

SOUTH CAROLINA STATE ACCIDENT FUND

COLUMBIA, SOUTH CAROLINA

FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2002

State of South Carolina



Office of the State Auditor

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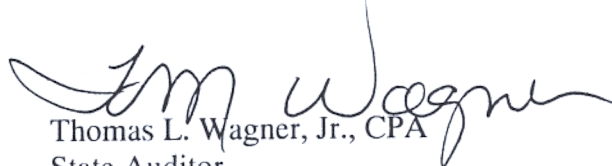
October 11, 2002

The Honorable Jim Hodges, Governor
and
Mr. Irvin D. Parker, Director
South Carolina State Accident Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Accident Fund for the fiscal year ended June 30, 2002, was issued by Rogers & Laban, 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,


Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/trb

SOUTH CAROLINA STATE ACCIDENT FUND

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ROGERS & LABAN, PA

CERTIFIED PUBLIC ACCOUNTANTS AND FINANCIAL CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the South Carolina State Accident Fund (the Fund) as of and for the year ended June 30, 2002 as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the accompanying financial statements of the Fund are intended to present the financial position, results of operations, and cash flows of only the portion of the funds of the State of South Carolina that are attributable to the transactions of the Fund and do not include any other divisions, instrumentalities or any component units of the State of South Carolina.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2002, and the results of its operations and its cash flows of its proprietary fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the basic financial statements, the Fund adopted the provisions of Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-For State and Local Governments and Statement No. 37, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments as of July 1, 2001. This results in a change in the format and content of the financial statements. Furthermore, as discussed in Note 19, the Fund changed its capitalization policy. The changes have been accounted for as prior period adjustments and accounting changes.



The Management's Discussion and Analysis on pages 3 through 6 are not a required part of the basic financial statements but are supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Rogers + Lalan, PA

September 20, 2002

STATE ACCIDENT FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statements and Financial Analysis

The State Accident Fund presents a discussion and analysis of its financial statements for fiscal year 2002. The discussion includes an overview of the financial activity for the year. This report is prepared in accordance with Governmental Accounting Standards Board Statement 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. The new reporting model is expected to be more comprehensive but yet easily understood by its readers. In future years a comparative analysis of the data will be presented. Three financial statements are presented: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. Please read in conjunction with the basic financial statements.

Statement of Net Assets

The Statement of Net Assets presents information reflecting the Fund's assets, liabilities, and net assets. This statement provides the reader with a snapshot view at a point in time. Net Assets represents the amount of total assets less liabilities. Assets and liabilities are shown as current and long term. Current assets and liabilities are those with immediate liquidity or which are collectible or due within twelve months of the statement date. The Statement of Net Assets indicates the funds available for the Fund's operation along with the liabilities that will come due during the next fiscal year.

Unpaid claim liabilities are a large part of the Fund's liabilities and have been separated into current (to be paid within one year) and long-term (to be paid after one year). Estimated unpaid claim liabilities increased approximately \$12,000,000 from the prior year. Another large part of the liabilities is Deferred Premium, which represents the amount of premium billed, but not yet earned, for the future period.

Condensed Statement of Net Assets
June 30, 2002

ASSETS

Current and other assets	\$ 69,606,512
Capital assets, net of accumulated depreciation	4,158,612
Other Noncurrent assets	1,144,768
Total assets	<u>74,909,892</u>

LIABILITIES

Current liabilities	79,165,857
Noncurrent liabilities	44,142,443
Total liabilities	<u>123,308,300</u>

Net Assets

Invested in capital assets	4,158,612
Unrestricted deficit	(52,557,020)
Total net assets	<u>\$ (48,398,408)</u>

Statement of Revenue, Expenses, and Changes in Net Assets

This statement represents the operating revenues and expenses, as well as the non-operating revenues and expenses during the operating year. The purpose of this statement is to present the reader with information relating to monies earned and expenses incurred during the year. The Fund's major revenue comes from premium income for workers' compensation insurance coverage. The major expenses are from incurred claim liabilities, which include medical and lost wages to injured workers and the change in anticipated future payments. Though the Fund is a state agency its normal operation is similar to that of other property and casualty insurance companies.

The Fund is a proprietary fund entity therefore; the statement of Revenues, Expenses, and Changes in Net Assets has been prepared on the accrual basis. Statements prepared using the accrual basis recognize revenues when earned and expenses when incurred.

The expenses presented in this statement include both administrative expenses and claims paid during the year. The administrative cost ratio was 16%, which means 16% of premium dollars were used to operate the Fund during the fiscal year.

The cumulative effect of changes in the accounting principles were due to the State of South Carolina requirement that equipment should have a cost of \$5,000 or more to be capitalized. As a result of this change the Fund had a prior period adjustment of \$126,345.

**Condensed Statement of Revenues, Expenses, and Changes in Net Assets
for the year ended June 30, 2002**

Operating revenues	45,274,268
Operating expenses	<u>65,073,872</u>
Operating loss	(19,799,604)
Nonoperating revenues and expenses	<u>1,392,056</u>
Loss before other revenues, expenses, gains or losses	(18,407,548)
Other revenues, expenses, gains, or losses	<u>(2,190)</u>
Income (Loss) before transfers	(18,409,738)
Transfer to General Fund of the state	<u>(4,408)</u>
Increase (Decrease) in net assets	(18,414,146)
Nets assets - beginning of year, as reported previously	(29,857,917)
Cumulative effect of changes in accounting principles	<u>(126,345)</u>
Net assets - beginning of year, as restated	<u>(29,984,262)</u>
Net assets at end of year	<u><u>\$ (48,398,408)</u></u>

Statement of Cash Flows

The statement of cash flows gives a detailed look at the Fund's cash flow from operating, capital and investing activities. The statement gives a summary of operating cash flows and operating activity for the year. Non-operating receipts include investment income received from cash held and invested by the state Treasurer's Office.

