

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

---

AUDITED FINANCIAL STATEMENTS

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YEAR ENDED JUNE 30, 2005

WITH  
REPORT OF INDEPENDENT AUDITORS

State of South Carolina



Office of the State Auditor

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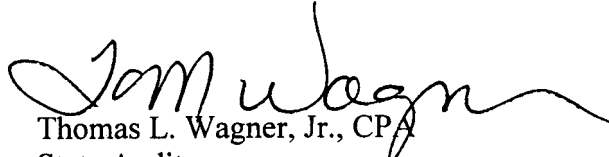
October 5, 2005

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, 2005, 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  
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AUDITED FINANCIAL STATEMENTS

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YEAR ENDED JUNE 30, 2005

WITH

REPORT OF INDEPENDENT AUDITORS

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# DELOACH & WILLIAMSON, L.L.P.

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### 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, 2005, 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, 2005 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.

As discussed in *Note 16*, the Fund has incurred significant decreases in net assets over the past three years. These losses have reduced the net assets of the Fund by approximately \$119 million resulting in net assets of \$29,992,100 at June 30, 2005. See *Note 16* for additional information.

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, 2005, and the results of operations and cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2005, 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.

*DeLoach & Williamson, L.L.P.*

September 23, 2005

## **MANAGEMENT DISCUSSION AND ANALYSIS**

This section of the South Carolina State Budget and Control Board, Insurance Reserve Fund (IRF) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of IRF's financial performance during the fiscal year ended June 30, 2005. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

This is the fourth 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, 2004 by \$29,992,100;
- IRF's net assets decreased by \$3,333,259 or 10 percent;
- IRF experienced an operating loss of \$14,888,726.

### **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, 2005 (In millions)**

|                              | <u>June 30, 2005</u> | <u>June 30, 2004</u> |
|------------------------------|----------------------|----------------------|
| Current assets               | \$ 130.8             | \$ 59.2              |
| Non-current assets           | <u>204.8</u>         | <u>255.1</u>         |
| Total assets                 | 335.6                | 314.3                |
|                              |                      |                      |
| Current liabilities          | 305.3                | 280.7                |
| Non-current liabilities      | <u>0.3</u>           | <u>0.3</u>           |
| Total liabilities            | 305.6                | 281.0                |
|                              |                      |                      |
| Net assets:                  |                      |                      |
| Investment in capital assets | 0.1                  | 0.1                  |
| Restricted for loans         | 20.0                 | 20.0                 |
| Unrestricted                 | <u>9.9</u>           | <u>13.2</u>          |
| Total net assets             | <u>\$ 30.0</u>       | <u>\$ 33.3</u>       |

Net assets may serve over time as a useful indicator on an entity's financial position. Assets exceeded liabilities by \$33,325,359 at the close of the fiscal year ended June 30, 2004 and assets exceeded liabilities by \$29,992,100 at the close of fiscal year ended June 30, 2005.

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, 2005  
(In millions)**

|                                       | <u>2005</u>    | <u>2004</u>    |
|---------------------------------------|----------------|----------------|
| Insurance premiums                    | \$ 81.2        | \$ 53.4        |
| Total operating revenue               | <u>81.2</u>    | <u>53.4</u>    |
| Operating expenses                    |                |                |
| Reinsurance premiums                  | 26.2           | 28.8           |
| Premiums                              | 0.2            | 0.2            |
| Claims                                | 42.1           | 65.1           |
| Administrative                        | <u>27.6</u>    | <u>22.4</u>    |
| Total operating expenses              | <u>96.1</u>    | <u>116.5</u>   |
| Operating income (loss)               | (14.9)         | (63.1)         |
| Non-operating revenue                 |                |                |
| Income from deposits and investments  | 10.2           | 4.2            |
| Notes receivable interest             | <u>1.4</u>     | <u>1.4</u>     |
| Loss before transfers                 | (3.3)          | (57.5)         |
| Transfers to State Agencies and other | <u>0.0</u>     | <u>(0.1)</u>   |
| Change in net assets                  | (3.3)          | (57.6)         |
| Net assets, beginning of the year     | <u>33.3</u>    | <u>90.9</u>    |
| Net assets, end of the year           | <u>\$ 30.0</u> | <u>\$ 33.3</u> |

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 in fiscal year 2005 - 2006.

