	--------------

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

Three notes, due in annual installments, including interest from 5.5% to 8%; range of maturity 2004 to 2009.	834,281
--	---------

**Due from South Carolina Grain Dealers Guaranty Fund administered by the South Carolina Department of Agriculture**

One note in the principal amount of \$3,500,000 with interest at 8.75%; maturity date is October 24, 2005.	607,793
--	---------

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

One note in the principal amount of \$2,500,000 with interest at 8%; maturity date is January 31, 2022.	1,500,710
---	-----------

One note in the principal amount of \$121,239 with interest at 8%; maturity date is January 31, 2022.	121,239
---	---------

One note in the principal amount of \$1,227,733 with interest at 8%; maturity date is January 31, 2023.	1,227,733
---	-----------

One note in the principal amount of \$22,690,812 with interest at 8%; maturity date is January 31, 2024.	2,690,812
--	-----------

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Notes Receivable (Continued)**

One note in the principal amount of \$1,260,186 with interest at 8%; maturity date is January 31, 2024.	1,260,186
One note in the principal amount of \$1,569,410 with interest at 8%; maturity date is January 31, 2024.	1,569,410
One note in the principal amount of \$1,730,361 with interest at 8%; maturity date is January 31, 2027.	1,730,361
One note in the principal amount of \$1,139,070 with interest at 8%; maturity date is January 31, 2028.	1,139,070
One note in the principal amount of \$2,423,517 with interest at 8%; maturity date is January 31, 2029.	2,423,517
One note in the principal amount of \$1,224,262 with interest at 8%; maturity date is January 31, 2030.	1,224,262
One note in the principal amount of \$606,517 with interest at 8%; maturity date is January 31, 2031.	606,517

**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	22,435,891
Less current portion	(3,856,760)
Total	<u><u>\$ 18,579,131</u></u>

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.

	<b>Balance July 1, 2002</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2003</b>
Furniture and equipment	\$ 341,041	\$ 24,269	\$ (2,206)	\$ 363,104
Accumulated depreciation	(195,135)	(47,045)	1,985	(240,195)
Capital assets, net	<u>\$ 145,906</u>	<u>\$ (22,776)</u>	<u>\$ (221)</u>	<u>\$ 122,909</u>

Depreciation expense for the year ended June 30, 2003, was \$47,045.

**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, 2001, and now expires June 30, 2005. Rental expense under this lease for the year ended June 30, 2003 was \$420,973.

The following schedule summarizes the Fund's obligations under operating leases having remaining terms in excess of one year as of June 30, 2003:

<b>Fiscal Year Ending June 30,</b>	<b>Total</b>
2004	\$ 365,634
2005	365,634
Total	<u>\$ 731,268</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**6. Lease Obligations (Continued)**

The Fund has also entered into an operating lease from a party outside the state government which will expire in 2004 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, 2003, expenses under these leases were approximately \$8,749.

**7. Restricted Net Assets – Savannah Valley Development Program**

At June 30, 2003, \$20,000,000 of the Fund's net assets are 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, 2003, \$15,493,817 was outstanding.

**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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**8. Pension Plans (Continued)**

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.

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. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**8. Pension Plans (Continued)**

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. For the year ended June 30, 2003, the employer contribution rate was 7.55 percent (before a surcharge to fund retiree health and dental insurance coverage). The Fund's actual contributions to the SCRS for the year was approximately \$255,000, and equaled the required contributions (excluding the surcharge) of 7.55 percent. Also, the Fund paid employer group-life insurance contributions at the rate of 0.15 percent of compensation for the year ended June 30, 2003.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Post-Employment and Other Employee Benefits**

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the 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 requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

These benefits are provided through annual appropriations by the General Assembly to the Fund for its active employees and to the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable sources of the 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 20,100 State retirees meet these eligibility requirements.

The Fund recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$181,000 for the year ended June 30, 2003. As discussed in *Note 8*, the Fund paid approximately \$75,000 for the year ended June 30, 2003, applicable to the surcharge included with the employer contributions for retirement benefits (3.15% for 2003).

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

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**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.

The State authorized deferred compensation matching contributions for fiscal year 2002-2003. The contributions are funded from various funding sources based on the same percentages used for employees' salaries. The State appropriated funds for the portion of contributions paid from State General Funds to 401(k) accounts of eligible state employees. The 401(k) match is limited to \$300. To be eligible, an employee must be a permanent full-time state employee or temporary grant employee who is actively contributing to a 401(k), 457 or 403(b) account on the date of distribution. Permanent full-time employees making less than \$20,000 as of July 1, 2000, are not required to contribute in order to receive the match.

