PALMETTO RAILWAYS

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2013

State of South Carolina

Office of the State Auditor

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COLUMBIA, S.C. 29201

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

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May 19, 2014

The Honorable Nikki R. Haley, Governor
and
Mr. Robert M. Hitt III, Secretary of Commerce
South Carolina Department of Commerce
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Department of Commerce – Division of Public Railways d/b/a Palmetto Railways, for the fiscal year ended December 31, 2013, was issued by Greene, Finney & Horton, LLP, 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,

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

RHGjr/cwc

PALMETTO RAILWAYS
TABLE OF CONTENTS
YEAR ENDED DECEMBER 31, 2013

Greene Finney & Horton
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the South Carolina Department of Commerce – Division of Public Railways d/b/a Palmetto Railways (the "Division") as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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.

Auditor's Responsibility

Our responsibility is to express 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 Division as of December 31, 2013, and the respective changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as listed in the table of contents, 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 May 6, 2014 on our consideration of the Division'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 Division's internal control over financial reporting and compliance.

Greene, Finney & Horton LLP

Greene, Finney & Horton, LLP
Mauldin, South Carolina
May 6, 2014

Management's Discussion and Analysis

Our discussion and analysis of South Carolina Department of Commerce – Division of Public Railways d/b/a Palmetto Railways (the "Division") financial performance provides an overview of the financial activities for the fiscal year ended December 31, 2013. Please read these comments in conjunction with the financial statements.

Using This Annual Report

This annual report consists of a series of financial statements. The *Statement of Net Position*; the *Statement of Revenues, Expenses and Changes in Fund Net Position*; and *Statement of Cash Flows* provide information regarding the activities of the Division's three subdivisions and as a whole.

The three operating subdivisions of the Division are:

Charleston Subdivision (CHS)
North Charleston Subdivision (NCS)
Charity Church Subdivision (CCS)

All subdivisions are enterprise fund activities, and all are reported on the accrual basis. CHS and NCS are combined in the financial statements.

These statements provide information on the Division's net position, operations, and cash flows for the year ended December 31, 2013. This discussion and analysis is intended to serve as an introduction to the financial statements. The notes to the financial statements also contain details on some of the information presented in the financial statements.

Reporting on the Division as a whole

The subdivisions are enterprise funds for accounting and reporting purposes. Enterprise funds are used when governmental entities charge customers for services. Enterprise funds very closely resemble the financial statements of business entities. These statements offer short and long-term financial information about the Division's activities. The Statement of Net Position presents information on all of the Division's assets, liabilities, and net position. Net position represents assets and deferred outflows of resources less liabilities and deferred inflows of resources.

Over time, increases and decreases in net position, specifically unrestricted net position, may serve as a useful indicator of whether the financial position of the Division is improving or deteriorating. The Statement of Revenues, Expenses and Changes in Fund Net Position presents information showing how the Division's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are recorded in this statement for some items that will only result in cash flows in future fiscal periods.

Financial Highlights

- Operating revenues increased in 2013 by $354,548 or 3.1% due primarily to increases in the volume of rail shipments by BP on the CCS.

- Earnings on investments decreased in 2013 by $391,744 or 127.2% primarily due to a decrease in invested cash following property acquisitions.

- Other non-operating revenue increased $798,100 or 167.9% due to rental income on the newly acquired property on the former navy base and fewer expenses associated with repairs on the navy base.

- Maintenance of way & structures expenses decreased $463,571 or 26.7%; this is primarily due to less maintenance of way work performed for customers in 2013. The 2012 expenses included over $400,000 in rail material for customer projects.

- Maintenance of equipment expenses increased $74,876 or 8.3% due primarily to contract labor associated with locomotive repairs.

- Transportation expenses increased $377,221 or 16.1% due primarily to salary, benefits and expenses associated with adding four trainmen in 2013 and a trainmaster in the middle 2012.

- General expenses increased $37,804 or 1.4% primarily due to merit increases in 2013.

- Other non-operating expenses increased $81,653 or over 100% due to additional non-core projects in 2013.

- Current and other assets decreased $10,744,361 or 40.0% due to the purchase in October of 2013 of office and warehouse buildings on the former Navy Yard for $10.0 million in October.

- Capital assets increased by $14,995,178 or 21.6% due to the purchase of the office and warehouse buildings noted above and further development of the Intermodal Container Transfer Facility.

- Current liabilities increased $1,255,034 or 39.8% primarily due to a $1,153,154 increase in accounts payable as a result of accrued expenses related to various ongoing capital projects.

- Other liabilities decreased $2,364,286 or 17.7% primarily due to the first $2,000,000 installment payment made to the City of North Charleston in March 2013.

- Net position increased by $5,311,944 or 6.6% in 2013. Net investment in capital assets increased $17,145,178 or 31.1% and unrestricted net position decreased $11,833,234 or 47.7%.

Financial Analysis

The following are the condensed financial statements of the Division for fiscal years 2013 and 2012, including information concerning the events and circumstances regarding the balances and changes:

Financial Analysis (Continued)

Condensed Statement of Net Position

	2013	2012	Amount Change	% Change
Current and other assets, net*	$ 16,149,638	26,942,124	$ (10,792,486)	-40.1%
Capital assets, net of depreciation*	84,523,453	69,528,275	14,995,178	21.6%
Total Assets	$ 100,673,091	96,470,399	$ 4,202,692	4.4%
Current liabilities	$ 4,410,402	3,155,368	$ 1,255,034	39.8%
Other liabilities	10,970,714	13,335,000	(2,364,286)	-17.7%
Total Liabilities	15,381,116	16,490,368	(1,109,252)	-6.7%
Net Position:				
Net investment in capital assets	72,313,453	55,168,275	17,145,178	31.1%
Unrestricted	12,978,522	24,811,756	(11,833,234)	-47.7%
Total Net Position	85,291,975	79,980,031	5,311,944	6.6%
Total Liabilities and Net Position	$ 100,673,091	$ 96,470,399	$ 4,202,692	4.4%

*Costs of $8,000,000 originally recorded as servicing rights (other assets) were reclassified to construction in progress (capital assets) in the table above

Changes in assets, liabilities and net position are discussed in the Financial Highlights section above.

Condensed Statement of Revenues, Expenses and Changes in Fund Net Position

	2013	2012	Amount Change	% Change
Revenues:				
Operating revenues	$ 11,858,749	11,504,201	$ 354,548	3.1%
Earnings on investments	(83,677)	308,067	(391,744)	-127.2%
Other non-operating revenues	1,272,262	475,277	796,985	167.7%
Total Revenues	13,047,334	12,287,545	759,789	6.2%
Expenses:				
Maintenance of way and structures	1,272,710	1,737,396	(464,686)	-26.7%
Maintenance of equipment	979,133	904,257	74,876	8.3%
Transportation	2,715,650	2,338,429	377,221	16.1%
General	2,681,724	2,643,920	37,804	1.4%
Total Railroad	7,649,217	7,624,002	25,215	0.3%
Other non-operating expenses	86,173	4,520	81,653	1806.5%
Total Expenses	7,735,390	7,628,522	106,868	1.4%
Change in Net Position	5,311,944	4,659,023	652,921	14.0%
Net Position, Beginning of Year	79,980,031	75,321,008	4,659,023	6.2%
Net Position, End of Year	$ 85,291,975	79,980,031	$ 5,311,944	6.6%

Changes in revenues and expenses are discussed in the Financial Highlights section above.

