

AUDITED FINANCIAL STATEMENTS  
AND  
REQUIRED SUPPLEMENTAL INFORMATION

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

June 30, 2014

*State of South Carolina*



*Office of the State Auditor*

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

RICHARD H. GILBERT, JR., CPA  
DEPUTY STATE AUDITOR

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

September 30, 2014

The Honorable Nikki R. Haley, 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 – Insurance Reserve Fund for the fiscal year ended June 30, 2014, was issued by The Hobbs Group, PA, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

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

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

RHGjr/trb

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June 30, 2014

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1704 Laurel Street  
Columbia, SC 29201  
  
P.O. Box 2411  
Columbia, SC 29202



Phone (803) 799-0555  
Fax (803) 799-4212  
  
[www.hobbsscpa.com](http://www.hobbsscpa.com)

## INDEPENDENT AUDITORS' REPORT

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

### REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the South Carolina State Budget and Control Board Insurance Reserve Fund (the "*Fund*"), a fund of the South Carolina State Budget and Control Board, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

### MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Fund's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### AUDITORS' RESPONSIBILITY

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 the standards applicable to financial audits contained in *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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## OPINION

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Carolina State Budget and Control Board Insurance Reserve Fund as of June 30, 2014, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## EMPHASIS OF MATTER

As discussed in Note A, the financial statements present only the South Carolina State Budget and Control Board Insurance Reserve Fund and do not purport to, and do not, present fairly the financial position of the State of South Carolina Budget and Control Board, which is a part of the State of South Carolina primary government, as of June 30, 2014, and the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

## OTHER MATTERS

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## OTHER REPORTING REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2014 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

Columbia, South Carolina  
September 29, 2014

*The Halle Group, P.A.*

REQUIRED SUPPLEMENTAL INFORMATION

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

This section of the South Carolina State Budget and Control Board, Insurance Reserve Fund (IRF) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of IRF's financial performance during the fiscal year ended June 30, 2014. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

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

### **Financial Highlights:**

- The assets of IRF exceeded its liabilities at June 30, 2014 by \$205,476,495
- IRF's net position increased by \$4,644,810 or 2.31 percent;
- IRF experienced an operating loss of \$11,299,201, which is an improvement over the prior year.

### **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 Position; Statement of Revenues, Expenses, and Changes in Net Position; and Statement of Cash Flows.

The Statement of Net Position 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 position section, which displays net position in three broad categories: net investment in capital assets, restricted and unrestricted. Net position is one indicator of the current financial condition of IRF, while the change in net position 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 Position 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, financing, and investment activities.

## **Financial Analysis of IRF**

This schedule is a condensed version of IRF's assets, liabilities, and net position and is prepared from the Statement of Net Position as of June 30, 2013 and 2014.

### **Condensed Statements of Net Position (In millions)**

|                                    | <b><u>June 30, 2014</u></b> | <b><u>June 30, 2013</u></b> |
|------------------------------------|-----------------------------|-----------------------------|
| <b>Assets</b>                      |                             |                             |
| Current assets                     | \$ 63.5                     | \$ 73.6                     |
| Noncurrent assets:                 | 456.8                       | 444.8                       |
| Total assets                       | <b><u>\$ 520.3</u></b>      | <b><u>\$ 518.4</u></b>      |
| <b>Liabilities</b>                 |                             |                             |
| Current liabilities                | \$ 314.7                    | \$ 317.4                    |
| Noncurrent liabilities             | 0.1                         | 0.2                         |
| Total liabilities                  | <u>314.8</u>                | <u>317.6</u>                |
| <b>Net Position</b>                |                             |                             |
| Investment in capital assets       | -                           | -                           |
| Restricted for loans               | 17.9                        | 16.8                        |
| Unrestricted                       | <u>187.6</u>                | <u>184.0</u>                |
| Total net position                 | <u>205.5</u>                | <u>200.8</u>                |
| Total liabilities and net position | <b><u>\$ 520.3</u></b>      | <b><u>\$ 518.4</u></b>      |

Net position may serve over time as a useful indicator of an entity's financial position. Assets exceeded liabilities by \$ \$200,831,685 at the close of the fiscal year ended June 30, 2013 and assets exceeded liabilities by \$205,476,495 at the close of fiscal year ended June 30, 2014.

The following schedule is a summary of the IRF's operating results for the fiscal years ended June 30, 2013 and 2014.

**Condensed Statements of Revenue, Expenses and Changes in Net Position**  
(In millions)

|                                      | <b>Year Ended June 30,</b> |                 |
|--------------------------------------|----------------------------|-----------------|
|                                      | <b>2014</b>                | <b>2013</b>     |
| <b>Operating</b>                     |                            |                 |
| Operating revenue:                   |                            |                 |
| Insurance premiums                   | \$ 114.1                   | \$ 112.2        |
| Operating expenses:                  |                            |                 |
| Claims                               | 49.8                       | 54.5            |
| Reinsurance and other premiums       | 46.8                       | 42.0            |
| Administrative                       | 28.8                       | 30.1            |
| Total operating expenses             | <u>125.4</u>               | <u>126.6</u>    |
| Net operating income (loss)          | (11.3)                     | (14.4)          |
| Non operating revenue:               |                            |                 |
| Income from deposits and investments | 15.5                       | 3.6             |
| Notes receivable interest            | 0.5                        | 0.5             |
| Total non operating revenue          | <u>16.0</u>                | <u>4.1</u>      |
| Change in net position               | 4.7                        | (10.3)          |
| Net position, beginning of the year  | 200.8                      | 211.1           |
| Net position, end of the year        | <u>\$ 205.5</u>            | <u>\$ 200.8</u> |

A condensed version of the Statement of Cash Flows is presented as follows for the years ended June 30, 2013 and 2014:

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

|  | <b>Year Ended June 30,</b> |               |
|--|----------------------------|---------------|
|  | <b>2014</b>                | <b>2013</b>   |
| Net cash (used in) operating activities              | \$ (8.7)                   | \$ (5.0)      |
| Net cash provided by (used in) investing activities  | 24.9                       | (1.4)         |
| Net increase (decrease) in cash and cash equivalents | 16.2                       | (6.4)         |
| Cash and cash equivalents, beginning of year         | 5.1                        | 11.5          |
| Cash and cash equivalents, end of year               | <u>\$ 21.3</u>             | <u>\$ 5.1</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:**

IRF has maintained adequate reinsurance; however, catastrophe models have changed significantly in the last few reinsurance cycles. The IRF has purchased \$500 million subject to a maximum self-insured retention of \$10 million per occurrence and \$15 million in the annual aggregate with a \$1 million trailing per occurrence for subsequent claims.