Condensed Statement of Cash Flows for the year ended June 30, 2002

Cash provided (used by):	
Operating activities	\$ (3,904,550)
Non-capital and related financing activities	411,257
Capital and related financing activities	(82,613)
Investing activities	1,415,990
Net change in cash	<u>(2,159,916)</u>
Cash and cash equivalents - beginning of year	25,413,412
Cash and cash equivalents - end of year	<u><u>\$ 23,253,496</u></u>

Capital Asset and Debit Activity

Two capital assets, an application server and a tape library, were replaced during the fiscal year. There were no other significant additions to capital assets. The Fund had no changes in credit rating or debt limitations that may affect future financing.

Economic Outlook

The Fund incurred an operating loss of \$19.8m during the fiscal year ending June 30, 2002. In order to recover from this operating loss, changes are being made during the current year to increase the premium revenue. Additional premium revenue of approximately \$1.1m was created from 43 new policyholders during fiscal year 2002. Due to the hardening of the workers' compensation market we expect to continue to attract new policyholders.

The National Council on Compensation Insurance estimates that medical and indemnity costs will continue to rise slightly through 2003. Even though the Fund's average claim costs remain below the industry average the following cost containment efforts are being made:

- A managed comp program was implemented during this fiscal year to reduce medical and indemnity cost.
- Reinsurance coverage was purchased to recover costs exceeding \$350,000 per claim from the reinsurer.
- A Request for Proposal (RFP) for vendors who offer a drug cost containment program has been submitted to the Materials Management Office. The bid process should be completed and the program implemented in the new fiscal year.

During the 2002 legislative session the General Assembly decided to exercise its authority to redirect an amount of funds equivalent to the interest accrued and held by agencies of the state government. In accordance with Proviso 72.97, the Fund will transfer a total of \$1,791,269 to the general fund during the next fiscal year.

SOUTH CAROLINA STATE ACCIDENT FUND

STATEMENT OF NET ASSETS

JUNE 30, 2002

ASSETS

Current Assets:

Cash and cash equivalents	\$ 23,253,496
Premiums receivable	45,123,380
Claims recoveries and reimbursement receivables	604,424
Recoverable under reinsurance annuity contract	120,364
Accrued interest receivable	268,989
Prepaid expenses	235,859
Total current assets	69,606,512

Noncurrent Assets:

Capital assets, net of accumulated depreciation	4,158,612
Prepaid expenses	15,052
Recoverable under reinsurance annuity contract	111,175
Investment in reinsurance annuity contract, net of accumulated amortization of \$263,753	1,018,541
Total noncurrent assets	5,303,380

Total assets

\$ 74,909,892

LIABILITIES AND NET ASSETS

Current Liabilities:

Cash overdraft	\$ 1,218,441
Accounts payable	538,513
Accrued compensated absences and related benefits	260,312
Accrued payroll and related liabilities	298,632
Accrued refundable premiums	6,878,025
Deferred premium revenue	45,729,334
Unpaid claims liability and claims adjustment expenses payable within one year - net	24,242,600
Total current liabilities	79,165,857

Noncurrent Liabilities:

Accrued compensated absences and related benefits	64,043
Unpaid claims liability and claims adjustment expenses payable beyond one year - net	44,078,400
Total noncurrent liabilities	44,142,443

Total liabilities

123,308,300

Net assets

Invested in capital assets	4,158,612
Unrestricted deficit	(52,557,020)

Total net assets

(48,398,408)

Total liabilities and net assets

\$ 74,909,892

See accompanying Notes to Financial Statements.

SOUTH CAROLINA STATE ACCIDENT FUND

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2002**

OPERATING REVENUES	
Premiums	<u>\$ 45,274,268</u>
OPERATING EXPENSES	
Claims	48,402,537
Administrative:	
Second Injury Fund assessment	7,409,956
Personal services and employee benefits	3,981,365
Contractual services	970,620
Rent and insurance	310,701
Supplies and materials	108,713
Depreciation	1,756,664
Amortization expense - reinsurance annuity contract premium	75,358
Reinsurance premiums	1,904,111
Other expenses	121,347
Actuarial fee	32,500
Total administrative expenses	<u>16,671,335</u>
Total operating expenses	<u>65,073,872</u>
OPERATING INCOME (LOSS)	(19,799,604)
NONOPERATING REVENUES (EXPENSES)	
Interest/investment income	1,392,056
Loss on disposal of assets	<u>(2,190)</u>
INCOME (LOSS) BEFORE TRANSFERS	(18,409,738)
TRANSFER TO GENERAL FUND OF THE STATE	<u>(4,408)</u>
CHANGE IN NET ASSETS	<u>(18,414,146)</u>
NET ASSETS (DEFICIT), AT BEGINNING OF YEAR -AS PREVIOUSLY REPORTED	(29,857,917)
PRIOR PERIOD ADJUSTMENT	<u>(126,345)</u>
NET ASSETS (DEFICIT), AT BEGINNING OF YEAR - AS RESTATED	<u>(29,984,262)</u>
NET ASSETS (DEFICIT), AT END OF YEAR	<u><u>\$ (48,398,408)</u></u>

See accompanying Notes to Financial Statements.