Financial Analysis (Continued)

Detailed Information on the Funds

CHS and NCS had a combined increase in net position of $12,882,355 or 24.7% primarily due to income before transfers of $1,982,355 and transfers in of $10,900,000 received from CCS. Net investment in capital assets increased $16,990,444 or 38.7% while unrestricted net position decreased $4,108,089 or 49.5%. These changes in net position are primarily due to the acquisition and construction of capital assets. Major changes in assets and liabilities include a $3,690,000 or 99.8% decrease in deposits to purchase land due to refunds received in 2013 of land deposits made in 2012, a $14,840,444 or 39.1% increase in capital assets discussed in detail below, and a $2,000,000 decrease in settlements payable as a result of the first installment payment made to the City of North Charleston per the terms of the settlement agreement. Revenues and expenses were fairly consistent with the prior year with the major change being the increased rental income from the Navy Yard properties purchased during the year.

CCS had a decrease in net position of $7,570,411 or 27.2% primarily due to income before transfers of $3,329,589 offset by transfers out of $10,900,000 made to CHS and NCS. Net investment in capital assets increased $154,734 or 1.4% while unrestricted net position decreased $7,725,145 or 46.8%. Major changes include a $7,677,864 or 47.4% decrease in cash and cash equivalents as a result of the transfer to CHS and NCS. Revenues and expenses were fairly consistent with the prior year with the major change being the increased revenue from freight charges and the transfer out as discussed above.

Financing Activities

As part of the settlement agreement with the City of North Charleston, the Division assumed responsibility for payment of $6,360,000 in Tax Increment Financing ("TIF") Bonds. Principal and interest is payable in annual installments beginning September 2013 through September 2037 with variable interest (.06% at June 30, 2013), as determined by the remarketing agent, payable each month. The balance outstanding at December 31, 2013 was $6,210,000.

More detailed information about the Division's financing activities is presented in the Notes to the Financial Statements.

Capital Asset Activities

Capital assets consist of land, land improvements, fencing, buildings, machinery and equipment, depreciable roads, non-depreciable roads, leasehold improvements and projects under construction. The Division had $84,523,453 invested in capital assets, net of accumulated depreciation, as of December 31, 2013, compared to $69,528,275 as of December 31, 2012. The table below provides a summary.

Capital Asset Activities (Continued)

Capital Assets at December 31,

	2013	2012
Land	$ 23,563,608	21,277,946
Land improvements	9,535,235	9,535,235
Fencing	51,478	51,478
Buildings	18,801,458	10,419,100
Machinery and equipment	6,062,164	5,539,526
Depreciable road	1,192,360	1,192,360
Non-depreciable road	9,810,789	9,160,119
Leasehold improvements	184,106	251,515
Projects under construction	21,892,041	18,115,287
Total Capital Assets	91,093,239	75,542,566
Less: Accumulated Depreciation	(6,569,786)	(6,014,291)
Capital Assets, Net	$ 84,523,453	69,528,275

Major additions in 2013 include the purchase of the office and warehouse buildings on the former Navy Yard for approximately $10.0 million and further development of the Intermodal Container Transfer Facility.

More detailed information about the Division’s capital asset activities is presented in the Notes to the Financial Statements.

Economic Factors and Next Year Operations

- Freight traffic on the CCS will be up for BP Amoco in 2014 mainly due to improved economic conditions.

- Traffic at CHS is projected to be higher in 2014 due to a BMW expansion.

- NCS traffic is expected to be higher as a new customer has leased the transloading facility in North Charleston.

- Capital expenditures will continue to be incurred as the permitting process continues for the construction of the Intermodal Container Transfer Facility.

BASIC FINANCIAL STATEMENTS

PALMETTO RAILWAYS
STATEMENT OF NET POSITION - ENTERPRISE FUNDS
DECEMBER 31, 2013

	CHS-NCS	CCS	INTERDIVISION ELIMINATIONS	TOTAL
ASSETS				
Current Assets:				
Cash and cash equivalents	$ 4,573,992	8,536,118	-	$ 13,110,110
Cash - security deposits	83,405	-	-	83,405
Accounts receivable	791,382	441,765	-	1,233,147
Accounts receivable from other division	288,378	56,640	(345,018)	-
Interest receivable	3,765	14,642	-	18,407
Deposits to purchase land	8,000	-	-	8,000
Inventories	1,291,769	51,103	-	1,342,872
Prepayments	236,772	1,925	-	238,697
Total Current Assets	7,277,463	9,102,193	(345,018)	16,034,638
Property, Plant and Equipment:				
Land and non-depreciable assets	54,643,268	10,158,405	-	64,801,673
Other depreciable assets, net of accumulated depreciation	18,422,003	1,299,777	-	19,721,780
Total Property, Plant and Equipment	73,065,271	11,458,182	-	84,523,453
Other Non-current Assets:				
Servicing rights	-	2,300,000	-	2,300,000
Accumulated amortization - Servicing Rights	-	(2,185,000)	-	(2,185,000)
Total Other Non-current Assets	-	115,000	-	115,000
TOTAL ASSETS	**$ 80,342,734**	**20,675,375**	**(345,018)**	**$ 100,673,091**
LIABILITIES				
Current Liabilities:				
Accounts payable to other division	$ 56,640	288,378	(345,018)	-
Accounts payable - other	1,399,882	-	-	1,399,882
Security deposits	83,405	-	-	83,405
Accrued payroll	216,018	-	-	216,018
Payroll taxes withheld and accrued employee benefits	53,337	-	-	53,337
Accrued annual leave and benefits	114,462	145,679	-	260,141
Settlement payable - Short-Term	2,000,000	-	-	2,000,000
TIF bonds payable - Short-Term	150,000	-	-	150,000
Unearned revenue	247,619	-	-	247,619
Total Current Liabilities	4,321,363	434,057	(345,018)	4,410,402
Non-current Liabilities:				
Settlement payable	4,000,000	-	-	4,000,000
TIF bonds payable	6,060,000	-	-	6,060,000
Unearned revenue	910,714	-	-	910,714
Total Non-current Liabilities	10,970,714	-	-	10,970,714
TOTAL LIABILITIES	**15,292,077**	**434,057**	**(345,018)**	**15,381,116**
NET POSITION				
Net investment in capital assets	60,855,271	11,458,182	-	72,313,453
Unrestricted	4,195,386	8,783,136	-	12,978,522
TOTAL NET POSITION	**$ 65,050,657**	**20,241,318**	**-**	**$ 85,291,975**

The accompanying notes to the financial statements are an integral part of this statement.
See accompanying independent auditor’s report.

PALMETTO RAILWAYS
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET POSITION - ENTERPRISE FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2013

	CHS-NCS	CCS	TOTAL
Operating Revenues:			
Switching fees	$ 3,165,653	408,019	$ 3,573,672
Freight charge	366,000	6,768,680	7,134,680
Rental revenue	591,412	7,574	598,986
Contractual services	158,940	-	158,940
Storage revenue	234,894	-	234,894
Dispatching service	-	44,406	44,406
Other revenue	113,171	-	113,171
Total Operating Revenues	4,630,070	7,228,679	11,858,749
Operating Expenses:			
Railways Operating Expenses:			
Maintenance of Way and Structures:			
Depreciation	100,199	50,636	150,835
Other maintenance of way expenses	424,891	696,984	1,121,875
Total Maintenance of Way and Structures	525,090	747,620	1,272,710
Maintenance of Equipment:			
Depreciation	177,154	146,239	323,393
Other equipment expenses	405,597	250,143	655,740
Total Maintenance of Equipment	582,751	396,382	979,133
Transportation:			
Superintendence	160,684	204,302	364,986
Yard employees	764,827	460,492	1,225,319
Other transportation expenses	556,123	569,222	1,125,345
Total Transportation	1,481,634	1,234,016	2,715,650
General:			
Administration	787,249	1,006,973	1,794,222
Insurance	418,866	353,636	772,502
Amortization of servicing rights	-	115,000	115,000
Total General	1,206,115	1,475,609	2,681,724
Total Railway Operating Expenses	$ 3,795,590	3,853,627	$ 7,649,217

The accompanying notes to the financial statements are an integral part of this statement.
See accompanying independent auditor’s report.