This Fund made no contributions for the fiscal year ending June 30, 2003.

**11. Transactions with State Entities**

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

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.

The following details the insurance premiums billed by the Fund to other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2003:

Senate	\$ 61,084
House of Representatives	66,484
Legislative Council	2,127
Legislative Printing and Archives	6,179
Legislative Audit Council	2,481
Education Oversight Commission	1,274
Board of Magistrates	45,288
Administrative Law Judges	1,478
Law Enforcement Division	546,577
Governor's Office	141,240
Governor's Office-Mansion & Grounds	16,733
Lt Governor's Office	861
Secretary of State	5,736
Comptroller General's Office	15,524
State Treasurer's Office	8,296
Attorney General's Office	16,596
Commission on Prosecution Coordination	6,725
Appellate Defense Commission	1,757
Adjutant General of South Carolina	120,827
State Election Commission	3,604
SC Budget and Control Board-Office of General Services	1,252,149
State Auditor's Office	8,742
Commission on Higher Education	12,020
Higher Education Tuition	913
The Citadel	292,736
Clemson University	2,349,643
College of Charleston	584,322

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

Coastal Carolina University	386,055
Francis Marion University	160,434
Lander University	195,948
SC State University	197,047
University of South Carolina	1,664,566
USC-Aiken County	30,415
Bucksport Water System	5,621
USC-Spartanburg	42,474
USC-Beaufort Campus	19,565
USC-Lancaster Campus	16,138
USC-Salkehatchie	14,543
USC-Sumter Campus	12,083
Winthrop University	246,421
Medical University of SC	3,085,064
Tri-County Technical College	900,879
Greenville Technical College	96,157
Central Carolina Technical College	26,678
Midlands Technical College	67,884
Spartanburg Technical College	36,812
Trident Technical College	932
Piedmont Technical College	52,359
Horry-Georgetown Technical College	43,275
Northeastern Technical College	19,429
Williamsburg Technical College	8,657
Aiken Technical College	22,888
Denmark Technical College	15,610
Collaboration Office	3,196,663
Educational Television	177,739
Wil Lou Gray Opportunity School	32,423
Vocational Rehabilitation Department	230,980
SC School for the Deaf and Blind	124,337
Archives & History Department	8,520
SC State Library	34,764
Arts Commission	17,965
State Museum Commission	21,924
Health and Human Services Finance	173,146
Department of Health & Environmental Control	1,094,959

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

Aiken County Mental Health	1,451,434
Disabilities & Special Needs Department	538,203
Anderson-Oconee Pickens	7,088
County Transportation Committee	546
Santee-Wateree Area	4,461
Newberry Disabilities & Special Needs	36,058
Lee County Disabilities & Special Needs	28,222
Laurens County Disabilities & Special Needs	51,452
Williamsburg County Disabilities & Special Needs	9,337
Anderson County Disabilities & Special Needs	54,457
Beaufort County Disabilities & Special Needs	605
Charleston Naval Complex	146,526
Protection and Advocacy, SC	7,587
The Hunley Commission	21,379
SC High School League	6,670
Alcohol & Other Drug Abuse Services	20,499
Public Safety Department	870,696
Charleston County Department of Social Services	331,574
John De La Howe School	52,339
Blind Commission	53,736
State Housing Finance and Development Authority	24,699
Commission on Human Affairs	6,128
State Commission on Minority Affairs	3,510
Department of Corrections	2,249,880
Probation, Parole & Pardon Services	79,494
Department of Juvenile Justice	601,505
Forestry Commission	207,176
Agriculture Department	55,061
Department of Natural Resources	693,635
SC Sea Grant Consortium	5,181
Parks Recreation & Tourism	430,384
Commerce Department-Tangent	22,142
Commerce Department-Aeronautics	93,208
Business Carolina	3,569
Patriots Point Development Authority	57,243

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

Old Exchange Building Commission	4,348
Public Service Commission	21,982
SC Worker's Compensation Commission	10,006
State Accident Fund	17,965
Medical Malpractice Patients	9,631
Second Injury Fund	2,864
SC Department of Insurance	8,595
State Board of Financial Institutes	6,801
Consumer Affairs	3,380
Labor, Licensing and Regulation	87,356
Revenue & Taxation Department	112,258
Employment Security Commission	84,679
Transportation Department	5,409,211
SC Transportation Infrastructure Bank	2,642
SC Public Service Authority	147,815
	<hr/>
	\$ 32,207,967