IRF changed its standard auto comprehensive and/or collision minimum deductible from \$250 to \$500 which should reduce small claims frequency in the future. These changes took effect as policies renewed beginning in March 2014.

Following the cyber security breach at the SC Department of Revenue in 2012, The Fund provided a short term loan of \$20,170,000 to the Department of Revenue for loss mitigation. The loan was fully repaid in October 2013 plus total interest of \$546,989. Due to market conditions, IRF investments increased \$1,804,216 in fair market value for the year, which was a factor in the rebound in net position.

## **Contact Information**

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

## BASIC FINANCIAL STATEMENTS

STATEMENT OF NET POSITION  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
 INSURANCE RESERVE FUND  
 JUNE 30, 2014

ASSETS

|                           |                       |
|---------------------------|-----------------------|
| Current Assets            |                       |
| Cash and cash equivalents | \$ 21,312,186         |
| Premiums receivable       | 16,578,910            |
| Accrued interest          | 3,688,520             |
| Other receivable          | 878,517               |
| Prepaid insurance         | 21,093,966            |
| Total Current Assets      | <u>63,552,099</u>     |
| Noncurrent Assets         |                       |
| Investments               | 454,596,643           |
| Long-term note receivable | 2,153,280             |
| Capital assets, net       | 6,584                 |
| Total Noncurrent Assets   | <u>456,756,507</u>    |
| TOTAL ASSETS              | <u>\$ 520,308,606</u> |

LIABILITIES AND NET POSITION

|  |                       |
|--|-----------------------|
| Current Liabilities                              |                       |
| Accounts payable and accrued payroll             | \$ 278,331            |
| Accrued compensated absences - current           | 172,767               |
| Deferred premium revenue                         | 55,874,333            |
| Claims payable                                   | 161,659,722           |
| Claims incurred but not reported                 | 96,738,389            |
| Total Current Liabilities                        | <u>314,723,542</u>    |
| Noncurrent Liabilities                           |                       |
| Accrued compensated absences - noncurrent        | 108,569               |
| Total Liabilities                                | <u>314,832,111</u>    |
| Net Position                                     |                       |
| Net investment in capital assets                 | 6,584                 |
| Restricted - Savannah Valley Development Program | 17,846,720            |
| Unrestricted                                     | 187,623,191           |
| Total Net Position                               | <u>205,476,495</u>    |
| TOTAL LIABILITIES AND NET POSITION               | <u>\$ 520,308,606</u> |

The accompanying notes are an integral part of these financial statements.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
 INSURANCE RESERVE FUND  
 FOR THE YEAR ENDED JUNE 30, 2014

|                                      |                             |                       |
|--------------------------------------|-----------------------------|-----------------------|
| Operating Revenues                   |                             |                       |
| Insurance premiums                   | \$                          | 114,141,854           |
| Operating Expenses                   |                             |                       |
| Claims                               |                             | 49,772,390            |
| Claims related expenses              |                             | 23,148,832            |
| Reinsurance premiums                 |                             | 46,774,485            |
| Professional services                |                             | 1,708,050             |
| Salaries and benefits                |                             | 2,824,169             |
| Other services                       |                             | 1,085,722             |
| Other expenses                       |                             | 127,407               |
|                                      | Total Operating Expenses    | <u>125,441,055</u>    |
|                                      | Operating Loss              | (11,299,201)          |
| Nonoperating Revenues                |                             |                       |
| Income from deposits and investments |                             | 15,413,657            |
| Interest from note receivables       |                             | 529,940               |
| Other nonoperating revenue           |                             | 414                   |
|                                      | Total Nonoperating Revenues | <u>15,944,011</u>     |
|                                      | CHANGE IN NET POSITION      | 4,644,810             |
| Net position at beginning of year    |                             | <u>200,831,685</u>    |
|                                      | NET POSITION AT END OF YEAR | <u>\$ 205,476,495</u> |

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CASH FLOWS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
 INSURANCE RESERVE FUND  
 FOR THE YEAR ENDED JUNE 30, 2014

CASH FLOWS FROM OPERATING ACTIVITIES

|  |                    |
|--|--------------------|
| Cash received for insurance premiums                 | \$ 113,008,720     |
| Cash payments for salaries and benefits              | (2,831,341)        |
| Cash payments for claims and claims related expenses | (75,050,944)       |
| Cash payments for reinsurance premiums               | (40,945,941)       |
| Cash payments for professional services              | (1,708,050)        |
| Cash payments for suppliers                          | (1,206,896)        |
| NET CASH USED IN OPERATING ACTIVITIES                | <u>(8,734,452)</u> |

CASH FLOWS FROM INVESTING ACTIVITIES

|  |                   |
|--|-------------------|
| Principal payments received on note receivable | 21,224,276        |
| Purchase of investments                        | (215,550,235)     |
| Proceeds from sale and maturity of investments | 204,140,489       |
| Interest received - deposits and investments   | 14,404,207        |
| Interest received - notes receivable           | 662,881           |
| NET CASH PROVIDED BY INVESTING ACTIVITIES      | <u>24,881,618</u> |