PALMETTO RAILWAYS

STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN FUND NET POSITION - ENTERPRISE FUNDS

FOR THE YEAR ENDED DECEMBER 31, 2013

	CHS-NCS	CCS	TOTAL
Operating Income	$ 834,480	3,375,052	$ 4,209,532
Non-operating Revenues (Expenses):			
Other rental income, net	967,653	100	967,753
Interest income and gain (loss) on investments	9,189	(92,866)	(83,677)
Gain (loss) on sale or disposal of fixed assets	31,325	(1,115)	30,210
Other income, net	15,830	48,418	64,248
Grant revenue	210,051	-	210,051
Industrial development costs	(86,173)	-	(86,173)
Total Non-Operating Revenues (Expenses)	1,147,875	(45,463)	1,102,412
Income Before Transfers	1,982,355	3,329,589	5,311,944
Transfers Between Divisions	10,900,000	(10,900,000)	-
Change in Net Position	12,882,355	(7,570,411)	5,311,944
Net Position, Beginning of Year	52,168,302	27,811,729	79,980,031
Net Position, End of Year	$ 65,050,657	20,241,318	$ 85,291,975

The accompanying notes to the financial statements are an integral part of this statement.
See accompanying independent auditor’s report.

PALMETTO RAILWAYS
STATEMENT OF CASH FLOWS - ENTERPRISE FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2013

	CHS-NCS	CCS	TOTAL
Cash Flows from Operating Activities:			
Cash received from customers	$ 4,578,446	7,211,047	$ 11,789,493
Cash payments to suppliers and employees	(4,025,987)	(3,701,934)	(7,727,921)
Rents received	1,525,524	-	1,525,524
Grants received	194,020	-	194,020
Security deposits	61,066	-	61,066
Other income received	63,955	48,518	112,473
Net Cash Provided By (Used In) Operating Activities	2,397,024	3,557,631	5,954,655
Cash Flows from Non-Capital Financing Activities:			
Cash received from/paid to other divisions	10,900,000	(10,900,000)	-
Net Cash Provided By (Used In) Non-Capital Financing Activities	10,900,000	(10,900,000)	-
Cash Flows from Capital and Related Financing Activities:			
Cash received from sale of fixed assets	31,325	-	31,325
Refund of land deposits	3,690,000	-	3,690,000
Payments for TIF bonds	(150,000)	-	(150,000)
Payments for legal settlement	(2,000,000)	-	(2,000,000)
Acquisition and construction of capital assets	(14,288,608)	(270,894)	(14,559,502)
Net Cash Provided By (Used In) Capital and Related Financing Activities	(12,717,283)	(270,894)	(12,988,177)
Cash Flows from Investing Activities:			
Investment income	13,409	(64,601)	(51,192)
Net Cash Provided By (Used In) Investing Activities	13,409	(64,601)	(51,192)
Net Increase (Decrease) in Cash and Cash Equivalents	593,150	(7,677,864)	(7,084,714)
Cash and Cash Equivalents, Beginning of Year	4,064,247	16,213,982	20,278,229
Cash and Cash Equivalents, End of Year	$ 4,657,397	8,536,118	$ 13,193,515

The accompanying notes to the financial statements are an integral part of this statement.
See accompanying independent auditor’s report.

PALMETTO RAILWAYS
STATEMENT OF CASH FLOWS - ENTERPRISE FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2013

	CHS-NCS	CCS	TOTAL
Reconciliation of Operating Income (Loss) to Net Cash Flows from Operating Activities:			
Operating Income (Loss)	$ 834,480	3,375,052	$ 4,209,532
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Depreciation	494,005	212,146	706,151
Depreciation charged to sister division	97,101	(97,101)	-
Amortization	-	115,000	115,000
Non-operating revenues (expenses)	1,107,361	48,518	1,155,879
(Increase) decrease in assets:			
Accounts receivable	(65,833)	(17,632)	(83,465)
Accounts receivable from other division	32,190	(56,640)	(24,450)
Inventories	67,088	4,017	71,105
Prepayments	(117,353)	-	(117,353)
Increase (decrease) in liabilities:			
Accounts payable - other	32,551	-	32,551
Accounts payable to other division	56,640	(32,190)	24,450
Security deposits	61,066	-	61,066
Payroll taxes withheld and accrued employee benefits	(9,417)	-	(9,417)
Accrued annual leave	5,077	6,461	11,538
Accrued salaries	16,354	-	16,354
Unearned revenue	(214,286)	-	(214,286)
Net Cash Provided By (Used In) Operating Activities	$ 2,397,024	3,557,631	$ 5,954,655
Schedule of Non-cash Investing, Capital and Financing Activities:			
Change in capital acquisitions included in accounts payable	$ 1,142,942	$ -	$ 1,142,942

The accompanying notes to the financial statements are an integral part of this statement.
See accompanying independent auditor’s report.

NOTE 1 - REPORTING ENTITY

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by generally accepted accounting principles, the financial reporting entity includes both the primary government and all its component units. Component units are legally separate organizations for which the elected officials or the primary government are financially accountable. In turn, component units may have component units.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity.

The primary entity is financially accountable if it appoints a voting majority of the organization's governing body including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally dependent on the primary entity that holds one or more of the following powers:

1. Determine its budget without another government's having the authority to approve and modify that budget.

2. Levy taxes or set rates or charges without approval by another government.

3. Issue bonded debt without approval by another government.

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

South Carolina Department of Commerce – Division of Public Railways d/b/a Palmetto Railways (the Division) is part of the State of South Carolina Primary Government. The Division is reported as an enterprise fund in the State’s Comprehensive Annual Financial Report.

Effective July 1, 1993, as part of the Government Restructuring Act of 1993, Code Section 13-1-1310 created the Division of Public Railways within the Department of Commerce which is governed by the Secretary of the Department of Commerce.

The Department of Commerce is a cabinet agency operating under the governor and is subject to state laws and regulations. The Division however is not subject to the State Procurement Code or Appropriation Act. Also, the Division is not subject to State Human Resource Regulations. The Secretary of the Department of Commerce is responsible for oversight of the Division. The Division has powers of a body corporate including:

NOTE 1 - REPORTING ENTITY (CONTINUED)

1. The power to sue or be sued, and make contracts.

2. To acquire by purchase or donation and to own, rent, lease, mortgage and dispose of real or personal property.

3. To operate, acquire, construct, maintain and control the tracks and equipment of the Division and be governed by rules and regulations of the Interstate Commerce Commission and its successor, the Surface Transportation Board.

4. To employ and dismiss the employees of the Division and to fix and to pay the compensation thereof.

5. To issue revenue bonds and other obligations, subject to approval by the State Budget and Control Board, to defray the cost of acquisition of other railroads.

The individual subdivisions of the South Carolina Department of Commerce - Division of Public Railways d/b/a Palmetto Railways are funds of the State of South Carolina established by various sections of the Code of Laws of South Carolina. The accompanying financial statements present the financial position, results of operations, and the cash flows solely of the South Carolina Department of Commerce - Division of Public Railways d/b/a Palmetto Railways and do not include any other funds of the State of South Carolina.