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



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

**Condensed Statement of Cash Flows**  
(In millions)

|  | Fiscal Year Ended<br>June 30, 2005 | Fiscal Year Ended<br>June 30, 2004 |
|--|------------------------------------|------------------------------------|
| Cash flows from Operating Activities                 | 7.5                                | \$ (18.3)                          |
| Cash flows from Noncapital Financing Activities      | (0.2)                              | ---                                |
| Cash flows from Investing Activities                 | <u>65.9</u>                        | <u>(42.4)</u>                      |
| Net increase (decrease) in cash and cash equivalents | <u>73.4</u>                        | <u>(60.7)</u>                      |
| <br>Cash and cash equivalents, beginning of year     | <br><u>23.0</u>                    | <br><u>83.7</u>                    |
| Cash and cash equivalents, end of year               | <u>\$ 96.4</u>                     | <u>\$ 23.0</u>                     |

**Overview of IRF**

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

**Economic Factors:**

By statute, IRF assets are invested by the State Treasurer in repurchase agreements, bonds (US Treasury, US Government Agency, Governmental guaranteed mortgage backed, and Corporate), and financial paper. During Fiscal Year 01-02, interest rates fell and the decline in interest rates was reflected in a decline in non-operating revenue. The September 11, 2001 terrorist attack generated major losses in the reinsurance industry and the losses triggered a major contraction in the reinsurance industry. Although IRF has been able to maintain adequate reinsurance, there has been a substantial increase in reinsurance premiums. Reinsurance rates declined slightly in fiscal year 04 – 05.

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. These provisos reduced net assets of almost \$51,000,000. The results of these two provisos had a significant financial impact on the Fund during fiscal year 2002-2003, 2003-2004, and 2004-2005.

The reduction in assets caused by Provisos 72.97 and 72.98 reduced the amount available to invest in fiscal year 2003-2004 and this reduced investment income. The effect continued through fiscal year 2004 – 2005.

IRF implemented a 45% rate increase that was effective November 1, 2004. IRF issues policies with renewal dates that are staggered throughout the year, but slightly over half of IRF's premium income is produced by policies that renew in July, August, September and October. Therefore, the rate increase did not apply to half of IRF's premium income in fiscal year 2003-2004. In fiscal year 2004-2005, the rate increase was fully implemented, increasing premium income and producing more favorable results.

### **Events Subsequent**

IRF implemented an overall 11% rate increase effective July 1, 2005. This rate increase, along with subsequent rate increases in future years, should begin to increase IRF's Net Assets. IRF recently recovered \$4.8 million as a result of subrogation on Fire Resistive Treated Wood claims; additional recoveries are expected in fiscal year 2005 – 2006. Although Hurricanes Katrina and Rita have had no direct impact on IRF, losses from these hurricanes are massive and will cause a significant increase in the cost of reinsurance as well as possibly limiting availability of reinsurance.

### **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, 2005

**Assets**

Current assets:

|   |                    |
|---|--------------------|
| Cash and cash equivalents ( <i>Note 2</i> )           | \$ 96,364,075      |
| Premiums receivable ( <i>Note 3</i> )                 | 17,454,025         |
| Reinsurance recovery receivable                       | 1,432,220          |
| Current portion of notes receivable ( <i>Note 4</i> ) | 3,033,179          |
| Accrued interest                                      | 2,646,194          |
| Prepaid insurance                                     | 9,824,486          |
| Total current assets                                  | <u>130,754,179</u> |

Non-current assets:

|   |                    |
|---|--------------------|
| Investments ( <i>Note 2</i> )                                     | 187,289,023        |
| Long-term notes receivable ( <i>Note 4</i> )                      | 17,450,235         |
| Capital assets, net of accumulated depreciation ( <i>Note 5</i> ) | 82,782             |
| Total non-current assets  | <u>204,822,040</u> |
| Total assets  | <u>335,576,219</u> |

**Liabilities**

Current liabilities:

|   |                    |
|---|--------------------|
| Accounts payable  | 823,566            |
| Accrued payroll   | 268,036            |
| Claims payable  | 161,855,901        |
| Deferred premium revenue  | 52,205,279         |
| Claims incurred but not reported                                | 90,099,611         |
| Accrued compensated absences-current portion ( <i>Note 16</i> ) | 32,166             |
| Total current liabilities                                       | <u>305,284,559</u> |