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

Premiums owed from these entities at June 30, 2003 were:

Arts Commission	\$ 8,394
Berkeley County Mental Health	2,436
Clemson University	1,156,206
Coastal Regional Center	506
College of Charleston	357
Commerce Department-Aeronautics	34,518
County Transportation Committee	728
Department of Commerce	85
Department of Corrections	1,040,424
Department of Health & Environmental Control	187
Department of Health and Human Services	3,134
Department of Juvenile Justice	276,906
Department of Natural Resources	59,758
Department of Revenue & Taxation	62,671
Department of Transportation	232
Division of General Services	1,023
Education Department	143
Florence-Darlington Technical College	40,011
Forestry Commission	236
Labor, Licensing, and Regulation	18
Lander University	98,151
Law Enforcement Division	266,005
Lee County Disabilities & Special Needs	247
Lt Governor's Office	861
Medical Malpractice Patients	4,634
Medical University of South Carolina	48,771
Mental Health Department	459
Patriots Point Development Authority	5
Piedmont Center	5,779
Public Service Commission	10,338
SC State Library	15,670

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

SC Budget & Control Board-Internal Operations	885
SC Budget & Control Board-SC Retirement System	14,979
SC Budget & Control Board-State Energy Office	2,509
SC Budget & Control Board-Office of General Services	2,376
SC Budget & Control Board-Research & Statistics	35
SC Sea Grant Consortium	2,582
SC State University	190
Spartanburg Technical College	2,761
State Auditor's Office	8,742
State Museum Commission	330
Technical College of the Lowcountry	20,393
Tri-County-Mental Health Center	6,755
Trident Technical College	3,167
University of South Carolina	21,553
Williamsburg County Disabilities & Special Needs	4,668
York Technical College	5,038
	<hr/>
	\$ 3,235,856
	<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 (*Note 8*) and insurance plans contributions, (*Note 9*) vehicle rental, surplus property disposal fees, office supplies, printing, and telephone, interagency mail, data processing services, purchasing, record maintenance, internal audit and personnel services. Significant payments were also made for unemployment and workers' compensation coverage for employees to other agencies. The amounts of 2003 expenses applicable to related party transactions not disclosed elsewhere are approximately:

SC Budget & Control Board-Internal Operations	\$ 161,786
SC Budget & Control Board-Legal Services	272,784
SC Employment Commission	2,452
SC Accident Fund	6,410

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Transactions with State Entities (Continued)**

Services received at no cost include payroll processing, disbursement processing and maintenance of certain accounting records from the Comptroller General; check preparation, banking and investment functions from the State Treasurer; and legal services from the Attorney General.

The following services are received from other Divisions (Offices) of the South Carolina State Budget and Control Board at no charge:

Division of Operations  
Record storage  
Internal audit

In addition, transfers to other State Agencies include the following:

Budget Proviso 72.97	\$ 22,937,800
Budget Proviso 72.98	<u>27,899,170</u>
State of South Carolina General Fund	<u><u>\$ 50,836,970</u></u>

**12. 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. 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. 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.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Risk Management/Reinsurance (Continued)**

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.

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, 2003, based on the requirements of GASB 10 because information at June 30 did not indicate that an asset had been impaired or a liability had been incurred. GASB 10 states that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30 and the amount of loss is reasonably estimable.

The Insurance Reserve Fund purchases insurance and reinsurance and separately reports the related reinsurance premium and premium expenses. Insurance is purchased to cover risks where the Insurance Reserve Fund has limited expertise (aircraft insurance and ocean marine insurance). Reinsurance is purchased to limit the Insurance Reserve Fund's liability for catastrophic loss (property reinsurance and medical professional liability reinsurance), to obtain specialized engineering services (boiler and machinery reinsurance), or to obtain services for which the Insurance Reserve Fund is not adequately staffed (automobile liability reinsurance).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Risk Management/Reinsurance (Continued)**

The Insurance Reserve Fund self insures Tort Liability Insurance, Automobile Physical Damage Insurance, and the self insured retention for Property, Medical Professional Liability, and Boiler and Machinery Insurance.