The South Carolina Department of Commerce - Division of Public Railways d/b/a Palmetto Railways consists of two separate divisions: 1) the Charleston Subdivision (CHS), formerly the Port Utilities Commission, and the North Charleston Subdivision (NCS), formerly Port Terminal Railroad, and 2) the Charity Church Subdivision (CCS), formerly the East Cooper and Berkeley Railroad. The functions of each of the divisions are outlined as follows:

a. The Charleston Subdivision and the North Charleston Subdivision (CHS-NCS) have the responsibility of operations of the railroad yards at Charleston Harbor. Switching activity between privately owned railroad lines and seagoing vessels is the primary operation and revenue source.

b. Operation and maintenance of the railroad line constructed in Berkeley County, South Carolina, is the primary responsibility of the Charity Church Subdivision (CCS). The railroad was constructed with financing by Amoco Chemicals Corporation, its major customer. This came after requests from the Commission and the State Budget and Control Board to service the east side of the Cooper River north of Charleston, South Carolina were denied by the common carrier railroads operating in South Carolina.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The Division adheres to generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board.

The South Carolina Department of Commerce - Division of Public Railways d/b/a Palmetto Railways (the "Division") maintains separate accounting of its two divisions: 1) the Charleston Subdivision and the North Charleston Subdivision, and 2) the Charity Church Subdivision. Presented here are the financial statements of the two divisions of the South Carolina Department of Commerce - Division of Public Railways d/b/a Palmetto Railways.

The Division utilizes the accrual basis of accounting. Under the accrual basis of governmental accounting for enterprise funds, revenues are recognized in the accounting period in which they are earned and become measurable. Expenses are recognized in the period incurred, if measurable. Net position is reported in three components: (1) net investment in capital assets, (2) restricted and (3) unrestricted. The operating statement presents increases (e.g., revenues) and decreases (e.g., expenses) in total net position. The accounting principles utilized by the Division are in conformity with the uniform system of accounts for railroad companies prescribed by the Surface Transportation Board and generally accepted accounting principles.

Operating income includes revenues and expenses related to the primary continuing operations of the fund. Principal operating revenues are charges to customers for sales or services. Principal operating expenses are the costs of providing goods and services and include administrative expenses and depreciation of capital assets.

Fund Accounting

The Division uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fund is a separate fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with related liabilities and residual equities or balances and changes therein which are segregated to carry on specific activities or attain certain objectives in accordance with applicable regulations, restrictions or limitations. Separate accounts are maintained for each fund however, in the accompanying financial statements, funds that have similar characteristics have been combined into fund types. Accordingly, all financial transactions have been reported by fund type.

Funds are classified into three categories: governmental, proprietary, and fiduciary. Each category, in turn, is divided into separate "fund types." The Division reports activities of the enterprise "fund type" under the proprietary fund category.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Accounting (Continued)

The Division's operations are classified as enterprise fund types within the proprietary fund classification. Enterprise funds account for activities that are self-sustaining, primarily through user charges or are used when management wants to control or measure costs of services.

Property, Plant, and Equipment

Except for track and roadway, capital assets with a unit acquisition cost in excess of $5,000 are capitalized and depreciated over the estimated useful lives of the assets using the straight-line method of depreciation. Estimated useful lives are as follows:

Buildings	15 - 40 years
Depreciable Road	75 years
Equipment	3 - 25 years
Leasehold Improvements	5 - 20 years

Track and roadway are capitalized at cost and depreciation is not recognized. Replacements and repairs are expensed in the period that costs are incurred. Betterments to track and roadway are capitalized.

Servicing Rights

The servicing rights assets are being amortized over the life of the agreement.

Inventories

Inventories consisting of materials and supplies are stated at the lower of cost or market using the weighted average method.

Policy for Uncollectible Accounts

At year-end management reviews past due accounts receivable and recognizes bad debt expense for those accounts determined to be uncollectible. This method is not in conformity with generally accepted accounting principles, which requires accounts receivable to be reported at net realizable value using an allowance for uncollectible accounts. However based on the Division's collection history, the results from using the direct write-off method are not materially different from the allowance method.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Inter-division Transactions and Balances

Transactions among the two divisions of the Division have been eliminated for purposes of the combined financial statements presented herein. Administration overhead incurred is divided between CHS-NCS and CCS. Overhead of the two divisions is split, 56% to CCS and 44% to CHS-NCS. Overhead expense includes superintendence, general administrative, and insurance.

Statement of Cash Flows

For purposes of this statement the Division considers deposits with State of South Carolina cash management pool to be cash equivalents because they are readily convertible to cash with an insignificant risk of loss in value.

Cash and Cash Equivalents

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

Because the State’s internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and invest in certain debt obligations of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Most State agencies participate in the State’s internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. For those accounts, cash equivalents include investments in short-term, highly liquid securities having an original maturity of three months or less.

Cash equivalents: 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 the State's internal cash management pool. The State’s internal cash management pool is comprised of the general deposit account and several special deposit accounts. The State records each agency's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Agencies record and report their deposits in the general deposit account at cost. However, agencies report their deposits in the special deposit accounts at fair value. Investments in the pool are recorded at fair value. Interest earned by the agencys' 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 undistributed interest received by the pool. Reported interest income includes interest earnings, realized gains/losses and unrealized gains/losses on investments in the pool arising from changes in fair value.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents (Continued)

The Division only has special deposit accounts. Realized gains and losses are allocated daily and are included in the accumulated income receivable. Unrealized gains and losses are allocated at year-end based on the agency's percentage of ownership in the pool.

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

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification

In the prior year, the $8,000,000 to be paid to the City of North Charleston as a result of the Settlement Agreeement and Release discussed in Note 14 below was classified as servicing rights. For the current year, this $8,000,000 is included in capital assets under works in progress as it relates to the acquisition of land for the construction of the intermodal container transfer facility.

NOTE 3 - DEPOSITS

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

State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days. At December 31, 2013, all State Treasurer bank balances were fully insured or collateralized with securities held by the State or by its agents in the State's name.

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

NOTE 4 - PROPERTY, PLANT, EQUIPMENT, AND DEPOSITS TO PURCHASE LAND

Property, plant, and equipment are stated at original cost with the exception of certain assets received from the State Ports Authority. Assets of $451,136 acquired by the Division from the South Carolina State Ports Authority during the organization of the South Carolina Department of Commerce - Division of Public Railways are stated at the cost to the State Ports Authority, less accumulated depreciation at the time of organization. Also, in 1997 the CHS-NCS Division exchanged certain assets with the State Ports Authority. The assets received from the State Ports Authority were recorded on CHS-NCS's books at book value of assets as recorded by the State Ports Authority. Amounts recorded included track and land improvements of $1,324,462 and an engine house in the amount of $1,182,402. Depreciation is computed on the straight-line method. In 2005 a capital contribution was recorded for land, land improvements and track on CCS. The amounts recorded were $201,000 for land, $308,229 for land improvements and $749,746 for non-depreciable road.

On July 26, 2010, the Division entered into a Purchase and Sales Agreement with Greystar GP, LLC. The agreement required the Division to provide the necessary funds to Greystar to purchase loan documents and the right to foreclosure under a Mortgage Loan and Sale agreement Greystar had entered into with Capmark Finance Inc., also on that date. The purchase price was $21,390,500. On August 27, 2010, Greystar assigned the Mortgage Loan and Sale agreement to CHSA, LLC, and also assigned 100% of CHSA, LLC to the Division. On December 7, 2010, the mortgage was satisfied by foreclosure at the former Navy Yard. The property, which includes 240 acres of land and approximately 65 buildings, was deeded to the Division for nominal consideration on December 15, 2010.

In October 2011, the Division entered into an agreement with the Charleston Naval Complex Redevelopment Authority ("the RDA") to redevelop the Shipyard Headquarters Building on the former Navy Yard. The RDA would pay $1,500,000 to rehabilitate the building and then occupy it for seven years rent free. See Note 6. The RDA's seven year period commenced on March 31, 2012. The Division is depreciating the building improvements over the building's useful life.