Long term liabilities:

|   |                |
|---|----------------|
| Contingencies ( <i>Note 12</i> )                          |                |
| Accrued compensated absences-long term ( <i>Note 16</i> ) | 299,560        |
| Total long-term liabilities                               | <u>299,560</u> |

|                   |                    |
|-------------------|--------------------|
| Total liabilities | <u>305,584,119</u> |
|-------------------|--------------------|

**Net assets**

|   |                             |
|---|-----------------------------|
| Investment in capital assets                        | 82,782                      |
| Restricted for:                                     |                             |
| Savannah Valley Development Loans ( <i>Note 7</i> ) | 20,000,000                  |
| Unrestricted  | 9,909,318                   |
| Total net assets                                    | <u><u>\$ 29,992,100</u></u> |

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF REVENUE, EXPENSES,  
AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2005

**Operating Revenue**

|                                     |                  |
|-------------------------------------|------------------|
| Insurance premiums:                 |                  |
| Tort liability                      | \$ 29,126,453    |
| Auto, School Bus, and Inland Marine | 21,701,142       |
| Professional liability              | 9,902,164        |
| Comprehensive and collision         | 2,891,871        |
| Fire                                | 9,114,176        |
| Extended coverage                   | 8,439,215        |
| Total operating revenues            | <hr/> 81,175,021 |

**Operating Expenses**

|                                     |                  |
|-------------------------------------|------------------|
| Reinsurance premiums                | 26,209,895       |
| Premiums                            | 173,107          |
| Claims:                             |                  |
| Tort liability                      | 17,163,242       |
| Auto, School Bus, and Inland Marine | 4,518,150        |
| Fire                                | 1,133,256        |
| Extended coverage                   | 4,765,690        |
| Hospitals and physicians            | 13,365,734       |
| Other                               | 1,118,828        |
| Salaries and benefits               | 3,205,918        |
| Professional services               | 23,403,143       |
| Telephone and utilities             | 44,775           |
| Supplies                            | 319,560          |
| Other services                      | 574,039          |
| Printing and publication            | 14,350           |
| Postage and shipping                | 27,412           |
| Depreciation                        | 26,648           |
| Total operating expenses            | <hr/> 96,063,747 |

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF REVENUE, EXPENSES,  
AND CHANGES IN NET ASSETS

(CONTINUED)

|  |                             |
|--|-----------------------------|
| Operating loss   | (14,888,726)                |
| Non-operating revenue (expense):                       |                             |
| Income from deposits and investments ( <i>Note 2</i> ) | 10,191,256                  |
| Notes receivable interest                              | 1,370,257                   |
| Loss on disposal of assets                             | <u>(6,046)</u>              |
| Change in net assets                                   | (3,333,259)                 |
| Net assets, beginning of year                          | <u>33,325,359</u>           |
| Net assets, end of year                                | <u><u>\$ 29,992,100</u></u> |

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2005

**Cash Flows from Operating Activities**

|   |                  |
|---|------------------|
| Insurance premiums from customers               | \$ 84,669,423    |
| Payments to employees                           | (2,956,323)      |
| Payments to suppliers/claimants                 | (74,189,240)     |
| Net cash flows provided by operating activities | <u>7,523,860</u> |

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

|   |                 |
|---|-----------------|
| Purchase of fixed assets                                  | (20,034)        |
| Proceeds from disposal of fixed assets                    | 730             |
| Net cash used in capital and related financing activities | <u>(19,304)</u> |

**Cash Flows from Investing Activities**

|   |                   |
|---|-------------------|
| Principal payments received on notes receivable | 1,256,015         |
| Purchases of investments                        | (61,711,363)      |
| Proceeds from sales and maturity of investments | 112,856,162       |
| Interest received-deposits and investments      | 12,201,513        |
| Interest received-notes receivable              | 1,290,602         |
| Net cash provided by investing activities       | <u>65,892,929</u> |

|  |                             |
|--|-----------------------------|
| Net increase in cash and cash equivalents    | 73,397,485                  |
| Cash and cash equivalents, beginning of year | <u>22,966,590</u>           |
| Cash and cash equivalents, end of year       | <u><u>\$ 96,364,075</u></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   | \$ (14,888,726)            |
| Adjustments to reconcile operating loss to net cash<br>provided by operating activities: |                            |
| Depreciation expense   | 26,648                     |
| Change in assets-(increase) decrease:  |                            |
| Premiums receivable  | (4,378,315)                |
| Reinsurance recovery receivable  | 1,396,197                  |
| Prepaid insurance  | 749,369                    |
| Change in liabilities-increase (decrease):   |                            |
| Accounts payable, accrued payroll and compensated<br>absences                            | 43,727                     |
| Deferred premium revenue   | 7,872,716                  |
| Claims payable and claims incurred but not reported                                      | 16,702,244                 |
| Net cash provided by operating activities  | <u><u>\$ 7,523,860</u></u> |