SOUTH CAROLINA STATE ACCIDENT FUND

**STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2002**

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received for premiums	\$ 47,413,861
Cash received for reimbursements of claims expense	10,304,944
Payments for claims	(46,811,948)
Payments for salaries and related benefits	(3,999,203)
Payments for other operating expenses	(10,812,204)
Net cash used by operating activities	<u>(3,904,550)</u>

CASH FLOWS FROM NON-CAPITAL AND RELATED FINANCING ACTIVITIES:

Transfer to General Fund of the State	(4,408)
Repay cash overdraft	(802,776)
Loans from cash overdraft	1,218,441
Net cash provided by non-capital and related financing activities:	<u>411,257</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Acquisition of capital assets	<u>(82,613)</u>
Net cash used by capital and related financing activities	<u>(82,613)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest/investment income received	<u>1,415,990</u>
Net cash provided by investing activities	<u>1,415,990</u>

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (2,159,916)

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 25,413,412

CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 23,253,496

SOUTH CAROLINA STATE ACCIDENT FUND

**STATEMENT OF CASH FLOWS (CONTINUED)
YEAR ENDED JUNE 30, 2002**

**Reconciliation of net operating revenues (expenses)
to net cash provided (used) by operating activities:**

Operating income (loss)	\$ (19,799,604)
Adjustments to reconcile operating income (loss) to net cash used by operating activities:	
Depreciation and amortization	1,832,022
Changes in assets and liabilities:	
(Increase) decrease in premiums receivable	(9,754,557)
(Increase) decrease in claims recoveries and reimbursement receivables	(161,268)
(Increase) decrease in prepaid expenses	(250,911)
(Increase) decrease in recoverable under reinsurance annuity contract	54,435
Increase (decrease) in accounts payable	296,656
Increase (decrease) in accrued compensated absences and related benefits	(10,826)
Increase (decrease) in accrued payroll and related liabilities	(7,012)
Increase (decrease) in accrued refundable premiums	1,582,539
Increase (decrease) in deferred premium revenue	10,311,610
Increase (decrease) in estimate of unpaid claims liability	<u>12,002,366</u>
Total adjustments	<u>15,895,054</u>
Net cash (used) by operating activities	<u><u>\$ (3,904,550)</u></u>

Noncash capital and related financing activities:

The Fund disposed of equipment with a cost of \$32,071 and accumulated depreciation of \$29,881 during the year.

The Fund traded in equipment with a cost of \$81,190 and accumulated depreciation of \$44,080 during the year.

See accompanying Notes to Financial Statements.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The financial statements of South Carolina State Accident Fund (the Fund) were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental entities. The Government Accounting Standards Board (GASB) is the accepted standard-setting body in the United States of America for establishing governmental accounting and financial reporting principles. The more significant of the Fund's accounting policies are described below.

Reporting Entity

The South Carolina State Accident Fund, a primary entity, is part of the primary government of the State of South Carolina and is included in the Comprehensive Annual Financial Report of the State of South Carolina. The Fund was established by Section 42-7-10 of the Code of Laws of South Carolina, as amended, to provide worker's compensation insurance coverage to State entities. Although the State of South Carolina is the Fund's predominant participant, counties, municipalities, and other political subdivisions of the State may elect to participate. The State assumes the full risk for the covered claims. The Fund is responsible for investigating, adjusting and paying worker's compensation claims as awarded by the Worker's Compensation Commission for job related accidental injury, disease, or death to employees of participants.

The Fund is administered by a director, appointed by the Governor, with the advice and consent of the Senate, for a term of six years. The accompanying financial statements present the financial position, results of operations, and cash flows solely of the Fund and do not include any other departments, institutions, component units, etc. of the State of South Carolina.

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 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.

A 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 government or entity that holds one or more of the following powers:

- (1) Determines its budget without another government's having the Fund to approve and modify that budget.
- (2) Levies taxes or set rates or charges without approval by another government.
- (3) Issues bonded debt without approval by another government.

The organization is fiscally independent if it holds all three of those powers. Based on the criteria, the Fund has determined it is not a component of another entity and it has no component units.

The budget, personnel, procurement, and other laws of the State and the policies and procedures for State agencies are applicable to the activities of the Fund.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

Fund Accounting

The South Carolina state government 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 entities 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.

The South Carolina State Accident Fund is an internal service fund of the proprietary fund types of the State of South Carolina. Such funds account for the financing of goods and services.

Basis of Accounting

The accounting policies of the Fund conform to generally accepted accounting principles (GAAP) applicable to proprietary activities as prescribed by the Governmental Accounting Standards Board (GASB), the recognized standard-setting body for GAAP for all state governmental entities. Proprietary fund entities use the accrual basis of accounting. If measurable, revenues are recognized when earned and expenses when incurred. In accordance with GASB Statement 20, the Fund has elected to apply all applicable GASB pronouncements as well as all applicable FASB pronouncements issued on or before November 30, 1989 not in conflict with GASB standards.

Cash and Cash Equivalents

The amount shown in the financial statements as "cash and cash equivalents" represents cash on deposit with the State's Treasurer, cash in banks, and cash invested in various instruments by the State Treasurer as part of the State's internal cash management pool and short-term investments not held by the State Treasurer's Office and having a maturity at purchase of three months or less.