On December 5, 2012 the Division agreed to sign a Settlement Agreement and Release (the "Agreement") to settle and release six civil actions in which the Division was the defendant. See Note 14. As part of the agreement, the Division assumed $6,360,000 in Tax Increment Financing ("TIF") Bonds for the Navy Base Redevelopment Project. The Division also agreed to pay $8,000,000 to the City of North Charleston to mitigate rail access impacts. The $6,360,000 and $8,000,000 are included as construction in progress of the proposed Intermodal Facility. See Note 15.

On October 9, 2013, the Division purchased land and several office and warehouse buildings on the former Navy Yard from the Noisette Company, LLC, Navy Yard New Market I, LLC and 10 Storehouse Row, LLC. The purchase price was $10,668,000.

NOTE 4 - PROPERTY, PLANT, EQUIPMENT, AND DEPOSITS TO PURCHASE LAND (CONTINUED)

A summary of property, plant, and equipment by division is as follows:

CHS-NCS

	Balance 12/31/2012	Transfers In (Out)	Additions	Deletions	Balance 12/31/2013
Non-depreciable capital assets:					
Land	$ 20,650,527	-	2,285,662	-	$ 22,936,189
Land improvements	3,507,686	-	-	-	3,507,686
Non-depreciable road	5,656,682	650,670	-	-	6,307,352
Projects under construction*	18,115,287	(788,664)	4,565,418	-	21,892,041
Total non-depreciable capital assets	47,930,182	(137,994)	6,851,080	-	54,643,268
Depreciable capital assets:					
Fencing	51,478	-	-	-	51,478
Buildings	9,504,827	-	8,382,358	-	17,887,185
Machinery and equipment	4,268,727	-	336,106	77,393	4,527,440
Depreciable road	246,509	-	-	-	246,509
Leasehold improvements	251,515	-	-	67,409	184,106
Total depreciable capital assets	14,323,056	-	8,718,464	144,802	22,896,718
Accumulated depreciation:					
Fencing	41,065	-	5,207	-	46,272
Buildings	1,128,893	-	295,763	-	1,424,656
Machinery and equipment	2,606,838	-	274,679	77,393	2,804,124
Depreciable road	36,379	-	11,577	-	47,956
Leasehold improvements	215,236	-	3,880	67,409	151,707
Total accumulated depreciation	4,028,411	-	591,106	144,802	4,474,715
Net depreciable capital assets	10,294,645	-	8,127,358	-	18,422,003
Net capital assets	$ 58,224,827	(137,994)	14,978,438	-	$ 73,065,271

* Costs of $8,000,000 resulting from the settlement with the City of North Charleston have been reclassified from servicing rights to projects under construction as of December 31, 2012.

NOTE 4 - PROPERTY, PLANT, EQUIPMENT, AND DEPOSITS TO PURCHASE LAND (CONTINUED)

CCS

	Balance 12/31/2012	Transfers In (Out)	Additions	Deletions	Balance 12/31/2013
Non-depreciable capital assets:					
Land	$ 627,419	-	-	-	$ 627,419
Land improvements	6,027,549	-	-	-	6,027,549
Non-depreciable road	3,503,437	-	-	-	3,503,437
Total non-depreciable capital assets	10,158,405	-	-	-	10,158,405
Depreciable capital assets:					
Buildings	914,273	-	-	-	914,273
Machinery and equipment	1,270,799	137,994	132,900	6,969	1,534,724
Depreciable road	945,851	-	-	-	945,851
Total depreciable capital assets	3,130,923	137,994	132,900	6,969	3,394,848
Accumulated depreciation:					
Buildings	804,020	-	18,925	-	822,945
Machinery and equipment	783,722	-	82,707	5,854	860,575
Depreciable road	398,138	-	13,413	-	411,551
Total accumulated depreciation	1,985,880	-	115,045	5,854	2,095,071
Net depreciable capital assets	1,145,043	137,994	17,855	1,115	1,299,777
Net capital assets	$11,303,448	137,994	17,855	1,115	$11,458,182

NOTE 4 - PROPERTY, PLANT, EQUIPMENT, AND DEPOSITS TO PURCHASE LAND (CONTINUED)

COMBINED

	Balance 12/31/2012	Transfers In (Out)	Additions	Deletions	Balance 12/31/2013
Non-depreciable capital assets:					
Land	$ 21,277,946	-	2,285,662	-	$ 23,563,608
Land improvements	9,535,235	-	-	-	9,535,235
Non-depreciable road	9,160,119	650,670	-	-	9,810,789
Projects under construction	18,115,287	(788,664)	4,565,418	-	21,892,041
Total non-depreciable capital assets	58,088,587	(137,994)	6,851,080	-	64,801,673
Depreciable capital assets:					
Fencing	51,478	-	-	-	51,478
Buildings	10,419,100	-	8,382,358	-	18,801,458
Machinery and equipment	5,539,526	137,994	469,006	84,362	6,062,164
Depreciable road	1,192,360	-	-	-	1,192,360
Leasehold improvements	251,515	-	-	67,409	184,106
Total depreciable capital assets	17,453,979	137,994	8,851,364	151,771	26,291,566
Accumulated depreciation:					
Fencing	41,065	-	5,207	-	46,272
Buildings	1,932,913	-	314,688	-	2,247,601
Machinery and equipment	3,004,976	-	357,386	83,247	3,279,115
Depreciable road	820,101	-	24,990	-	845,091
Leasehold improvements	215,236	-	3,880	67,409	151,707
Total accumulated depreciation	6,014,291	-	706,151	150,656	6,569,786
Net depreciable capital assets	11,439,688	137,994	8,145,213	1,115	19,721,780
Net capital assets	$ 69,528,275	-	14,996,293	1,115	$ 84,523,453

* Costs of $8,000,000 resulting from the settlement with the City of North Charleston have been reclassified from servicing rights to projects under construction as of December 31, 2012.

Depreciation expense for the period by division and in total was as follows: CHS-NCS $591,106 and CCS $115,045, Total - $706,151. Included in other rental income-net is $228,044 of depreciation on buildings that are held for rent. The cost of the leased buildings is $15,408,562 and net book value is $14,876,083. The majority of these assets were acquired as part of the Greystar purchase in paragraph 2 and the Noisette Company, LLC, Navy Yard New Market I, LLC and 10 Storehouse Row, LLC purchases in paragraph 5 of this note. See Note 9 also.

NOTE 5 - ACCRUED ANNUAL LEAVE

Non-union employees are entitled to accrue and carry forward at calendar year end a maximum of 180 days sick leave and 45 days annual vacation leave. Upon termination of employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum of 45 days, but are not entitled to any payment for unused sick leave. Employees do not accrue or carry forward holiday leave, compensatory time, or overtime.

Union employees can earn up to 25 days annual vacation leave per year, but do not earn any sick leave. Union employees do not carry forward any unused vacation leave. Upon termination of employment, union employees are entitled to be paid for accumulated unused annual vacation leave up to 25 days. Union employees do not accrue or carry forward holiday leave, compensatory time, or overtime.

The Division calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments is recorded as a current liability. The net change in the liability is recorded in the current year in the applicable operating department.