**Supplemental Information**

|   |                            |
|---|----------------------------|
| Reduction in investments for amortization and accretion | <u><u>\$ 22,896</u></u>    |
| Net (appreciation)/depreciation of investments          | <u><u>\$ 1,075,606</u></u> |
| Disposal of fixed assets                                | <u><u>\$ 2,386</u></u>     |

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Basis of Presentation

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

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

Financial Statements

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

Basis of Accounting

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

The Fund uses the accrual basis of accounting. Revenue 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 \$300,000 as of June 30, 2005. 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.

Investments

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

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agents in the State's name. Information pertaining to the reported amounts, fair values, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The following table presents the amortized cost and fair values of the investments of the Fund at June 30, 2005.

|  | Amortized<br>Cost     | Unrealized<br>Gains | Unrealized<br>Losses | Market<br>Value       |
|--|-----------------------|---------------------|----------------------|-----------------------|
| U. S. Treasury obligations                 | \$ 20,906,698         | \$ 2,952,868        | \$ (2,504)           | \$ 23,857,062         |
| U. S. Government agencies securities       | 17,860,707            | -                   | (122,301)            | 17,738,406            |
| Collateralized mortgage-backed obligations | 16,706,342            | 133,323             | -                    | 16,839,665            |
| SC State political subdivision bonds       | 16,518,644            | 193,902             | (31,185)             | 16,681,361            |
| Repurchase agreement                       | 96,295,000            | -                   | -                    | 96,295,000            |
| Corporate bonds                            | 32,974,442            | 2,215,069           | (101,231)            | 35,088,280            |
| Corporate asset-backed securities          | 24,091,410            | 591,335             | (95,697)             | 24,587,048            |
| Financial paper                            | 52,476,723            | 602,547             | (582,069)            | 52,497,201            |
| Total                                      | <u>\$ 277,829,966</u> | <u>\$ 6,689,044</u> | <u>\$ (934,987)</u>  | <u>\$ 283,584,023</u> |

At June 30, 2005, the amortized cost of the above investments was comprised of the following:

|  | Par Value             | Unamortized<br>Premiums | Unaccrued<br>Discounts | Amortized<br>Cost     |
|--|-----------------------|-------------------------|------------------------|-----------------------|
| U. S. Treasury obligations                 | \$ 21,285,000         | \$ 8,880                | \$ (387,182)           | \$ 20,906,698         |
| U. S. Government agencies securities       | 17,855,000            | 58,297                  | (52,590)               | 17,860,707            |
| Collateralized mortgage-backed obligations | 16,740,537            | -                       | (34,195)               | 16,706,342            |
| SC State political subdivision bonds       | 16,518,644            | -                       | -                      | 16,518,644            |
| Repurchase agreement                       | 96,295,000            | 291,833                 | (502,391)              | 96,084,442            |
| Corporate bonds                            | 33,185,000            | -                       | -                      | 33,185,000            |
| Corporate asset-backed securities          | 24,084,863            | 7,477                   | (930)                  | 24,091,410            |
| Financial paper                            | 52,550,455            | 121,891                 | (195,623)              | 52,476,723            |
| Total                                      | <u>\$ 278,514,499</u> | <u>\$ 488,378</u>       | <u>\$ (1,172,911)</u>  | <u>\$ 277,829,966</u> |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Deposits

For cash and cash equivalents, the fair values are equal to the bank balances which approximate the carrying amount. The cash and cash equivalents reported consist of the following as of June 30, 2005:

|  |                  |
|--|------------------|
| Deposits held by Third Party Administrators              | \$ 46,520        |
| Cash held by the South Carolina State Treasurer's Office | 22,555           |
|  | <u>\$ 69,075</u> |

Balances held by the third party administrator are exposed to custodial credit risk. In the case of deposits, this is the risk that in the event of a bank failure, the Fund's deposits may not be returned. The Fund does not have a deposit policy for custodial credit risk. As of June 30, 2005, \$46,520 of the Fund's bank balance was uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the Fund's name.