NET INCREASE IN CASH AND CASH EQUIVALENTS 16,147,166

Cash and cash equivalents at beginning of year 5,165,020

CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 21,312,186

RECONCILIATION OF OPERATING LOSS TO NET CASH  
 USED IN OPERATING ACTIVITIES:

|   |                       |
|---|-----------------------|
| Operating Loss  | \$ (11,299,201)       |
| Adjustments to reconcile operating loss to net cash<br>used in operating activities |                       |
| Depreciation  | 6,233                 |
| Change in assets and liabilities:   |                       |
| Decrease in premiums receivable   | 388,602               |
| Decrease in prepaid insurance   | 5,810,118             |
| Increase in other receivable  | (878,517)             |
| Increase in accounts payable and accrued payroll                                    | 34,707                |
| Decrease in compensated absences  | (23,453)              |
| Decrease in deferred premium revenue  | (1,521,736)           |
| Decrease in claims payable and claims incurred but not reported                     | (1,251,205)           |
| NET CASH USED IN OPERATING ACTIVITIES   | <u>\$ (8,734,452)</u> |

Non-Cash Investing Activities:

|   |              |
|---|--------------|
| Net changes in investments for accretion and amortization | \$ 222,689   |
| Net increase in fair value of investments                 | \$ 1,804,216 |

The accompanying notes are an integral part of these financial statements.

NOTES TO THE BASIC FINANCIAL STATEMENTS

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

June 30, 2014

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the South Carolina State Budget and Control Board Insurance Reserve Fund (the "Fund") have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to enterprise funds of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting principles and policies utilized by the Fund 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.

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

The South Carolina State Budget and Control Board Insurance Reserve Fund is a fund of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. This report contains only the Fund and no other Offices or funds of the South Carolina State Budget and Control Board or any other part of the State of South Carolina primary government are included. The Insurance Reserve Fund (the "Fund") is under the control 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.

NOTES TO THE BASIC FINANCIAL STATEMENTS

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

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES – Continued

The 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 Board. The funds of the Board are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Fund operates as a unit under the 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.

The Fund was created by the 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 Fund.

The Fund insures state agencies, school districts, special purpose political subdivisions, county governments and municipal governments in South Carolina. The Fund provides property insurance on governmentally owned buildings, the contents of such buildings, equipment and automobiles. The 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 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 Fund collects premiums from participating entities, issues policies, and pay 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 Board. The 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.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS

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

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES – Continued

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 position, revenue, expenses and changes in net position and cash flows that replaces the fund-group perspective previously required.

Financial Statements: The 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 liabilities associated with the operation of the Fund are included on the statement of net position. Net position is segregated into investment in capital assets, net of related debt, restricted, and unrestricted net position components.

The Fund uses the accrual basis of accounting. Revenue is recognized in the accounting period in which they are earned and become measureable; 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.

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. 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. For credit risk information pertaining to the internal cash management pool, see the Deposits and Investments disclosures in Note B.

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. 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.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE A -- 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 GASB Statement No. 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/losses resulting from changes in fair value. Earnings are posted to the Fund’s account at the end of each month. Securities and securities transactions are reflected in the financial statements on a trade-date basis.

Premium Revenue: 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.

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 pro-rata 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 the gift. The Fund has one class of capital asset, furniture and equipment, which is depreciated on the straight-line basis over the estimated useful lives of 3-10 years. The capitalization dollar threshold limit for furniture and equipment is \$5,000.

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. 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 but not paid at June 30<sup>th</sup>. 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.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES – Continued

Compensated Absences: Generally all permanent full-time State employees and certain part-time employees scheduled to work at least twenty hours per workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and 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 Position: Effective for the fiscal year ended June 30, 2013, the Fund adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflow of Resources, Deferred Inflows of Resources, and Net Position*. Among other things, GASB 63 amends net assets reporting requirements by incorporating deferred inflows and outflows of resources into the definition of the required components presented in a statement of financial position, with the residual measure identified as net position.

The Fund has incorporated the term “net position” from GASB 63 into these statements but has determined that no amounts were required to be recognized as deferred inflows or outflows of resources for the year ended June 30, 2014.

Net position is reported in three categories:

*Net Investment in Capital Assets:* Consists of capital assets, net of accumulated depreciation, reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

*Restricted Net Position:* Result when constraints placed on the use of assets reduced by liabilities and deferred inflows of resources related to those assets are either externally imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.

*Unrestricted Net Position:* Consists of the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES – Continued

Items Previously Reported as Assets and Liabilities: The Fund has adopted for fiscal year end June 30, 2014, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets or liabilities. The Fund has determined that no amounts were required to be reclassified as a result of its adoption of this statement.

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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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 revenues include (1) premiums for insurance coverage, (2) administrative fees, and (3) other receipts arising from services provided.

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

Subsequent events: Management of the Fund has evaluated events through September 29, 2014, which represents the date the financials were available to be issued.

NOTE B -- DEPOSITS AND INVESTMENTS

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.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE B -- DEPOSITS AND INVESTMENTS – Continued

The following table presents the amortized cost and fair values of the investments of the Fund at June 30, 2014:

|  | Amortized<br>Cost     | Unrealized           |             | Fair<br>Value         |
|--|-----------------------|----------------------|-------------|-----------------------|
|  |                       | Gains                | Losses      |                       |
| Federal agency bonds                       | \$ 5,000,000          | \$ 2,800             |             | \$ 5,002,800          |
| Collateralized mortgage-backed obligations | 11,404,688            | 1,255,623            |             | 12,660,311            |
| Other governmental guaranteed investments  | 8,275,555             | 3,370                |             | 8,278,925             |
| Political subdivision bonds                | 75,665,103            | 5,544,603            |             | 81,209,706            |
| Corporate bonds                            | 281,369,912           | 12,254,614           |             | 293,624,526           |
| Financial paper                            | 51,522,305            | 2,298,070            |             | 53,820,375            |
| <b>TOTAL</b>                               | <b>\$ 433,237,563</b> | <b>\$ 21,359,080</b> | <b>\$ 0</b> | <b>\$ 454,596,643</b> |