Because the internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and 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 certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, certain corporate bonds.

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

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

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

Capital Assets

Capital assets are recorded at cost at the date of acquisition. The Fund follows capitalization guidelines established by the State of South Carolina. All land is capitalized, regardless of cost. The Fund capitalizes movable personal property with a unit value in excess of \$5,000 and a useful life in excess of two years and intangible assets including software costing in excess of \$100,000. Routine repairs and maintenance are charged to operating expenses in the year in which the expense was incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 3 to 10 years.

Unpaid Claims Liability

The Fund establishes unpaid claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. The amount accrued includes estimated specific incremental claims adjustment expenses but not administrative expenses. Estimated amounts of salvage and subrogation and reinsurance recoverable, if any, on both settled and unsettled claims have been deducted from the liability for unpaid claims to the extent reasonably estimable. In addition, to the extent reasonably estimable, the liability for unpaid claims has been adjusted for amounts to be recovered or reimbursed from participants who retain the risk of loss for specific periods. This includes amounts recoverable from the State of South Carolina for state agency claims prior to July 1, 1986. See Note 7 for further explanation. Claims liabilities for DOT claims prior to January 1, 1994, are not included in the State Accident Fund's claims liability. See below and Note 4 for further information. Because actual claims costs depend on such complex factors as inflation, changes in doctrine of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed annually as of fiscal year end using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. While management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided.

The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in current earnings. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

Prior to July 1, 1998 the Fund acted as a claims service with respect to claims incurred by the Department of Transportation prior to January 1, 1994 and the Department of Public Safety prior to August 1, 1993. For the year ended June 30, 1999 the General Assembly required the State Accident Fund to purchase an annuity for the purpose of funding the future obligation for workers compensation claims filed prior to restructuring by Department of Highways and Public Transportation employees. After June 30, 1998 workers compensation claims from these agencies are be paid from funds received from the annuity purchased. Risk of loss on these claims became the responsibility of the State Accident Fund.

Reinsurance

The fund has obtained reinsurance coverage to reduce its exposure to losses on insured events. Losses in excess of \$350,000 from an insured event are covered up to limits based on the type of injury as set by the workmen's compensation statutes of the South Carolina Code of Laws, with the Fund retaining the risk for the first \$350,000 of loss. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Fund as direct

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

insurer of the risks reinsured. The Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by reinsurers. The coverage period runs from September 1, 2001 to August 31, 2002.

Recognition of Premium Revenue, Receivables and Deferred Revenue

Premiums are recognized as revenue on a pro rata basis over the policy term. Policies are billed and issued on both the fiscal year and calendar year basis. Premiums are based on an actuarial method and are currently adjusted so that over a reasonable period of time expected revenues, including investment income, and anticipated expenses will be approximately equal. In addition premium revenue includes accrued premium adjustments for additional premiums owed by policyholders as determined based on actual payrolls for the policy period which are in excess of estimated premiums billed which were based on estimated payroll costs. Revenue is reduced for refunds payable. Estimated premiums receivables and refund payables are recorded as of year-end for future anticipated premium adjustments for the policy years which end within the fund's fiscal year. A receivable is recorded at the time the annual estimated premium is billed even though some/all of the amount may not be currently due. Deferred revenue is recognized to the extent that the premiums billed and not yet received are for future periods. In addition, deferred revenue is recognized for unearned premiums received.

Budget Policy

The Fund is granted an annual appropriation for operating purposes by the General Assembly (to be funded by workers' compensation premiums and interest earned thereon). The appropriation as enacted becomes the legal operating budget for the Fund. The General Assembly enacts the budget through passage of specific line-item appropriations by program within budgetary unit, within budgetary fund category, State General Fund or other budgeted funds. Budgetary control is maintained at the line-item level of the entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist.

Transfers of funds may be approved by the State Budget and Control Board under its Fund or by the agency as set forth in the 2001 Appropriations Act proviso 72.14 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

Agencies may charge vendor, interagency, and interfund payments for fiscal year 2002 to 2002 appropriations in July. Any unexpended appropriations as of June 30 automatically lapse on July 31 unless authorization is received from the General Assembly to carry over the funds to the ensuing fiscal year. State law does not precisely define the budgetary basis of accounting. For each fiscal year, the level of legal control for each agency is reported in a publication by the State Comptroller General. The current Appropriations Act states that the General Assembly intends to appropriate all monies to operate State government for the current fiscal year. The State's annual budget is prepared primarily on the modified accrual basis of accounting with several exceptions, principally the cash basis for payroll expenses and certain non-State appropriations revenue.

The Fund's budget includes administrative expenses and specifically excludes claims expense and the Second Injury Fund assessment. Amounts to be expended for capital assets are also budgeted. Expenses prepared on the accrual basis do not vary significantly from the budgetary basis. In accordance generally accepted accounting principles applicable to business type activities, a comparison of actual revenues and expenses to the budgeted amounts has not been presented.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

Statement of Cash Flows

For purposes of cash flows, the Fund considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The State's internal cash management pool is included in this definition of cash equivalents.

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the Fund's workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave.

Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave and compensatory holiday and overtime leave earned for which the employees are entitled to paid time off or payment at termination. The Fund calculates the compensated absences liability based on recorded balances of unused leave for which the employer expects to compensate employees through paid time off or cash payments at termination. That liability is determined by using fiscal year-end current salary costs and the cost of the salary-related benefit payments. The net change in the liability is recorded in the current year in the applicable personal services and employee benefits expense category.