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

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

|  | <u>Statements</u>     | <u>Note<br/>Disclosure</u> |
|--|-----------------------|----------------------------|
| Cash and cash equivalents                  | \$ 96,364,075         | \$ -                       |
| Deposits held by Third Party Administrator | -                     | 46,520                     |
| Held by the State Treasurer:               |                       |                            |
| Cash                                       | -                     | 22,555                     |
| Specifically identified investments        | -                     | 283,584,023                |
| Investments                                | 187,289,023           | -                          |
| Total                                      | <u>\$ 283,653,098</u> | <u>\$ 283,653,098</u>      |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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

|                                     |                      |
|-------------------------------------|----------------------|
| Interest earned                     | \$ 11,351,855        |
| Accretion of discount               | 560,662              |
| Amortization of premium             | (583,558)            |
| Realized gains (losses)             | (62,097)             |
| Change in unrealized gains (losses) | (1,075,606)          |
|                                     | <u>\$ 10,191,256</u> |

**3. Premiums Receivable**

Premiums receivable at June 30, 2005, consist of the following:

|                                     |                      |
|-------------------------------------|----------------------|
| Local government                    | \$ 8,020,094         |
| State government ( <i>Note 11</i> ) | 9,112,552            |
| Other                               | 321,379              |
|                                     | <u>\$ 17,454,025</u> |

Premiums receivable and deferred premium revenue include approximately \$14,047,000 attributable to premiums billed in advance of coverage as of June 30, 2005.

As of June 30, 2005, 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, 2005.

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, 2005, 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 postponed by Proviso 63.58. | \$ 3,500,000 |
|--|--------------|

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

|  |         |
|--|---------|
| One note in the principal amount of \$1,500,000 with interest at 5.50%; maturity date is June 1, 2009. | 391,960 |
|--|---------|

**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 4.00%; maturity date is October 16, 2005. | 192,913 |
|--|---------|

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

|   |            |
|---|------------|
| One note in the principal amount of \$14,983,215 with interest at 8.00%; maturity date is January 31, 2031. | 14,398,541 |
|---|------------|

**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 |
|---|-----------|

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Notes Receivable (Continued)**

**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                | 20,483,414           |
| Less current portion | (3,033,179)          |
| Total                | <u>\$ 17,450,235</u> |

**5. Capital Assets**

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

|                          | <b>Balance<br/>July 1,<br/>2004</b> | <b>Additions</b>  | <b>Deletions</b>  | <b>Balance<br/>June 30,<br/>2005</b> |
|--------------------------|-------------------------------------|-------------------|-------------------|--------------------------------------|
| Furniture and equipment  | \$ 383,855                          | \$ 20,034         | \$ (59,864)       | \$ 344,025                           |
| Accumulated depreciation | (287,684)                           | (26,648)          | 53,089            | (261,243)                            |
| Capital assets, net      | <u>\$ 96,171</u>                    | <u>\$ (6,614)</u> | <u>\$ (6,775)</u> | <u>\$ 82,782</u>                     |

Depreciation expense for the year ended June 30, 2005, was \$26,648.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**6. Lease Obligations**

The Fund leases office space from a party outside of State government and this lease is accounted for as an operating lease. The office space lease was amended effective July 1, 2005, and now expires June 30, 2008. Rental expense under this lease for the year ended June 30, 2005 was \$421,634.

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, 2005, expenses under these leases were approximately \$10,901.

The following schedule summarizes the Fund's obligations under non-cancelable operating leases having remaining terms in excess of one year as of June 30, 2005:

| Fiscal Year<br>Ending June 30, | Total                 |
|--------------------------------|-----------------------|
| 2006                           | \$ 284,753            |
| 2007                           | 278,275               |
| 2008                           | <u>276,576</u>        |
| Total                          | <u><u>839,604</u></u> |

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

At June 30, 2005, \$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, 2005, \$14,398,541 was outstanding.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**8. Pension Plans**

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

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**8. Pension Plans (Continued)**

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

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. For the year ended June 30, 2005, 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 were approximately \$270,000, 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, 2005.

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).



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**8. Pension Plans (Continued)**

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.