At June 30, 2014, the amortized cost of the above investments was comprised of the following:

|  | Par Value             | Unamortized | Unaccrued             | Amortized             |
|--|-----------------------|-------------|-----------------------|-----------------------|
|  |                       | Premiums    | Discounts             | Cost                  |
| Federal agency bonds                       | \$ 5,000,000          |             |                       | \$ 5,000,000          |
| Collateralized mortgage-backed obligations | 11,463,907            |             | \$ (59,219)           | 11,404,688            |
| Other governmental guaranteed investments  | 8,284,040             |             | (8,485)               | 8,275,555             |
| Political subdivision bonds                | 75,878,295            |             | (213,192)             | 75,665,103            |
| Corporate bonds                            | 282,021,004           |             | (651,092)             | 281,369,912           |
| Financial paper                            | 51,750,000            |             | (227,695)             | 51,522,305            |
| <b>TOTAL</b>                               | <b>\$ 434,397,246</b> | <b>\$ 0</b> | <b>\$ (1,159,683)</b> | <b>\$ 433,237,563</b> |

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, 2014:

|  |                      |
|--|----------------------|
| Deposits held by Third Party Administrators        | \$ 72,361            |
| Cash held at the South Carolina Treasurer’s Office | 21,239,825           |
|  | <u>\$ 21,312,186</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, 2014, \$122,186 of the Fund’s bank balance was uninsured or collateralized with securities held by the pledging financial institution’s trust department or agent, but not in the Fund’s name.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE B -- DEPOSITS AND INVESTMENTS – Continued

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 reported in the statement of net position to disclosures included in this note.

|   | <u>Note Disclosure</u> | <u>Statement of<br/>Net Position</u> |
|---|------------------------|--------------------------------------|
| Cash and cash equivalents                   |                        | \$ 21,312,186                        |
| Deposits held by Third Party Administrators | \$ 72,361              |                                      |
| Cash held at the State Treasurer's Office   | 21,239,825             |                                      |
| Investments                                 | 454,596,643            | 454,596,643                          |
| TOTAL                                       | <u>\$ 475,908,829</u>  | <u>\$ 475,908,829</u>                |

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

|                                     |                      |
|-------------------------------------|----------------------|
| Interest earned                     | \$ 13,832,130        |
| Accretion of discount               | (222,689)            |
| Change in unrealized gains (losses) | 1,804,216            |
|                                     | <u>\$ 15,413,657</u> |

NOTE C -- PREMIUMS RECEIVABLE

Premiums receivable at June 30, 2014 consist of the following:

|                  |                      |
|------------------|----------------------|
| Local government | \$ 8,425,906         |
| State government | 6,736,046            |
| Other            | 1,416,958            |
|                  | <u>\$ 16,578,910</u> |

Premiums receivable and deferred premium revenue include \$10,986,709 attributable to premiums billed in advance of coverage at June 30, 2014.

As of June 30, 2014, 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, 2014.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE D -- NOTE RECEIVABLE

Note receivable at June 30, 2014 consist of the following:

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

Note in the original principal amount of \$14,983,215 with interest at 3.57%; maturity date is January 31, 2031. Entire balance is noncurrent as no principal payments are due until January 31, 2029. \$ 2,153,280

Future principal payments receivable are as follows:

| Year Ended June 30, | Principal    |
|---------------------|--------------|
| 2029                | \$ 322,501   |
| 2030                | 1,224,262    |
| 2031                | 606,517      |
|                     | \$ 2,153,280 |

NOTE E -- CAPITAL ASSETS

The following is a summary of changes in capital assets for the year ended June 30, 2014:

|                                   | Beginning<br>Balance | Additions  | Disposals | Ending<br>Balance |
|-----------------------------------|----------------------|------------|-----------|-------------------|
| Capital Assets Being Depreciated: |                      |            |           |                   |
| Furniture and equipment           | \$ 100,451           |            |           | \$ 100,451        |
| Accumulated depreciation          | (87,634)             | \$ (6,233) |           | (93,867)          |
| CAPITAL ASSETS, NET               | \$ 12,817            | \$ (6,233) | \$ 0      | \$ 6,584          |

Depreciation expense for the year ended June 30, 2014 was \$6,233.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE F -- LEASE OBLIGATIONS

The Fund leases office space from a party outside of State government and this lease is accounted for as an operating lease. Rental expense under this lease for the year ended June 30, 2014 was \$228,352.

The future minimum lease payments due under this lease are as follows for the year ended June 30:

|           |    |                  |
|-----------|----|------------------|
| 2015      | \$ | 228,362          |
| 2016      |    | 246,119          |
| 2017      |    | 246,119          |
| 2018      |    | 246,119          |
| 2019      |    | 246,119          |
| 2020-2024 |    | 1,266,111        |
| 2025      |    | 254,998          |
|           | \$ | <u>2,733,947</u> |

The Fund has also entered into an operating lease from a party outside the State government for office equipment which contains a cancellation provision and is subject to annual appropriation. In the normal course of business, operating leases are generally renewed or replaced by other leases. Operating leases are generally payable on a monthly basis. For the year ended June 30, 2014, expenses under this lease were \$7,575.

NOTE G -- RESTRICTED NET POSITION – SAVANNAH VALLEY DEVELOPMENT PROGRAM

At June 30, 2014, \$17,846,720 of the Fund’s net position is restricted for loans to the Savannah Valley Development Division of the Department of Commerce, as authorized under South Carolina State Code 13-9-10, formerly the Clark’s Hill-Russell Authority (a Joint Resolution; R-22, H2516; of the State, approved March 12, 1987, and R-755, H2680; of the State, approved June 20, 1988). The Fund is authorized to acquire up to \$20,000,000 of revenue notes in the aggregate, or \$3,500,000 in any calendar year. As of June 30, 2014, \$2,153,280 was outstanding on loans made under this program.