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

Property-\$2,000,000 per location/\$10,000,000 per occurrence

Medical malpractice-\$250,000 for claims incurred prior to November 2002, \$550,000 thereafter

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**14. Reconciliation of Claims Liabilities by Fund**

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

	<b>2003</b> <b>(in thousands)</b>	<b>2002</b> <b>(in thousands)</b>
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 185,003	\$ 168,243
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	34,418	31,903
Increases (decreases) in provision for insured events of prior fiscal years	17,334	25,339
Total incurred claims and claim adjustment expenses	51,752	57,242
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	9,971	2,143
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	19,900	38,339
Total payments	29,871	40,482
Total unpaid claims and claim adjustment expenses at end of the fiscal year	<u>\$ 206,884</u>	<u>\$ 185,003</u>
The above totals are comprised of the following:		
Claims payable	\$ 135,704	\$ 122,488
Claims incurred but not reported	71,180	62,515
Total	<u>\$ 206,884</u>	<u>\$ 185,003</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**15. Restatement**

As a result of the Proviso 72.98 requiring the Fund to provide a non-recurring “premium savings” to all State agencies, the deferred premium revenue as of June 30, 2002 was overstated. Deferred premium revenue results from premiums billed prior to the effective date of the coverage or payments received in advance of coverage. When premiums are billed, a receivable is recognized resulting in an increase in the revenue. At the end of a period, deferred premium revenue is recognized by reducing premium revenue and increasing the liability account. As of June 30, 2002, a portion of the premiums billed were subject to proviso 72.98 resulting in that portion being excluded from the entry to recognize a receivable and revenue. When the deferred premium revenues calculation as of June 30, 2002 was performed, it ignored the effect of Proviso 72.98 reducing revenue for all of the premiums for which policies were written. The recording of this calculation resulted in an overstatement of deferred premium revenue and an understatement of premium revenue.

The effect of this correction of an error is the restatement of the beginning net assets as follows:

Net assets, July 1, 2002, as previously reported	\$ 157,313,490
Restatement adjustment for understated revenue	<u>4,639,524</u>
Net assets July 1, 2002, as restated	<u><u>\$ 161,953,014</u></u>

**16. Changes in Long-Term Liabilities**

Changes in long-term obligations for the year ended June 30, 2003 were as follows:

	<b>Beginning Balance July 1, 2002</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending Balance June 30, 2003</b>	<b>Due Within 1 Year</b>
Compensated absences payable	<u>\$ 257,966</u>	<u>\$ 31,935</u>	<u>\$ (29,979)</u>	<u>\$ 259,922</u>	<u>\$ 47,591</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**17. Decrease in Net Assets**

Over the past two years, the Fund has incurred significant decreases in net assets. Part of the decline is attributable to operational deficits and part is attributable to transfers to other State Agencies. For example, during fiscal year 2003, the Fund incurred losses from operations of \$40,864,622. After consideration of non-operating revenue and expenses, the Funds loss before transfers was \$23,021,600. Additionally, the Fund was required to transfer to the State of South Carolina General Fund a total of \$50,836,970. All of these factors led to a decrease in net assets of \$73,858,570.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

**DeLOACH & WILLIAMSON, L.L.P.**

**CERTIFIED PUBLIC ACCOUNTANTS**

1401 MAIN STREET, SUITE 660  
COLUMBIA, SOUTH CAROLINA 29201

PHONE: (803) 771-8855

FAX: (803) 771-6001

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL**

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

Dear Mr. Wagner:

We have audited the basic 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, 2003, and have issued our report thereon dated September 26, 2003. 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.

**Compliance**

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 grants, 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 that are required to be reported under *Government Auditing Standards*.

## **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions identified are as follows:

Over the past two years, the Fund has incurred significant decreases in net assets. Part of the decline is attributable to operational deficits and part is attributable to transfers to other State Agencies. For example, during fiscal year 2003, the Fund incurred losses from operations of \$40,864,622. After consideration of non-operating revenue and expenses, the Fund's loss before transfers was \$23,021,600. Additionally, the Fund was required to transfer to the State of South Carolina General Fund a total of \$50,836,970. All of these factors led to a decrease in net assets of \$73,858,570.

We recommend that the management of the Fund review this situation and take steps to return the Fund to profitable operations.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

\* \* \* \* \*

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

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

*Deborah S. Williamson, C.C.P.*

September 26, 2003