**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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The Fund recorded employer contributions expenditures within the applicable administrative expenditure categories for these insurance benefits for active employees of approximately \$180,000 for the year ended June 30, 2005. As discussed in *Note 8*, the Fund paid approximately \$80,000 for the year ended June 30, 2005, applicable to the surcharge included with the employer contributions for retirement benefits (3.25% for 2005).

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.

**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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**10. Deferred Compensation Plans (Continued)**

The State authorized deferred compensation matching contributions for fiscal year 2004-2005. 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, 2005.

**11. Transactions with State Entities**

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

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

The following details the insurance premiums received by the Fund from other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2005:

|                                    |            |
|------------------------------------|------------|
| Adjutant General Of South Carolina | \$ 179,603 |
| Administrative Law Judges          | 1,415      |
| Agriculture Department             | 293,281    |
| Aiken Technical College            | 32,108     |
| Appellate Defense Commission       | 2,454      |
| Archives & History Department      | 5,598      |
| Arts Commission                    | 13,386     |
| Attorney General Office            | 21,698     |
| Blind Commission                   | 31,840     |
| Board Of Financial Institutions    | 9,776      |
| Budget And Control Board           | 1,261,388  |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

|   |           |
|---|-----------|
| Central Carolina Technical College                | 32,300    |
| Clemson University                                | 1,575,789 |
| Coastal Carolina University                       | 284,818   |
| College of Charleston                             | 924,637   |
| Commission on Higher Education                    | 14,284    |
| Commissionn Prosecution Coordinators              | 9,715     |
| Comptroller General                               | 13,410    |
| Denmark Technical College                         | 21,914    |
| Department of Corrections                         | 1,441,930 |
| Department of Juvenile Justice                    | 413,262   |
| Department of Natural Resources                   | 679,089   |
| Department of Social Services                     | 657,844   |
| Department of Alcohol & Other Drug Abuse Services | 12,732    |
| Department of Commerce                            | 50,953    |
| Department of Consumer Affairs                    | 3,053     |
| Department of Disabilities and Special Needs      | 685,034   |
| Department of Health & Environmental Control      | 1,319,943 |
| Department of Labor Licensing and Regulation      | 135,489   |
| Department of Mental Health                       | 1,923,883 |
| Department of Motor Vehicles                      | 111,233   |
| Department of Probation, Parole & Pardon Services | 164,591   |
| Education Department                              | 4,472,510 |
| Education Oversight Commission                    | 4,304     |
| Educational Television                            | 233,409   |
| Election Commission State                         | 4,979     |
| Employment Security Commission                    | 121,480   |
| Ethics Commission, SC                             | 3,387     |
| Florence-Darlington Technical College             | 1,128,379 |
| Forestry Commission                               | 229,627   |
| Francis Marion University                         | 241,725   |
| Governors Office - Executive Policy and Programs  | 111,519   |
| Governors Office - Mansion and Grounds            | 24,262    |
| Greenville Technical College                      | 120,896   |
| Health and Human Services                         | 93,674    |
| Higher Education Tuition Grants Commission        | 1,309     |
| Horry - Georgetown Technical College              | 56,575    |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

|   |           |
|---|-----------|
| House of Representatives  | 73,303    |
| Housing Finance and Development Authority                             | 26,682    |
| Human Affairs Commission  | 7,345     |
| Infrastructure Bank Board   | 3,712     |
| Jobs and Economic Development Authority                               | 5,017     |
| John De La Howe School  | 61,644    |
| Judicial Department   | 68,568    |
| Lander University   | 200,780   |
| Legislative Audit Council   | 4,382     |
| Legislative Department - Codification of Laws and Legislative Council | 3,073     |
| Legislative Printing  | 8,068     |
| Library, SC State   | 21,418    |
| Lieutenant Governors Office   | 1,952     |
| Medical University of SC  | 4,631,766 |
| Midlands Technical College  | 99,149    |
| Northeastern Technical College  | 29,140    |
| Office of Regulatory Staff  | 17,689    |
| Parks Recreation & Tourism  | 550,760   |
| Patient's Compensation Fund   | 6,759     |
| Patriots Point Development Authority                                  | 51,488    |
| Piedmont Technical College  | 74,564    |
| Public Safety Department  | 779,571   |
| Public Service Authority SC   | 313,200   |
| Public Service Commission   | 17,180    |
| Revenue & Taxation Department   | 70,259    |
| SC Department of Insurance  | 9,821     |
| SC School for the Deaf and Blind                                      | 164,449   |
| SC State University   | 243,533   |
| SC Worker's Compensation Commission                                   | 23,168    |
| Sea Grant Consortium, SC  | 4,135     |
| Second Injury Fund  | 4,156     |
| Secretary of State  | 8,278     |
| Senate  | 18,225    |
| Spartanburg Technical College   | 55,581    |
| State Accident Fund   | 9,589     |
| State Auditor's Office  | 7,789     |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