Operating and Nonoperating Revenues and Expenses

The Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and delivering goods in connection with a proprietary fund's principal ongoing operations. The Fund's primary operating revenues are from premium revenues. Operating expenses include the cost of sales or services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Net Assets

Net assets are categorized as follows:

Invested in capital assets: This represents the Fund's total investment in capital assets, net of outstanding debt obligations, if any, related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Unrestricted net assets: Unrestricted net assets (deficit) represent the remainder of the Fund's liabilities in excess of assets excluding those net assets reported in other categories.

Use of 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. Such estimates include the unpaid claims liability.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

Investment in Reinsurance Annuity Contract

As more fully explained in Note 4 under the 1993 Restructuring Act, the Department of Transportation and the Department of Public Safety were created and were charged with responsibilities of the former Department of Highways and Public Transportation effective July 1, 1993. Proviso 44.4 of the 1998-1999 Appropriation Act passed by the General Assembly required the State Accident Fund to purchase an annuity for the purpose of funding the future obligation for workers' compensation claims filed prior to restructuring by the Department of Highways and Public Transportation employees using funds from the Workers' Compensation Trust Fund. This annuity is being amortized over the life of the contract in proportion to annuity proceeds received.

Changes in Accounting and Restatement of Beginning Net Asset Balances

As a result of the adoption of GASB Statement s No. 34, the fund was also required to make certain changes in accounting principles regarding the changes in the presentation of net assets.

NOTE 2 RISK MANAGEMENT:

Insurance Coverage

The Fund, an administrative agency, is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks. 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 prior years. The cost of settled claims and claim losses have not exceeded this coverage in any of the past three years. The Fund pays insurance premiums to itself and certain other State agencies to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in 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 type of claims:

1. Claims of State employees for unemployment compensation benefits. This type of claim is handled through the South Carolina Employment Security Commission;
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries. This type of claim is handled by the State Accident Fund;
3. Claims of covered public employees for health and dental insurance benefits. This type of claim is handled by the Office of Insurance Services; and
4. Claims of covered public employees for long-term disability and group-life insurance benefits. This type of claim is handled through the Office of Insurance Services.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

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

1. Theft of, damage to, or destruction of assets – building contents;
2. General tort claims; and
3. Data processing equipment.

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 insurance. Also, the IRF purchases reinsurance for catastrophic property insurance. Reinsurance permits partial recovery of losses from reinsurers, but the IRF remains primarily liable. The IRF's rates are determined actuarially.

State agencies and other entities are the primary participants in the State's Health and Disability Insurance Fund and in the IRF.

The Fund obtains coverage of up to \$25,000 per occurrence through a commercial insurer for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation. The Fund has not transferred the portion of the risk of loss related to insurance policy deductibles for its property contents, general torts, and fidelity bond coverage's to a State or commercial insurer. There were no expenses incurred for the year ended June 30, 2002 for actual claim payments related to such retained risk of loss.

The Fund has not reported an estimated claims loss expense and the related liability at June 30, 2002, based on the requirements of GASB Statements No. 10 and No. 30, which state 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, 2002, and the amount of loss is reasonably estimable.

In management's opinion, claims losses in excess of insurance coverage, if any, are unlikely and, if incurred, would be insignificant to the Fund's financial position. Furthermore, there is no evidence of asset impairment or other information to indicate that a loss should be recorded. Therefore, no loss accrual has been recorded.

SOUTH CAROLINA STATE ACCIDENT FUND

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002**

NOTE 3 DEPOSITS AND INVESTMENTS:

Cash and cash equivalents consist of deposits under the control of the State Treasurer, who by law, has sole Fund for investing State funds and deposits under the control of the State Accident Fund. However, as authorized by the State Treasurer's office, certain funds used to pay claims are invested and deposited with financial institutions.

The following schedule reconciles deposits within the footnotes to the statement of net asset amounts:

Statement of Net Assets		Footnotes	
Cash and cash equivalents	\$ 23,253,496	Deposits Held by State Treasurer	\$ 22,864,529
Cash overdraft	(1,218,441)	Other Deposits	(1,218,441)
		Investments	388,967
	\$ 22,035,055		\$ 22,035,055

Deposits

State law requires full collateralization of all State Treasurer's bank balances. The State Treasurer must correct any deficiencies in collateral within seven days. 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 agents in the State's name. Information pertaining to the carrying amounts, market values, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

At June 30, 2002 the bank balance was \$455,000 and the amount reported in the financial statements is an overdraft of \$1,218,441. The entire bank balance was either covered by the insurance or collateralized with securities held by the Fund, or by its agent in the Fund's name.

Investments

Legally authorized investments include obligations of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, certain corporate bonds, and commercial paper.

All of the Fund's investments are stated at fair value except those meeting certain specific requirements. Purchases and sales are accounted for on the trade date. Unrealized gains and losses on investments have been recorded. Realized gains and losses on securities transactions are recorded on the accrual basis. Earnings are recorded on the accrual basis.

SOUTH CAROLINA STATE ACCIDENT FUND

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002**

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

1. Insured or registered, or for which the securities are held by the government or its agent in the government's name.
2. Uninsured and unregistered, with securities held by the counter-party's trust department or agent in the government's name.
3. Uninsured and unregistered, with securities held by the counter-party, or by its trust department or agent but not in the government's name.