NOTE H -- PENSION PLANS

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 Benefits Division of the South Carolina Public Employee Benefit Authority (PEBA). Generally, all full-time or part-time equivalent State employees in a permanent position 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, as amended, or are eligible and elect to participate in the State Optional Retirement Program (ORP). The SCRS plan provides life-time monthly retirement annuity benefits to eligible members as well as disability, survivor options, annual benefit adjustments, and incidental death benefits to eligible employees and retired members.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE H -- PENSION PLANS – Continued

The Retirement Division maintains five 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 Public Employee Benefit Authority, P.O. Box 11960, Columbia, South Carolina 29211-1960. Furthermore, the Division and the five pension plans are included in the State of South Carolina's CAFR.

Under the SCRS, Class II members are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years of credited service regardless of age. Employees who first became members of the System after June 30, 2012 are considered Class III members and are eligible for a full service retirement annuity upon reaching age 65 or upon meeting the rule of 90 requirement (i.e., the members age plus the years of service add up to a total of at least 90). 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 (AFC) multiplied by the number of years of credited service. For Class II members, AFC is the average annual earnable compensation during twelve consecutive quarters and includes an amount for up to 45 days termination pay at retirement for unused annual leave. For Class III members, AFC is the average annual earnable compensation during twenty consecutive quarters and termination pay for unused annual leave at retirement is not included. Early retirement options with reduced benefits are available as early as age 55 for Class II members and age 60 for Class III members. Class II members are vested for a deferred annuity after five years of earned service. Class III members are vested for a deferred annuity after eight years of earned service. Members qualify for a survivor's benefit upon completion of fifteen years of credited service (five years effective January 1, 2002).

Disability annuity benefits are available to Class II members if they have permanent incapacity to perform regular duties of the member's job and they have at least five years of earned service (this requirement does not apply if the disability is a result of a job related injury). Class III members can apply for disability annuity benefits provided they have a permanent incapacity to perform the regular duties of the member's job and they have a minimum of eight years of credited service. For disability applications received after December 31, 2013, a member of SCRS will have to be approved for disability benefits from the Social Security Administration in order to be eligible for SCRS disability retirement benefits.

An incidental death 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 or to a working retired contributing member. There is no service requirement for death resulting from actual performance of duties for an active member. For eligible retired members, a lump-sum payment is made to the retiree's beneficiary of up to \$6,000 based on years of service at retirement. TERI participants and retired contributing members are eligible for the increased death benefit equal to their annual salary in lieu of the standard retired member benefit.

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 benefit adjustments granted during the TERI period. Because participants are considered retired during the TERI period,

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE H -- PENSION PLANS – Continued

they do not earn service credit, and are ineligible for disability retirement benefits. The TERI program will end effective June 30, 2018 and a member's participation may not continue after this date.

Effective July 1, 2013, employees participating in the SCRS were required to contribute 7.50% of all earnable compensation. The employer contribution rate for SCRS was 15.52%. Included in the total SCRS employer contribution rate is a base retirement contribution of 10.45%, .15% for the incidental death benefit program and a 4.92% surcharge that will fund retiree health and dental insurance coverage. The Fund's actual contributions to the SCRS for the years ended June 30, 2014, 2013, and 2012 were \$304,515, \$386,451, and \$333,154, respectively, and equaled the base required retirement contribution rate, excluding retiree insurance surcharge, of 10.45% for 2014, 10.45% for 2013, and 9.385% for 2012. Also, the Fund paid employer incidental death benefit program contributions of \$2,972, \$3,864, and \$3,659, at the rate of .15% of compensation for the current fiscal years ended June 30, 2014, 2013, and 2012 respectively.

As an alternative to membership in the SCRS, newly hired State and school district employees may elect to participate in the State Optional Retirement Program (ORP), a defined contribution retirement plan. The ORP was established in 1987 under Title 9, Chapter 20, of the South Carolina Code of Laws. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. The State assumes no liability for the State ORP plan other than for the employer's payment of contributions to designated companies. To elect participation in the ORP, eligible employees must elect membership within their first 30 days of employment. Under State law, contributions to the ORP are required at the same rates as for the SCRS, 10.60% plus the retiree surcharge of 4.92% from the employer in fiscal year 2014. Of the 10.60% employer contribution rate, the employer remits 5.00% directly to the participant's ORP account and the remaining 5.45% retirement contribution and .15% incidental death benefit program contribution amounts are remitted to SCRS. For fiscal year 2014, total contributions requirements to the ORP were \$21,060 (excluding the surcharge) from the Fund as employer and \$10,124 from its employees as plan members.

The amounts paid by the Fund for pension, incidental death benefit program, and accidental death program contributions are reported as employer contribution expenditures within the applicable functional 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.

While the surcharge to fund retiree health and dental insurance benefits is collected by the Retirement Benefits Division of PEBA, it is remitted to the Insurance Benefits Division of PEBA, which is responsible for administration of retiree health and dental insurance benefits and establishment of the applicable retiree insurance surcharge rate.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE H -- PENSION PLANS – Continued

For the current fiscal year, the SCRS does not make separate measurements of assets and pension benefit obligations for individual employers within the cost-sharing plan. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of required employer contributions (stated as a percentage of covered payroll) as established by the South Carolina Public Employee Benefit Authority and as appropriated in the South Carolina Appropriation Act and from other applicable revenue sources. Accordingly, the Fund recognizes no contingent liability for unfunded costs associated with participation in the plans.