|                                       |               |
|---------------------------------------|---------------|
| State Commission for Minority Affairs | 6,998         |
| State Law Enforcement Division        | 304,008       |
| State Museum Commission               | 26,468        |
| State Treasurer's Office              | 10,507        |
| The Citadel                           | 468,871       |
| Tobacco Settlement Revenue Management | 2,380         |
| Transportation Department             | 7,357,275     |
| University Of South Carolina          | 2,533,010     |
| USC - Beaufort Campus                 | 31,591        |
| USC - Lancaster Campus                | 27,143        |
| USC - Salkehatchie                    | 24,665        |
| USC - Sumter Campus                   | 30,679        |
| USC - Upstate                         | 82,955        |
| Vocational Rehabilitation Department  | 325,766       |
| Wil Lou Gray Opportunity School       | 32,347        |
| Williamsburg Technical College        | 12,228        |
| Winthrop University                   | 353,941       |
|                                       | <hr/>         |
|                                       | \$ 38,483,510 |
|                                       | <hr/>         |

Premiums owed from these entities at June 30, 2005 were:

|  |           |
|--|-----------|
| Adjutant General of South Carolina           | \$ 20     |
| Aiken Technical College                      | 186       |
| Budget and Control Board                     | 98,819    |
| Central Carolina Technical College           | 33,367    |
| Charleson/Dorchester County                  | 76        |
| City of Folly Beach                          | 2,293     |
| Clemson University                           | 1,725,693 |
| Coastal Carolina University                  | 669       |
| Coastal Regional Center                      | 1,007     |
| Department of Corrections                    | 6,617     |
| Department of Disabilities and Special Needs | 45,362    |
| Department of Education                      | 4,414,897 |
| Department of Health & Environmental Control | 912       |
| Department of Juvenile Justice               | 461,523   |
| Department of Labor Licensing and Regulation | 30        |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

|   |              |
|---|--------------|
| Department of Mental Health               | 4,088        |
| Department of Natural Resources           | 2,466        |
| Division of General Services              | 132          |
| Educational Television                    | 243,787      |
| Ethics Commission of SC                   | 3,829        |
| Florence-Darlington Technical College     | 340,870      |
| Governor's Office                         | 14,110       |
| Governor's School                         | 30           |
| Greenville Area Mental Health Department  | 7,289        |
| Health And Human Services                 | 79,231       |
| Lander University                         | 214,155      |
| Medical University of SC                  | 110,982      |
| Midlands Technical College                | 102,482      |
| Parks Recreation and Tourism              | 528          |
| Patient's Compensation Fund               | 8,702        |
| Patriots Point Development Authority      | 82,879       |
| Piedmont Center                           | 100          |
| Piedmont Community Action Council         | 190          |
| Piedmont Technical College                | 60           |
| SC School for the Deaf And Blind          | 1,847        |
| SC State Library                          | 23,528       |
| SC State University                       | 261,970      |
| SC Worker's Compensation Commission       | 11,435       |
| Spartanburg Area Mental Health Department | 10           |
| State Auditor's Office                    | 8,740        |
| State Law Enforcement Division            | 328,911      |
| State Museum Commission                   | 32,486       |
| University of South Carolina              | (45,868)     |
| USC - Upstate                             | 84,010       |
| USC School of Medicine                    | 54,026       |
| Vocational Rehabilitation Department      | 343,852      |
| Winthrop University                       | 34           |
| York Technical College                    | 190          |
|   | <hr/>        |
|   | \$ 9,112,552 |
|   | <hr/>        |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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 2005 expenses applicable to related party transactions not disclosed elsewhere are approximately:

|   |            |
|---|------------|
| SC Budget & Control Board-Internal Operations | \$ 180,044 |
| SC Budget & Control Board-Legal Services      | 164,675    |
| SC Employment Commission                      | 4,755      |
| SC Accident Fund                              | 6,658      |
|   | <hr/>      |
|   | \$ 356,132 |

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

Additionally, during the current year, the Fund sold capital assets to the Division of General Services with an acquisition cost of \$36,008 and accumulated depreciation of \$31,619 for a net value of \$4,389.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**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.