NOTE 6 - DEFERRED REVENUE/OPERATING LEASES/OPERATING RENTAL REVENUE

Effective March 4, 1994, CHS-NCS began leasing land and improvements in Spartanburg County, South Carolina for $200,000 a year. The lease is for ten years with two ten-year options to renew. During the lease term the lessee has the right to purchase the land and improvements for CHS-NCS's cost not to exceed $5,000,000. The rent is paid at the beginning of each year's anniversary for one year effective March 4, 1994 and will be adjusted annually based on 90-day Treasury bill rates. The initial rent was based on a 4% annual return on the initial investment of $2,000,000, which is why Treasury bill rates will be used to determine changes in the annual rent. The Division's total investment in this project ended up being $4,365,595 which is the amount on which a new rental rate will be determined annually effective March 4. The annual rental rate determined at March 4, 2012 was $200,000 and at March 4, 2013 was $200,000. The land is used as a railroad spur to the BMW plant. During 2013, $200,000 was recognized as operating rental revenue and $33,333 was deferred revenue based on the terms of this agreement. In February 2014, this lease was extended for the final 10 year renewal term through March 3, 2024. Also effective March 4, 1996, the Division began receiving revenue on certain car hauls out of the BMW plant by Norfolk Southern. This amounted to $366,000 in 2013 and is included in freight income.

NOTE 6 - DEFERRED REVENUE/OPERATING LEASES/OPERATING RENTAL REVENUE (CONTINUED)

CHS-NCS received rental revenue from the North Charleston Terminal Company in the amount of $323,194 for 2013. Effective May 30, 1995, this lease was renewed. The lease is a supplemental lease to preexisting 1980 and 1986 leases. The lease expires on February 16, 2015, with automatic one-year renewals unless either party serves the other with at least twelve months notice. Under the supplemental lease each year's rent will be adjusted to correspond to the change in the national consumer price index ("CPI") for the previous year. The cost of land and non-depreciable track being leased to the North Charleston Terminal Company is $655,881. The Division provided the North Charleston Terminal Company with written notice cancelling the lease of properties at the Cosgrove Yard in January 2014; thus, the lease is expected to terminate in January 2015.

On December 15, 2010 the Division was deeded over approximately 240 acres of property and approximately 65 buildings at the former Navy Yard and on October 9, 2013 the Division purchased additional property and buildings, see Note 4 and Note 9. The property has several commercial leases ranging from month to month leases to nine year leases. See Note 9 for total revenue and expenses related to the property.

In October 2011, the Division entered into an agreement with the Charleston Naval Complex Redevelopment Authority ("the RDA") to redevelop the Shipyard Headquarters Building on the former Navy Yard. The RDA would pay $1,500,000 to rehabilitate the building and then occupy it for seven years rent free. The RDA's seven year period commenced on March 31, 2012. The Division is amortizing the $1,500,000 rent over the period of the lease. Current deferred rent for this lease is $214,286 and the noncurrent portion is $910,714.

Minimum rentals on non-cancelable leases based on current year rates are as follows:

2014	$ 2,857,659
2015	1,700,195
2016	1,545,730
2017	1,512,708
2018	1,074,987
2019-2022	2,681,565
	$ 11,372,844

NOTE 7 – LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligation activity for the year ended December 31, 2013.

	January 1, 2013	Increases	Decreases	December 31, 2013	Due Within One Year
Compensated absences:					
CHS-NCS	$ 109,385	92,082	87,005	114,462	$ 114,462
CCS	139,218	117,195	110,734	145,679	145,679
	248,603	209,277	197,739	260,141	260,141
TIF Bonds	6,360,000	-	150,000	6,210,000	150,000
Total long-term obligations	$ 6,608,603	209,277	347,739	6,470,141	$ 410,141

See Note 15 for a detail description of the Tax Increment Financing bonds long-term obligation.

NOTE 8 – OTHER REVENUE

The category under "Operating Revenues" entitled "Other Revenue," is used to report miscellaneous income. For the year ended December 31, 2013 it consists of offset charges of $113,171 received from the State Ports Authority (SPA) - see note 12. A breakdown by division of "Other revenue" is as follows:

	CHS-NCS	CCS	TOTAL
Offset charges with SPA	$ 113,171	-	$ 113,171
Total	$ 113,171	-	$ 113,171

NOTE 9 – OTHER RENTAL INCOME, NET, NON OPERATING REVENUES

The Division leases several buildings on the former navy base and parking spaces. The revenue and expenses for 2013 were as follows:

Rental revenue	$ 1,771,498
Less: expenses	
Depreciation	228,044
Landscaping and janitorial	190,017
Professional fees	126,735
Utilities	99,793
Maintenance	72,058
Property tax and disposal fees	57,617
Insurance	23,822
Other	5,759
	803,845
Net Income	$ 967,653

NOTE 10 - PENSION PLANS AND EMPLOYEE BENEFIT PLANS

The majority of employees of the Division are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the South Carolina Public Employee Benefit Authority (PEBA), a public employee retirement system. 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 a life-time monthly retirement annuity benefits to members as well as disability, survivor options, annual benefit adjustments, death benefits, and incidental death benefits to eligible employees and retired members.

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 Retirement Division and the five pension plans are included in the statewide CAFR of the State of South Carolina.

NOTE 10 - PENSION PLANS AND EMPLOYEE BENEFIT PLANS (CONTINUED)

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 12 consecutive quarters and includes an amount for up to 45 days of termination pay at retirement for unused annual leave. For Class III members, AFC is the average annual earnable compensation during 20 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 15 years of credited service (five years effective January 1, 2002).

Disability annuity benefits are payable to Class II members if they have permanent incapacity to perform regular duties of the member's job and they have at least 5 years of earned service (this requirement does not apply if the disability is a result of a job related injury). Class III members qualify for disability annuity benefits provided they have a minimum of eight years of credited service. 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 cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits. The TERI program will be closed and end for all participants effective June 30, 2018.

NOTE 10 - PENSION PLANS AND EMPLOYEE BENEFIT PLANS (CONTINUED)

As an alternative to membership to SCRS, newly hired State and school district employees may elect to participate in the State Optional Retirement Program (ORP), a defined contribution 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 State ORP plan other than for payment of contributions to designated companies. To elect participation of 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 incidental death amounts are remitted to SCRS.

Effective July 1, 2013, the member contribution was increased from 7.0% to 7.5%.

The effective employer rates by year for SCRS and the State ORP are as follows:

SCRS and State ORP

Effective Date	Base Employer Rate	Insurance Surcharge	Total Employer Rate	Optional Incidental Death Benefit	Optional Accidental Death Prog.
07/01/13	10.450%	4.92%	15.370%	0.15%	N/A
07/01/12	10.450%	4.55%	15.000%	0.15%	N/A
07/01/11	9.385%	4.30%	13.685%	0.15%	N/A
07/01/10	9.240%	3.90%	13.140%	0.15%	N/A

Five percent of the earnable compensation contributed as part of the State ORP employer contribution is remitted directly to the ORP vendor to be allocated to the member’s account while the remaining five point forty-five percent is remitted to the SCRS.

The Division’s actual contributions to the SCRS and State ORP for the years ended December 31, 2013, 2012 and 2011 were $290,522, $258,656 and $210,921 respectively, and equaled the base required retirement contribution rate as shown in the above table. Also, the Division paid employer incidental death contributions of $4,170, $3,994 and $3,485, at the rate of 0.15% of compensation for the current fiscal years ended December 31, 2013, 2012, and 2011 respectively.

NOTE 10 - PENSION PLANS AND EMPLOYEE BENEFIT PLANS (CONTINUED)

The South Carolina Police Officers Retirement System (PORS) is a cost-sharing multiple employer defined benefit public employee retirement system. Generally, all full-time employees whose principal duties are the preservation of public order or the protection or prevention and control of property destruction by fire are required to participate in and contribute to PORS as a condition of employment. This plan provides lifetime monthly annuity benefits as well as disability survivor benefits and incidental benefits to eligible employees and retirees. In addition, participating employers in the PORS contribute to the accidental death fund which provides annuity benefits to beneficiaries of police officers and firemen killed in the actual performance of their duties. These benefits are independent of any other retirement benefits available to the beneficiary.