NOTE I -- POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS

Plan Description

In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State provides post-employment health and dental and long-term disability benefits to retired State and school district employees and their covered dependents. The Fund contributes to the South Carolina Retiree Health Insurance Trust Fund (SCRHITF) and the South Carolina Long-Term Disability Insurance Trust Fund (SCLTDITF), cost-sharing multiple employer defined benefit postemployment healthcare, and long-term disability plans administered by the Insurance Benefits Division (IB), a part of the South Carolina Public Employee Benefit Authority (PEBA).

Generally, retirees are eligible for the health and dental benefits if they have established at least ten years of retirement service credit. For new hires beginning employment May 2, 2008 and after, retirees are eligible for benefits if they have established 25 years of service for 100% employer funding and 15 through 24 years of service for 50% employer funding.

Benefits become effective when the former employee retires under a State retirement system. Basic Long-Term Disability (BLTD) benefits are provided to active state, public school district, and participating local government employees approved for disability.

Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the IB and participating retirees to the PEBA, except for the portion funded through the pension surcharge and provided from the other applicable sources of the IB, for its active employees who are not funded by State General Fund appropriations. Employers participating in the RMP are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 4.92% of annual covered payroll for 2014 and 4.55% of annual covered payroll for 2013. The IB sets the employer contribution rate based on a pay-as-you-go basis. The Fund paid \$112,305 and \$131,728 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2014 and 2013, respectively. BLTD benefits are funded through a person's premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to IB was \$3.22 for the fiscal years ended June 30, 2014 and 2013. The Fund recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of \$1,549 and \$2,225 for the years ended June 30, 2014 and 2013, respectively.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE I -- POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS – Continued

Effective May 1, 2008 the State established two trust funds through Act 195 for the purpose of funding and accounting for the employer costs of retiree health and dental insurance benefits and long-term disability insurance benefits. The SCRHITF is primarily funded through the payroll surcharge. Other sources of funding include additional State appropriated dollars, accumulated IB reserves, and income generated from investments. The SCLTDITF is primarily funded through investment income and employer contributions.

A copy of the separately issued financial statements for the benefit plans and the trust funds may be obtained by writing to the South Carolina Public Employee Benefit Authority – Insurance Benefits Division, P.O. Box 11960, Columbia, South Carolina 29211-1960.

NOTE J -- TRANSACTIONS WITH STATE ENTITIES

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

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, 2014:

|   |    |           |
|---|----|-----------|
| Adjutant General's Office                 | \$ | 220,733   |
| Administrative Law Court                  |    | 2,193     |
| Aeronautics Division                      |    | 51,380    |
| Agriculture Department of South Carolina  |    | 75,858    |
| Aiken County Mental Health                |    | 3,792     |
| Anderson -Oconee Pickens                  |    | 8,423     |
| Appellate Defense Commission              |    | 10,826    |
| Archives and History Department           |    | 17,841    |
| Arts Commission                           |    | 12,073    |
| Attorney General Office                   |    | 31,980    |
| Beckman Center for Mental Health          |    | 4,275     |
| Berkeley County Mental Health             |    | 4,279     |
| Board of Law Examiners                    |    | 664       |
| Board of Magistrates                      |    | 4,482     |
| Budget and Control Board                  |    | 1,801,493 |
| Catawba Center for Growth and Development |    | 3,267     |
| Charleston Dorchester Community           |    | 7,832     |
| Citadel                                   |    | 646,245   |

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE J -- TRANSACTIONS WITH STATE ENTITIES – Continued

|   |           |
|---|-----------|
| Clemson University                                  | 3,131,929 |
| Coastal Carolina University                         | 1,003,723 |
| Coastal Empire-M H Center                           | 5,717     |
| Codification of Laws and Legislative Council        | 2,734     |
| College of Charleston                               | 1,231,767 |
| Columbia Area Mental Health Center                  | 16,086    |
| Commission on Prosecution Coordination              | 10,756    |
| Comptroller General's Office                        | 9,940     |
| Court of Appeals                                    | 12,629    |
| Department of Alcohol and Other Drug Abuse Services | 8,038     |
| Department of Commerce                              | 17,784    |
| Department of Corrections                           | 1,887,938 |
| Department of Disabilities and Special Needs        | 436,199   |
| Department of Education                             | 4,122,360 |
| Department of Health and Human Services             | 144,022   |
| Department of Health and Environmental Control      | 1,012,733 |
| Department of Juvenile Justice                      | 409,531   |
| Department of Mental Health                         | 1,673,130 |
| Department of Motor Vehicles                        | 153,910   |
| Department of Natural Resources                     | 829,203   |
| Department of Probation, Parole & Pardon Services   | 212,090   |
| Department of Public Safety                         | 666,451   |
| Department of Social Services                       | 375,212   |
| Department of Transportation                        | 6,798,542 |
| Department of Vocational Rehabilitation             | 342,834   |
| Education Oversight Committee                       | 6,723     |
| ETV/SDN   | 314,141   |
| Financial Institutions Board                        | 13,823    |
| Forestry Commission                                 | 243,166   |
| Francis Marion University                           | 387,812   |
| Governor's Office                                   | 58,182    |
| Governor's Office - SLED                            | 432,866   |
| Governor's School for Science                       | 59,445    |
| Greenville Mental Health                            | 9,083     |
| Higher Education Commission                         | 10,878    |
| Higher Education Tuition Grant Commission           | 1,523     |