A summary of other investments at June 30, 2002 by credit risk category follows:

	Category			Carrying Amount	Fair Value
	1	2	3		
Repurchase agreements	\$388,967			\$388,967	\$388,967

NOTE 4 INVESTMENT IN REINSURANCE ANNUITY CONTRACT:

Under the 1993 Restructuring Act, the Department of Transportation and the Department of Public Safety were created and were charged with responsibilities of the former Department of Highways and Public Transportation effective July 1, 1993. Proviso 44.4 of the 1998-1999 Appropriation Act passed by the General Assembly required the State Accident Fund to purchase an annuity for the purpose of funding the future obligation for workers' compensation claims filed prior to restructuring by the Department of Highways and Public Transportation employees using funds from the Workers' Compensation Trust Fund.

While the State believes the annuity will provide funding adequate to cover this liability, the Fund has ultimate responsibility to pay these claims should the annuity funding be inadequate. On March 11, 1999 the State Accident Fund purchased a type one annuity that will pay a fixed amount quarterly for a period of forty years. The annuity was effective as of January 1, 1999. The Fund received its first quarterly annuity payment on April 5, 1999. For the year ended June 30, 2002 the Fund paid \$96,020 of Department of Transportation claims covered by this annuity. They received reimbursement of \$150,455 under this contract for the year ended June 30, 2002. The amount of \$231,539, shown on the statement of net assets as recoverable under reinsurance annuity contract, represents amounts due under the annuity that will be collected in the future for cumulative claims payments in excess of cumulative annuity receipts, which includes the 4th quarterly annuity payment due in 2002. The estimated future claims is \$1,141,000 which is not included in the unpaid claims liability and claims adjustment expenses payable on the statement of net assets. Under the terms of the annuity the Fund will receive 160 quarterly payments. For the first forty payments the Fund will receive \$30,091 per quarter, the next forty payments will be for \$15,022, the next forty payments will be for \$3,726, and the last forty will be for \$2,364. Total amount to be received under the annuity will be \$2,048,120. The total price of the annuity was \$1,282,294 and was paid in a single premium. The amount of the annuity to purchase was determined actuarially.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2002

The liability for these claims is not reported by either the State Accident Fund or the Department of Transportation because the State of South Carolina feels that the proceeds from the annuity contract will provide adequate funding to pay these claims and the risk of loss is remote. The annuity is being amortized over the life of the annuity in proportion to annuity proceeds received. The amount of amortization charged for the year ended June 30, 2002 was \$75,358 and is included as amortization expense in the statement of revenues, expenses, and changes in net assets.

NOTE 5 PREMIUMS RECEIVABLE:

Premiums receivable consist of amounts receivable from the following:

County and Municipal Governments and Agencies	\$ 4,409,997
State Agencies	<u>40,713,383</u>
	<u>\$45,123,380</u>

Included in premium receivable and premium revenue is \$1,954,178 receivable from state agencies and \$925,001 from county and municipal governments and agencies for estimated additional premium adjustments not processed as of June 30, 2002. The majority of premiums receivable represent billings for future periods which have not been earned as of fiscal year-end.

NOTE 6 CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2002 is summarized as follows:

	Beginning Balance As Restated July 1, 2001	Increases	Decreases	Ending Balance June 30, 2002
Equipment and furniture	\$ 870,166	\$ 119,724		\$ 876,629
Software	<u>8,152,000</u>			<u>8,152,000</u>
Total capital assets at historical cost	<u>9,022,166</u>	<u>119,724</u>	<u>(113,261)</u>	<u>9,028,629</u>
Less accumulated depreciation for:				
Equipment and furniture	(402,278)	(234,505)	73,960	(562,823)
Software	<u>(2,785,035)</u>	<u>(1,522,159)</u>		<u>(4,307,194)</u>
Total accumulated depreciation	<u>(3,187,313)</u>	<u>(1,756,664)</u>	<u>73,960</u>	<u>(4,870,017)</u>
Capital assets, net of accumulated depreciation	<u>\$ 5,834,853</u>	<u>\$ (1,636,940)</u>	<u>\$ (39,301)</u>	<u>\$ 4,158,612</u>

SOUTH CAROLINA STATE ACCIDENT FUND

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002**

NOTE 7 ACCRUED REFUNDABLE PREMIUMS:

Policyholders are billed annually for estimated premiums based on the policyholder's estimated payroll. After the policy period ends, policyholders submit the details of the actual salaries paid and the Fund adjusts the premium based on the actual payroll and a rating modifier based on claims experience. The amounts the Fund owed policyholders for estimated premiums in excess of actual adjusted premiums at June 30, 2002 was \$320,518 for those county and municipal policyholders. An additional \$6,557,507 was due to State agencies.

Included in refunds payable is \$179,344 estimated due to county and municipal governments and agencies and \$6,439,398 estimated due to State agencies for estimated premium adjustments not processed as of June 30, 2002.

NOTE 8 UNPAID CLAIMS LIABILITY AND CLAIMS ADJUSTMENT EXPENSES:

The amount accrued for unpaid claims liability and claims adjustment expenses is an actuarially determined amount, based on the Fund's historical claims expenses adjusted for current factors, for the estimated ultimate cost of settling claims for events which occurred on or before year-end but were unpaid at the end of the year. To the extent claims were incurred on behalf of state agencies prior to July 1, 1986, reimbursement will be due from the State of South Carolina when the claims are paid. Estimated amounts recoverable from subrogation have been deducted from the claims liability.