Under the PORS, Class II members are eligible for a full service retirement annuity upon reaching age 55 or completion of 25 years of credited service regardless of age. Class III members are eligible for a full service retirement annuity upon reaching age 55 or 27 years of credited service. The benefit formula for full benefits effective since July 1, 1989 for the SCRS is 2.14 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 compensation during 12 consecutive quarters and includes an amount for up to 45 days termination pay for unused annual leave. For Class III members, AFC is the average annual earnable compensation during 20 consecutive quarters and termination pay for unused annual leave at retirement is not included. PORS does not have an early retirement option. 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 15 years of credited service (five years effective January 1, 2002).

Effective July 1, 2013, the member contribution was increased from 7.0% to 7.84%.

The effective employer rates by year for PORS are as follows:

PORS

Effective Date	Base Employer Rate	Insurance Surcharge	Total Employer Rate	Optional Incidental Death Benefit	Optional Accidental Death Prog.
07/01/13	12.440%	4.920%	17.360%	0.20%	0.20%
07/01/12	11.900%	4.550%	16.450%	0.20%	0.20%
07/01/11	11.363%	4.300%	15.663%	0.20%	0.20%
07/01/10	11.130%	3.900%	15.030%	0.20%	0.20%

The Division's actual contribution to the PORS for the years ended December 31, 2013, 2012, and 2011 were $6,090, $5,047, and $4,923, respectively, and equaled the base retirement required contribution rate, shown in the above table.

NOTE 10 - PENSION PLANS AND EMPLOYEE BENEFIT PLANS (CONTINUED)

Also, the Division paid employer incidental death contributions of $100, $120 and $89, at the rate of 0.20% of compensation for the current fiscal years ended December 31, 2013, 2012, and 2011 respectively. In addition, the Division paid accidental death program contributions of approximately $100, $120, and $89, at the rate of 0.20% of compensation for the current fiscal years ended December 31, 2013, 2012, and 2011 respectively.

The amounts paid by the Division for pension, incidental death program benefits, and accidental death program benefits are reported as employer contribution expenditures within the applicable functional expenditure categories to which the related services 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 and PORS are actuarially determined.

The contributions by each division for 2013 are as follows:

	CHS-NCS	CCS	Total
Retirement Plan Employer	$ 165,936	$ 130,676	$ 296,612
Group Incidental & Acc. Death	$ 2,445	$ 1,925	$ 4,370

The amounts paid by the Division for pension and group-life benefits and accidental death benefits are recorded in the appropriate operating department corresponding to the employee for whom the contributions are made.

The surcharges to fund retiree heath and dental insurance are not part of the actuarially established rates. 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 Division'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 Division recognizes no contingent liability for unfunded costs associated with participation in the plans.

NOTE 10 - PENSION PLANS AND EMPLOYEE BENEFIT PLANS (CONTINUED)

The Division contributed $578,269 this year to the U.S. Railroad Retirement System, which covers all employees. CHS-NCS contributed $322,406 and CCS $255,863. Participation is mandatory. This program is a two-tier system, which is funded, based on each employee's gross annual wages. Effective January 1, 2013, wages up to $113,700 were funded at 6.2 percent by the Division and 6.2 percent by the employee to meet Tier 1 funding requirements and all wages were funded at 1.45 percent by the Division to meet Tier I Medicare funding requirements. The Division funded wages up to $84,300 at 12.6 percent to meet Tier II funding requirements. Employees paid 4.4 percent on wages up to $84,300.

The U. S. Railroad Retirement Board, in accordance with the Railroad Retirement Acts, administers this plan.

Data concerning the actuarial status of the U.S. Railroad Retirement System as related to the Division is not available. The Division is not liable for any unfunded costs associated with the plan and recognized no contingent liability for such cost.

Pending Implementation of GASB Statement on Pensions

GASB Statement No. 68, *"Accounting and Financial Reporting for Pensions"* ("Statement"), was issued by the Governmental Accounting Standards Board ("GASB") in June 2012. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local government employers about financial support for pensions that are provided by other entities. In addition, state and local governments who participate in a cost-sharing multiple employer plan will now be required to recognize a liability for its proportionate share of the net pension liability of that plan. It is GASB's intention that this new Statement will provide citizens and other users of the financial statements with a clearer picture of the size and nature of the Division's financial obligations to current and former employees for past services rendered.

In particular, the Division will be required to report a net pension liability for its participation in the SCRS and PORS on financial statements prepared on the economic resources measurement focus and accrual basis of accounting (i.e., the Statement of Net Position) and present more extensive note disclosures.

The effect of implementation of this Statement has not been determined at this time, but it is anticipated that it will materially decrease the Division's unrestricted net position. This Statement is required to be implemented by the Division no later than the fiscal year ending December 31, 2015.

NOTE 11 – 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 heath and dental and long-tem disability benefits to retired State and school district employees and their covered dependents. The Division 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 heath 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 retiree health and dental insurance program are mandated by State statue to contribute at a rate assessed each year by the Office of the State Budget, and which are included in the tables in Note 10. The IB sets the employer contribution rate based on a pay-as-you-go basis. The Division paid $134,096 and $117,106 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended December 31, 2013 and 2012, 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 December 31, 2013 and 2012. The Division recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of $821 and $898 for the years ended December 31, 2013 and 2012, respectively.

NOTE 11 – POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

Funding Policies (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 heath 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.

One may obtain a copy of the complete financial statements for the benefit plans and the trust funds from PEBA Retirement Benefits and Insurance Benefits, 202 Arbor Lake Drive, Suite 360, Columbia, SC 29223.

NOTE 12 - TRANSACTIONS WITH STATE ENTITIES AND SISTER DIVISIONS

CHS-NCS allocated to CCS $97,101 of depreciation expense as part of the administrative overhead expense allocation between the two divisions explained in Note 2. This is shown as depreciation expense under general railway operating expenses of CCS.

The Ports Authority pays CHS-NCS monthly offset charges. In 1988, the S.C. State Ports Authority took possession of a certain area of trackage at the Port Terminal Railroad which caused CHS-NCS to incur additional operating costs. The Ports Authority continues to pay CHS-NCS for the additional costs, which equals the initial annual base amount of $58,615 adjusted for changes in the consumer price index. The amount paid to CHS-NCS was $120,744 in 2013 and is included in other operating revenues. See Note 8 regarding other revenue.

Other amounts in accounts payable for CCS and CHS-NCS are normal monthly amounts initially paid by one division that will be reimbursed by the division receiving the goods/services.

Services received at no cost from State agencies include banking and investment functions from the State Treasurer, and, retirement and insurance plan administration from the Public Employee Benefit Authority ("PEBA"). The Division had financial transactions with various State agencies during the year. Payments made in 2013 to the State Budget and Control Board were primarily for insurance coverage.

NOTE 13 - OPERATING LEASES

The Division's Port Utilities Commission and Port Terminal Railroad Division, and the South Carolina State Ports Authority entered into an agreement, effective July 1, 1976, allowing the South Carolina Department of Commerce - Division of Public Railways to lease the building known as the Shore Patrol Office for a period of twenty (20) years. The Division is now occupying these premises on a month-to-month lease. The monthly rental charge is $300. The Division incurred $3,600 for rental of this building in 2013. The Division is required to carry insurance for property damage and to maintain and repair the leased building. This amount is included in general administration expenses.

The only other lease payment is $3,742 per year by CCS to the U.S. Department of Agriculture for right of way for the railroad on National Forest Land. This lease is for an indefinite term. This amount is included in other operating expenses.