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE J -- TRANSACTIONS WITH STATE ENTITIES – Continued

|  |           |
|--|-----------|
| Horry County Higher Education Commission     | 8,160     |
| House of Representatives                     | 127,352   |
| Housing, Finance and Development Authority   | 30,199    |
| Human Affairs Commission                     | 6,801     |
| John De La Howe School                       | 84,661    |
| Judicial Department                          | 540       |
| Lander University                            | 293,849   |
| Legislative Audit Council                    | 4,913     |
| Legislative Services Agency                  | 15,534    |
| Lexington County Community Mental Health     | 8,170     |
| Lieutenant Governor's Office                 | 15,546    |
| LLR-Architectural Exam Board                 | 179,466   |
| Medical University of SC                     | 8,314,171 |
| MUSC Hospital Authority                      | 2,531,861 |
| Office of Regulatory Staff                   | 11,574    |
| Orangeburg Area Mental Health                | 8,667     |
| Parks Recreation and Tourism                 | 587,365   |
| Patients' Compensation Fund                  | 7,589     |
| Patriots Point Development Authority         | 105,877   |
| Pee Dee Mental Health                        | 7,544     |
| Piedmont Mental Health Center                | 13,702    |
| Procurement Review Panel                     | 3,173     |
| Public Service Authority SC                  | 473,562   |
| Public Service Commission                    | 12,005    |
| Retirement System Investment Commission      | 13,278    |
| Revenue and Taxation Department              | 96,124    |
| Santee Wateree Mental Health                 | 6,843     |
| SC Commission for the Blind                  | 16,094    |
| SC Conservation Bank                         | 6,059     |
| SC Criminal Justice Academy                  | 83,761    |
| SC Department of Insurance                   | 15,972    |
| SC Department of Consumer Affairs            | 9,266     |
| SC Department of Employment and Workforce    | 113,732   |
| SC Governor's School for Arts and Humanities | 53,336    |
| SC Rural Infrastructure Authority            | 6,817     |
| SC School for the Deaf and Blind             | 193,764   |

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE J -- TRANSACTIONS WITH STATE ENTITIES – Continued

|   |                      |
|---|----------------------|
| SC State Accident Fund                            | 9,463                |
| SC State Senate                                   | 27,641               |
| SC State University                               | 395,565              |
| SC Transportation Infrastructure Bank             | 4,385                |
| SC Workers Compensation Commission                | 14,657               |
| Sea Grant Consortium                              | 3,720                |
| Secretary of State                                | 4,333                |
| Spartanburg Area Mental Health                    | 17,824               |
| State Auditor's Office                            | 5,724                |
| State Board of Financial Institutions             | 140                  |
| State Commission for Minority Affairs             | 3,737                |
| State Election Commission                         | 8,539                |
| State Ethics Commission                           | 5,769                |
| State Library                                     | 12,196               |
| State Museum Commission                           | 27,187               |
| State Treasurer's Office                          | 17,021               |
| Technical and Comprehensive Education Board       | 40,107               |
| Tobacco Settlement Revenue Management             | 2,490                |
| Tri-County Community Mental Health                | 6,915                |
| University of South Carolina - Aiken              | 158,001              |
| University of South Carolina - Beaufort           | 69,503               |
| University of South Carolina - Lancaster          | 38,857               |
| University of South Carolina - Salkehatchie       | 52,533               |
| University of South Carolina - School of Medicine | 1,067,566            |
| University of South Carolina - Spartanburg        | 218,642              |
| University of South Carolina - Sumter             | 39,744               |
| University of South Carolina - Columbia Campus    | 3,577,386            |
| Waccamaw Mental Health Center                     | 11,911               |
| Wil Lou Gray Opportunity School                   | 35,230               |
| Winthrop University                               | 615,601              |
|   | <u>\$ 48,920,250</u> |

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE J -- TRANSACTIONS WITH STATE ENTITIES – Continued

Premiums owed from these entities as of June 30, 2014 were:

|  |    |                  |
|--|----|------------------|
| Adjutant General's Office                      | \$ | 235,224          |
| Arts Commission                                |    | 11,409           |
| Berkeley County Mental Health                  |    | 4,253            |
| Budget and Control Board                       |    | 22,941           |
| Carolina Cup Racing Association                |    | 190              |
| Central Carolina Technical College             |    | 94,680           |
| Clemson University                             |    | 1,554            |
| Court of Appeals                               |    | 73,169           |
| Department of Disabilities and Special Needs   |    | 47,910           |
| Department of Education                        |    | 13,626           |
| Department of Health and Human Services        |    | 144,626          |
| Department of Juvenile Justice                 |    | 404,078          |
| Governor's Office - SLED                       |    | 330,378          |
| Horry-Georgetown Technical College             |    | 172,172          |
| Midlands Technical College                     |    | 10,200           |
| MUSC Hospital Authority                        |    | 106              |
| Office of Regulatory Staff                     |    | 12,229           |
| Patriots Point Development Authority           |    | 103,834          |
| Public Service Authority SC                    |    | 23               |
| Revenue and Taxation Department                |    | 100,329          |
| SC Criminal Justice Academy                    |    | 87,196           |
| SC Education Lottery                           |    | 54,513           |
| SC State University                            |    | 391,788          |
| State Auditor's Office                         |    | 5,984            |
| State Ethics Commission                        |    | 10,593           |
| State Library                                  |    | 12,009           |
| State Museum Commission                        |    | 31,400           |
| Trident Technical College                      |    | 426,288          |
| University of South Carolina - Aiken           |    | 160,043          |
| University of South Carolina - Columbia Campus |    | 3,608,715        |
| University of South Carolina - Lancaster       |    | 917              |
| University of South Carolina - Spartanburg     |    | 107              |
| York Technical College                         |    | 163,562          |
|  | \$ | <u>6,736,046</u> |

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE J -- TRANSACTIONS WITH STATE ENTITIES – Continued

The Fund has financial transactions with various State agencies during the fiscal year. Significant payments were made to Divisions (Offices) of the State Budget and Control Board for retirement and insurance plan contributions, vehicle rental, printing, and telephone, interagency mail, data processing services, purchasing, record maintenance, internal audit and personnel services. Significant payments were also made for unemployment and workers’ compensation coverage for employees to other agencies. The amounts of 2014 expenses applicable to related party transactions not disclosed elsewhere are:

|   |           |               |
|---|-----------|---------------|
| South Carolina Department of Employment and Workforce | \$        | 1,733         |
| South Carolina State Accident Fund                    |           | 12,975        |
|   | <u>\$</u> | <u>14,708</u> |

NOTE K -- CONTINGENCIES

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

As a result of the 2004-2005 Appropriations Act Proviso 63.47, the Fund is to provide funds to cover legal defense costs of the State associated with the Abbeville School Funding litigation case. During the year ended June 30, 2014, the Fund did not incur any legal defense costs associated with the case. However, the ultimate amount of this liability is not known as of the date of our report.