The amounts accrued for unpaid claims liability and claims adjustment expenses, net of amounts recoverable from the State, for the past two years are as follows:

	2002	2001
Unpaid claims liability and claim adjustment expenses at beginning of year	\$ 56,318,634	\$ 55,374,000
Current year claims and changes in estimates	60,404,903	35,153,926
Claims payments	(48,402,537)	(34,209,292)
 Total unpaid claims liability and claim adjustment expenses at the end of year	 \$ 68,321,000	 \$ 56,318,634
 This claims liability is further categorized as follows:		
State Agencies	\$ 53,105,000	
Counties and Municipalities	15,216,000	
Total	\$ 68,321,000	

The estimated reimbursement due from the State for claims prior to July 1, 1986 is as follows:

Due within one year	\$ 67,300
Due after one year	605,700
Total	\$ 673,000

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

NOTE 9 SECOND INJURY FUND ASSESSMENT:

The Fund is required to pay an annual assessment to the Second Injury Fund of the State of South Carolina. The assessment is usually billed in the first quarter of the fiscal year and is based on a specified percentage of total claims paid by the Second Injury Fund during the previous calendar year. The Second Injury Fund handles claims for workers who have permanent physical impairments and incur subsequent disability from injury by accidents arising out of and in the course of employment. The assessment for fiscal year 2002 was \$7,409,956. The Fund receives reimbursements of claims expense from the Second Injury Fund. The total amount received during fiscal year 2002 was approximately \$9,608,000 which is reported as a reduction of claims expense.

NOTE 10 PENSION PLAN:

The Retirement Division of the State Budget and Control Board maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the Retirement Division, 202 Arbor Lake Drive, Columbia, South Carolina 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

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

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years of service and qualify for a survivor's benefit upon completion of 15 years credited service (five years effective January 1, 2001). Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service. This requirement does not apply if the disability is a result of a job related injury. A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

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

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6.0 percent of all compensation. Effective July 1, 2000 the employer contribution rate became 10.40 percent which included a 2.85 percent surcharge to fund retiree health and dental insurance coverage. The Fund's actual contributions to the SCRS for the most recent fiscal years ended June 30, 2002, 2001 and 2000 were approximately \$234,000, \$235,000 and \$231,000, respectively, and equaled the required contributions of 7.55% (excluding the surcharge) for each year. Also, the Fund paid employer group life insurance contributions of approximately \$4,700 for the current fiscal year at the rate of .15% of compensation. In addition to the \$234,000, the Fund paid approximately \$53,000 to the system to purchase additional years of service for certain employees.

The amounts paid by the Fund for pension, group-life, and post-retirement benefits are included as personal services expenses.

Article X, Section 16, of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title Nine of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefits, and employee/employer contributions for each pension plan. Employee and employer contribution rates to SCRS are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of compensation).

The Systems do not make separate measurements of assets and pension liabilities obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Fund's liability under the pension plans is limited to the contribution requirements for the applicable year from amounts appropriated therefore in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Fund recognizes no contingent liability for unfunded costs associated with participation in plans. At retirement, employees participating in the SCRS may receive additional service credit (at a rate of 20 days equal to one month of service) for up to 90 days for accumulated unused sick leave.

NOTE 11 POSTEMPLOYMENT AND OTHER EMPLOYEE BENEFITS:

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the Fund are eligible to receive these benefits. The State provides postemployment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date.

Generally those who retire must have at least 10 years of retirement service credit to qualify for these State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

These benefits are provided through annual appropriations by the General Assembly to the Fund for its active employees and to the State Budget and Control Board for all participating State retirees except the portions funded through the pension surcharge and provided from other applicable fund sources of the Fund for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Approximately 22,000 State retirees met these eligibility requirements as of June 30, 2001.

The Fund recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of approximately \$271,000 for the year ended June 30, 2002. As discussed in Note 10, the Fund paid approximately \$88,000 applicable to the 2.85 percent surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Office of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to Fund retirees is not available. By State law, the Fund has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements. In addition, the South Carolina General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from the System's earnings; however, a portion of the required amount is appropriated from the South Carolina General Fund annually.

NOTE 12 DEFERRED COMPENSATION PLANS:

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Fund have elected to participate. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401 (k), and 403 (b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employees.

The State has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

NOTE 13 OPERATING LEASES:

The Fund leases its office space from an external party. The lease for the rental of office space expired June 30, 2002. A new lease was entered into in May 2002 for the period July 1, 2002 through June 30, 2007. The lease contains a renewal option for up to five years at the same terms and conditions, except that the rental rate shall be negotiated. It also leases office equipment and vehicles under short-term and/or cancelable operating leases. 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. Minimum future rental obligations under the noncancelable lease are as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2003	\$ 281,042
2004	281,042
2005	281,042
2006	281,042
2007	<u>281,042</u>
Totals	<u>\$ 1,405,210</u>

SOUTH CAROLINA STATE ACCIDENT FUND

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002**

Operating lease expenses for the fiscal year ended June 30, 2002, was approximately \$277,000 for office space and approximately \$35,000 for office equipment and vehicles. The Fund reports these costs in rent and insurance administrative expenses.

NOTE 14 LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2002 was as follows:

	June 30, 2001	Additions	Reductions	June 30, 2002	Due within One year
Accrued compensated absences and related benefits	\$ 335,181	\$ 249,486	\$ (260,312)	\$ 324,355	\$ 260,312

NOTE 15 TRANSACTIONS WITH STATE ENTITIES:

The Fund has significant transactions with the State of South Carolina and various State agencies. Services received at no cost from State Agencies include maintenance of certain accounting records and payroll and disbursement processing from the Comptroller General's office; check preparation, banking, and investment functions from the State Treasurer; legal services from the Attorney General's office; and record storage for the Department of Archives and History.