Total operating lease expense in 2013 was $3,742. Minimum future payments of the Division for the lease with the indefinite terms as of December 31, 2013 are as follows:

2014	$	3,742
2015		3,742
2016		3,742
2017		3,742
2018		3,742
Total	$	18,710

NOTE 14 – SETTLEMENT AGREEMENT AND RELEASE

On December 5, 2012 the Division, the City of North Charleston (“North Charleston”) and the North Charleston Sewer District (“Sewer District”) agreed to sign the Settlement Agreement and Release (the “Agreement”) to settle and release six civil actions in which North Charleston or the Sewer District were the plaintiff and the Division was the defendant. The effective date of the agreement was March 25, 2013, the date on which the consent order was entered adopting and incorporating the terms of the Agreement. The Agreement was necessary to obtain land in order for the Division to plan and construct an intermodal container transfer facility (ICTF) on the former Navy Yard.

The terms of the agreement are as follows:

1. The Division will pay North Charleston $8,000,000 over 4 years to mitigate rail access impacts. The first payment of $2,000,000 was made on March 23, 2013. Thereafter, the $2,000,000 payments will be made no later than the anniversary date of the first payment in 2014, 2015 and 2016.
2. The Division will assume approximately $6,500,000 in Tax Increment Financing (“TIF”) Bonds for the Navy Base Redevelopment Project. See Note 15.
3. The Division will transfer to North Charleston certain buildings and land on the former Navy Yard as soon as practicable after the effective date.

NOTE 14 – SETTLEMENT AGREEMENT AND RELEASE (CONTINUED)

4. North Charleston will transfer to the Division certain buildings and land on the former Navy Yard as soon as practicable after the effective date.
5. Before December 31, 2017, the Division will transfer to North Charleston additional buildings and land on the former Navy Yard.
6. Before December 31, 2017, North Charleston will transfer to the Division additional buildings and land on the former Navy Yard.

NOTE 15 – NONCURRENT LIABILITY – TIF BONDS

As part of the Settlement Agreement and Release, see Note 14, the Division assumed responsibility for payment of $6,360,000 in TIF Bonds from the City of North Charleston. Principal and interest is payable in annual installments beginning September 2013 through September 2037 with variable interest (.06% at June 30, 2013), as determined by the remarketing agent, payable each month. The balance outstanding at December 31, 2013 was $6,210,000.

Future principal payments of the bonds are as follows:

2014	$ 155,000
2015	160,000
2016	165,000
2017	175,000
2018	180,000
2019-2023	1,030,000
2024-2028	1,275,000
2029-2033	1,560,000
2034-2037	1,510,000
Total	$ 6,210,000

NOTE 16 - RISK MANAGEMENT

The Division is exposed to various risks of loss and maintains State or commercial insurance coverage for certain risks. Management believes such coverage is sufficient to preclude any significant uninsured losses to the Division. Settled claims have not exceeded this coverage in any of the past three years. There were no significant reductions in insurance coverage from coverage in the prior year. The Division pays insurance premiums to 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 accord with the 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:

NOTE 16 - RISK MANAGEMENT (CONTINUED)

1. Claims of covered public employees for health and dental insurance benefits (PEBA – Insurance Benefits Division); and

2. Claims of covered public employees for long-term disability and group-life insurance benefits (PEBA – Insurance Benefits Division).

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 which are remitted to commercial carriers.

The Division and other entities pay premiums to the State's Insurance Reserve Fund ("IRF") which issues policies, accumulate assets to cover the risks of loss and pays claims incurred for covered losses related to the following Division assets, activities, and/or events.

1. Real property, its contents and other equipment - Coverage per loss for real property is based on current valuation with a $250 deductible. Eighty percent of each loss is covered by the IRF.

2. Motor vehicles - Coverage is up to $1,000,000 per loss with a $200 deductible for comprehensive coverage and $500 for collision.

3. Torts

The IRF is a self insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of property, boiler and machinery, and automobile liability. The IRF's rates are determined actuarially.

State agencies are the primary participants in the PEBA – Insurance Benefits Division and in IRF.

The Division purchases insurance, which covers all divisions, through private carriers for liability and property loss on road and locomotive assets, and employee fidelity bond insurance coverage for all employees to cover losses of up to $100,000 arising from theft or misappropriations. Management believes based on exposure and likelihood of loss that this coverage is sufficient.

The Division has purchased insurance, which covers all divisions, from a private carrier for liability under the Federal Employers Liability Act (FELA), which is similar to workmans' compensation insurance and covers all employees. The Division has elected to retain the risk of loss on this coverage for up to the first $100,000 of costs per claim. Management has elected to retain this amount of risk because it feels that it is more economical than paying additional premiums for increased coverage. In the current year, no expenses were incurred on claims under the policy. Also a tax is paid to the U.S. Railroad Retirement System to cover all the Division employees for unemployment benefits.

NOTE 16 - RISK MANAGEMENT (CONTINUED)

The Division has recorded insurance premium expenses in the applicable operating department corresponding to the employees for whom contributions are made or in insurance expense under administrative costs.

The Division's management believes risk of loss from business interruption is a remote likelihood, however the Division does have $250,000 coverage through their equipment liability coverage policy for this risk.

The Division did not incur any significant losses in 2013 for self insured risks. Also, no reserves have been established for potential losses for self insured risks. The Division reports such expenses if information prior to issuance of the financial statement indicates that it is probable that an asset has been impaired or a liability has been incurred on or before fiscal year end and the amount is reasonably estimable. The recorded expense is valued at an estimate of the ultimate cost of settling the claim or of the asset loss.

NOTE 17 – CONTINGENCIES AND LITIGATION

The Division is party to a number of civil lawsuits and other legal proceedings. At the current time management and legal counsel are unable to determine any ultimate outcome of existing and potential legal actions. The Division has undertaken condemnation actions on certain properties in connection with the intermodal container transfer facility to be constructed in North Charleston, South Carolina. The Division has determined just compensation in the outstanding condemnation actions to be in excess of $13,800,000; however, the Division anticipates the resolution of the condemnation actions will involve exchanges of land in lieu of cash.

NOTE 18 – ENTERPRISE FUND INFORMATION

Charges for services	$ 13,694,695
Operating grant and contributions	157,699
Less: expenses	(8,540,450)
Net program revenue	4,659,023
Change in net position	5,311,944
Net position - beginning	79,980,031
Net position - ending	$ 85,291,975

This information is included only for the State of South Carolina GAAP reporting purposes and includes terminology and classifications which are not consistent with the financial statements

NOTE 19 – INTERFUND BALANCES

Interfund balances at December 31, 2013 (which are expected to be received or paid within one year), consisted of the following individual fund receivables and payables:

Fund	Receivables	Payables
CHS-NCS	$ 288,378	$ 56,640
CCS	56,640	288,378
Totals	$ 345,018	$ 345,018

The receivables and payables are primarily the result of expenses for CCS being paid using the CHS-NCS cash account. These interfund receivables and payables were relieved subsequent to December 31, 2013.

NOTE 20 – INTERFUND TRANSFERS

Transfers from (to) other funds for the year ended December 31, 2013 consisted of the following:

Fund	Transfers from	Transfers to
CHS-NCS	$ 10,900,000	$ -
CCS	-	10,900,000
Totals	$ 10,900,000	$ 10,900,000

These transfers were made in order to help fund the purchase of the land at the former Navy Yard.

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*

INDEPENDENT AUDITOR'S REPORT

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

We have audited, in accordance with the 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 South Carolina Department of Commerce – Division of Public Railways d/b/a Palmetto Railways (the "Division") as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Division's basic financial statements, and have issued our report thereon dated May 6, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Division'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division'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 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 Division'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.

Greene, Finney & Horton LLP

Greene, Finney & Horton, LLP
Mauldin, South Carolina
May 6, 2014