As a result of the 2004-2005 Appropriations Act Proviso 63.47, the Fund is to provide funds to cover legal defense costs of the State associated with the Abbeville School Funding litigation case. As of June 30, 2005, the Fund had incurred \$643,182 of legal defense costs associated with the case. However, the amount of this liability is not known as of the date of our report.

**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 other than the Fund did not renew reinsurance for Medical Professional Liability. Settled claims have not exceeded this coverage in any of the past three years.

The Fund pays insurance premiums to itself, certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits.

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);

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

3. Claims of covered public employees for health and dental insurance benefits (Employee Insurance Programs); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Employee Insurance Programs).

Employees elect health coverage through either a health maintenance organization or through the State's self-insured plan. All of the other coverages listed above are through the applicable State self-insured plan except dependent and optional life premiums are remitted to commercial carriers.

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

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

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

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

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

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, 2005, 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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

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

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

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

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.

|  | 2005<br><u>(in thousands)</u> | 2004<br><u>(in thousands)</u> |
|--|-------------------------------|-------------------------------|
| Unpaid claims and claim adjustment expenses at beginning of the fiscal year                    | \$ 235,253                    | \$ 206,884                    |
| Incurred claims and claim adjustment expenses:   |                               |                               |
| Provision for insured events of the current fiscal year  | 41,379                        | 42,501                        |
| Increases (decreases) in provision for insured events of prior fiscal years                    | <u>686</u>                    | <u>22,642</u>                 |
| Total incurred claims and claim adjustment expenses  | <u>42,065</u>                 | <u>65,143</u>                 |
| Payments:  |                               |                               |
| Claims and claim adjustment expenses attributable to insured events of the current fiscal year | 7,670                         | 12,117                        |
| Claims and claim adjustment expenses attributable to insured events of prior fiscal years      | <u>17,692</u>                 | <u>24,657</u>                 |
| Total payments   | <u>25,362</u>                 | <u>36,774</u>                 |
| Total unpaid claims and claim adjustment expenses at end of the fiscal year                    | <u><u>\$ 251,956</u></u>      | <u><u>\$ 235,253</u></u>      |
| The above totals are comprised of the following:   |                               |                               |
| Claims payable   | \$ 161,856                    | \$ 157,773                    |
| Claims incurred but not reported   | <u>90,100</u>                 | <u>77,480</u>                 |
| Total  | <u><u>\$ 251,956</u></u>      | <u><u>\$ 235,253</u></u>      |

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Changes in long-term obligations for the year ended June 30, 2005 were as follows:

|                              | Beginning<br>Balance<br>July 1, 2004 | Increases | Decreases   | Ending<br>Balance<br>June 30, 2005 | Due<br>Within<br>1 Year |
|------------------------------|--------------------------------------|-----------|-------------|------------------------------------|-------------------------|
| Compensated absences payable | \$ 307,131                           | \$ 43,307 | \$ (18,712) | \$ 331,726                         | \$ 32,166               |

**16. Decrease in Net Assets**

Over the past three 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 years 2005, 2004 and 2003, the Fund incurred losses from operations of \$14,888,726, \$63,244,020, and \$40,864,622, respectively. Additionally, in fiscal year 2003, the Fund was required to transfer to the State of South Carolina General Fund a total of \$50,836,970. All of these factors have led to a total decrease in net assets over the past three years of \$118,997,368 leaving a balance of \$29,992,100 as of June 30, 2005.

**17. Subsequent Events**

The Fund is currently in litigation with several manufacturers of fire-resistant treated wood for subrogation of paid losses on claims in prior years. In July 2005, the Fund has been awarded \$3,800,000 thus far in subrogation from the manufacturers.

In August 2005, the Fund received payment for the Department of Commerce note receivable (*Note 4*) in the amount of \$3,500,000.

## INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

# DELOACH & WILLIAMSON, L.L.P.

## CERTIFIED PUBLIC ACCOUNTANTS

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

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

Dear Mr. Wagner:

We have audited the financial statements of the South Carolina State Budget and Control Board, Insurance Reserve Fund (the "Fund") as of and for the year ended June 30, 2005, and have issued our report thereon dated September 23, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

#### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not

express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

\* \* \* \* \*

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

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

September 23, 2005