Other services received at no cost from the various divisions of the State Budget and Control Board include pension plan administration, insurance plans administration, audit services, personnel management, assistance in the preparation of the State Budget, property management and record keeping, review and approval of certain budget amendments, procurement services, and other centralized functions.

The Fund had financial transactions with various State Agencies during the year ended June 30, 2002. Significant payments were made to divisions of the State Budget and Control Board for pension and insurance plan contributions, vehicle rental, insurance coverage, office supplies, printing, telephone, interagency mail, and data processing services. Payments were also made for unemployment coverage for employees to the Employment Security Commission. The amount of expenses applicable to these transactions are not readily determinable.

The Fund provided no services free of charge to other State Agencies during the year ended June 30, 2002; however, the Fund provided worker's compensation coverage to all State Agencies for a fee. Premium revenue from State Agencies during the year ended June 30, 2002 was \$34,597,812.

The Fund received \$59,662 in the fiscal year from the State of South Carolina for claims prior to 1986. \$44,704 was received subsequent to June 30, 2002 and is included in the claims recoveries and reimbursement receivables account on the balance sheet.

The Fund was required to remit \$4,408 to the General Fund of the State pursuant to Proviso 72.111 of the 2002 Appropriations Act.

SOUTH CAROLINA STATE ACCIDENT FUND

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2002

NOTE 16 NET LOSS/NET ASSETS DEFICIT:

The statement of revenues, expenses, and changes in net assets shows a net loss of approximately \$18,414,000 for the year ended June 30, 2002. The Fund has a deficit retained earnings deficit of approximately \$48,400,000. The loss for the year was due primarily to an increase in liability for future losses based on the recommendation of the Fund's actuary and an increase in administrative expenses. In addition, investment earnings decreased. The deficit includes lost interest earnings through 1995.

Prior to 1990, all investment income earnings of the Fund were credited to the General Fund of the State. For fiscal years 1991 and 1992, the Fund received one-third and two-thirds of the investment income. Section 42-7-75 of the South Carolina Code of Laws require the State Treasurer to deposit in the Fund's trust account monthly sufficient funds to pay expenses and claims required by law to be paid with the amount limited to the amount of investment income which the Fund would have earned since its inception if all investment earnings had been credited to the Fund. Estimates prepared by management in 1995 estimated that limit to be approximately \$12,300,000 assuming an interest rate of 4% to approximately \$20,600,000 using an interest rate of 6%.

To reduce the deficit, the Fund purchased excess of loss reinsurance for accidents that occur on and after July 1, 2000. Claim costs in excess of \$250,000 were reinsured with the amount increasing to \$350,000 as of September 1, 2001. Also, effective January 1, 2001, the experience rating formula was modified to generate additional revenue of 10.9% and effective January 1, 2002, the premium volume discount program was modified to generate an additional 5.3% in premium revenue. The Fund implemented a medical management cost containment program in 2001 that is expected to reduce claim costs significantly.

Management is hopeful that these actions along with a rate increase in January 2003 will result in positive movement toward elimination of the Fund financial deficit.

NOTE 17 CONCENTRATIONS OF CREDIT RISK AND OTHER CONCENTRATIONS:

The Fund has reinsurance contracts with providers which share or limit the Fund's exposure to losses. However, should the reinsurance providers be unable to meet their obligations settlement of these amounts will ultimately be the responsibility of the South Carolina State Accident Fund. The Fund provides services to South Carolina governmental entities. The limited make-up of the membership group, as well as the limited geographic region in which the Fund operates, increases the Fund's exposure to business concentrations.

NOTE 18 SUBSEQUENT EVENTS

The Fund will be required to remit approximately \$1,791,000 to the General Fund of the State during the year ended June 30, 2003 pursuant to Proviso 92.97 of the 2003 Appropriations Act.

SOUTH CAROLINA STATE ACCIDENT FUND

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002**

NOTE 19. PRIOR PERIOD ADJUSTMENT

All state agencies and institutions were required to adopt a capitalization limit of \$5,000 for movable personal property and \$100,000 for depreciable land improvements, buildings and improvements, and intangible assets, as of July 1, 2001. As a result of the change in asset capitalization policy, the Fund removed capitalized assets on hand at July 1, 2001, which did not meet the new capitalization levels. A summary of the changes to capital assets are as follows:

	Balance as Previously Reported July 1, 2001	Effect of Changes In Accounting Principles	Balance as Restated July 1, 2001
Equipment and furniture	\$ 1,666,193	\$ (796,027)	\$ 870,166
Software	8,152,000		8,152,000
Total capital assets at historical cost	<u>9,818,193</u>	<u>(796,027)</u>	<u>9,022,166</u>
Less accumulated depreciation for:			
Equipment and furniture	(1,071,960)	669,682	(402,278)
Software	<u>(2,785,035)</u>		<u>(2,785,035)</u>
Total accumulated depreciation	<u>(3,856,995)</u>	<u>669,682</u>	<u>(3,187,313)</u>
Capital assets, net of accumulated depreciation	<u>\$ 5,961,198</u>	<u>\$ (126,345)</u>	<u>\$ 5,834,853</u>