As a result of the 2006-2007 Appropriations Act Proviso 63.33, the Fund is to provide funds to cover legal defense costs of the State associated with the Prison Mental Health Care litigation case. During the year ended June 30, 2014, the Fund did not incur any legal defense costs associated with the case. However, the ultimate amount of this liability is not known as of the date of our report.

As a result of the 2007-2008 Appropriations Act Proviso 63.51, the Fund is to provide funds to cover legal defense costs of the State associated with the State Ethics Commission litigation case. During the year ended June 30, 2014, the Fund did not incur any legal defense costs associated with the case. However, the ultimate amount of this liability is not known as of the date of our report.

NOTE L -- 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.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE L -- RISK MANAGEMENT/REINSURANCE – Continued

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 losses sustained during the policy period in accordance 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 (Department of Employment and Workforce);
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Public Employee Benefits Authority); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Public Employee Benefits Authority).

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 acts as an insurance company in that it 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 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, 2014, based on the requirements of GASB 10 because information at June 30, 2014 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<sup>th</sup> and the amount of loss is reasonably estimable.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
*SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND*

NOTE L -- RISK MANAGEMENT/REINSURANCE – Continued

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

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

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

\$10,000,000 per occurrence, \$15,000,000 in the aggregate, \$1,000,000 trailing after both occurrence and aggregate.

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE M -- RECONCILIATION OF CLAIMS LIABILITY

The schedule below presents the changes in claims liabilities for the years ended June 30:

|  | <u>2014</u><br><u>(in thousands)</u> | <u>2013</u><br><u>(in thousands)</u> |
|--|--------------------------------------|--------------------------------------|
| Unpaid claims and claim adjustment expenses at beginning of the fiscal year                    | \$ 259,649                           | \$ 244,520                           |
| Incurred claims and claim adjustment expenses:   |                                      |                                      |
| Provision for insured events of the current fiscal year  | 12,595                               | 15,221                               |
| Increases (decreases) in provision for insured events of prior fiscal years                    | <u>60,326</u>                        | <u>64,286</u>                        |
| Total incurred claims and claim adjustment expenses  | <u>72,921</u>                        | <u>79,507</u>                        |
| Payments:  |                                      |                                      |
| Claims and claim adjustment expenses attributable to insured events of the current fiscal year | 12,811                               | 12,325                               |
| Claims and claim adjustment expenses attributable to insured events of prior fiscal years      | <u>61,361</u>                        | <u>52,053</u>                        |
| Total payments   | <u>74,172</u>                        | <u>64,378</u>                        |
| Total unpaid claims and claim adjustment expenses at end of the fiscal year                    | <u>\$ 258,398</u>                    | <u>\$ 259,649</u>                    |
| The above totals are comprised of the following:   |                                      |                                      |
| Claims payable   | \$ 161,660                           | \$ 158,600                           |
| Claims incurred but not reported   | <u>96,738</u>                        | <u>101,049</u>                       |
| TOTAL  | <u>\$ 258,398</u>                    | <u>\$ 259,649</u>                    |

NOTE N -- CHANGES IN LONG-TERM LIABILITIES

Changes in long-term obligations for the year ended June 30, 2014 were as follows:

|                              | <u>Balance</u><br><u>July 1, 2013</u> | <u>Increases</u>  | <u>Decreases</u>    | <u>Balance</u><br><u>June 30, 2014</u> | <u>Due Within</u><br><u>One Year</u> |
|------------------------------|---------------------------------------|-------------------|---------------------|--|--------------------------------------|
| Compensated absences payable | <u>\$ 304,789</u>                     | <u>\$ 177,477</u> | <u>\$ (200,930)</u> | <u>\$ 281,336</u>                      | <u>\$ 172,767</u>                    |

NOTES TO THE BASIC FINANCIAL STATEMENTS  
 SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD INSURANCE RESERVE FUND

NOTE O -- INSURANCE PREMIUMS AND CLAIMS EXPENSE

Total insurance premium revenues and direct claims expenses by line of insurance are as follows:

|                                   | <u>Insurance<br/>Premiums</u> | <u>Claims<br/>Expenses</u> |
|-----------------------------------|-------------------------------|----------------------------|
| Tort Liability                    | \$ 34,682,326                 | \$ 28,017,174              |
| Data Processing and Inland Marine | 7,426,277                     | 1,330,327                  |
| Auto                              | 18,148,328                    | 3,284,450                  |
| Building and Personal Property    | 33,159,811                    | 7,279,405                  |
| Professional Liability            | 16,875,782                    | 7,040,396                  |
| School Bus                        | 3,849,330                     | 2,820,638                  |
|                                   | <u>\$ 114,141,854</u>         | <u>\$ 49,772,390</u>       |

## COMPLIANCE AND INTERNAL CONTROL

1704 Laurel Street  
Columbia, SC 29201  
  
P.O. Box 2411  
Columbia, SC 29202



Phone (803) 799-0555  
Fax (803) 799-4212  
  
[www.hobbsscpa.com](http://www.hobbsscpa.com)

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND  
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited, 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, the financial statements of the business-type activities of the South Carolina State Budget and Control Board Insurance Reserve Fund (the "*Fund*") as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated September 29, 2014.

#### INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from 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*.

## PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Columbia, South Carolina  
September 29, 2014

*The Holla Group, P.A.*