

**SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND**

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2017

WITH

INDEPENDENT AUDITORS' REPORT



George L. Kennedy, III, CPA
State Auditor

August 23, 2017

Members of the Board of Governors
South Carolina Medical Malpractice Patients' Compensation Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Medical Malpractice Patients' Compensation Fund for the fiscal year ended June 30, 2017, was issued by The Brittingham Group, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

George L. Kennedy, III, CPA
State Auditor

GLKIII/cwc

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INDEPENDENT AUDITORS' REPORT

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INDEPENDENT AUDITORS' REPORT

Mr. George L. Kennedy, III, CPA
State Auditor
Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, South Carolina 29201

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the South Carolina Medical Malpractice Patients' Compensation Fund (the "Fund" or "PCF"), a non-major enterprise fund of the State of South Carolina as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions 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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the South Carolina Medical Malpractice Patients' Compensation Fund, as of June 30, 2017, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Other Matter

As discussed in *Note 1*, the financial statements present only the South Carolina Medical Malpractice Patients' Compensation Fund and do not purport to, and do not, present fairly the financial position of the State of South Carolina, as of June 30, 2017, and the 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, Schedule of Proportionate Share of the South Carolina Retirement System Net Pension Liabilities, and Schedule of South Carolina Retirement System Contributions on pages 3–8, 35, and 36, 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 August 23, 2017 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

The Brittingham Group LLP

West Columbia, South Carolina
August 23, 2017

Management's Discussion and Analysis

Overview of the Financial Statement and Financial Analysis

In accordance with Government Accounting Standards, the Fund produces three primary financial statements: (1) The Statement of Net Position, (2) The Statement of Revenues, Expenses and Changes in Net Position, and (3) The Statement of Cash Flows. This management's discussion and analysis of the South Carolina Patients' Compensation Fund's (PCF) financial statements provide an overview of its financial activities for the year.

Statement of Net Position

The Statement of Net Position presents the assets, liabilities and equity of the PCF as of the end of the fiscal year. The Statement of Net Position presents end-of-year data concerning assets as well as liabilities (current and non-current). Our current assets are those, which are reasonably expected to be, realized in one year. Current liabilities are obligations whose liquidation is expected to require the use of current assets.

Condensed Statements of Net Position

	June 30,		
	2017	2016	Variance
Assets and Deferred Outflows of Resources:			
Cash and investments	\$ 9,243,895	\$ 6,322,421	\$ 2,921,474
Interest receivable and prepaid expenses	367,453	355,589	11,864
Capital assets, net	1,035,491	1,026,570	8,921
Deferred outflows of resources	83,167	40,305	42,862
	\$ 10,730,006	\$ 7,744,885	\$ 2,985,121
Liabilities and Deferred Inflows of Resources:			
Current liabilities	\$ 9,837,870	\$ 6,909,375	\$ 2,928,495
Claims payable non current portion	42,496,947	51,607,515	(9,110,568)
Pension liability	575,007	513,775	61,232
Deferred inflows of resources	26,106	34,637	(8,531)
	52,935,930	59,065,302	(6,129,372)
Net Position (Deficit):			
Net investment in capital assets	1,035,491	1,026,570	8,921
Unrestricted deficit	(43,241,415)	(52,346,987)	9,105,572
	\$ (42,205,924)	\$ (51,320,417)	\$ (9,114,493)

Statement of Revenues, Expenses and Changes in Net Position (Deficit)

The purpose of the statement is to present the revenues earned by the PCF, operating and non-operating, and the expenses incurred by the PCF. Non-operating revenues are those for which goods or services are not provided.

The Statement of Revenues, Expenses and Changes in Net Position is prepared on the accrual basis of accounting. Accrual accounting attempts to record the financial effects of transactions of an entity in the period in which those transactions occur, rather than in the period in which cash is received. Revenues are recognized when goods or services are provided. Expenses are recognized when resources are utilized in order to produce goods or services.

Condensed Statement of Revenues, Expenses and Changes in Net Position

	Year Ended June 30,		
	2017	2016	Variance
Operating revenues	\$ 9,731,142	\$ 9,211,255	\$ 519,887
Operating expenses	(577,822)	(1,066,874)	489,052
Operating income	9,153,320	8,144,381	1,008,939
Non-operating revenue (expense)	(38,827)	158,506	(197,333)
Change in net position	9,114,493	8,302,887	\$ 811,606
Net position (deficit) - beginning of year	(51,320,417)	(59,623,304)	
Net position (deficit) - end of year	\$ (42,205,924)	\$ (51,320,417)	

Statement of Cash Flows

The final statement presented by the PCF is the Statement of Cash Flows. The Statement of Cash Flows presents detailed information about the cash activity during the year. The statement is divided into four parts. The first part deals with operating cash flows and reports the net cash flows from the operating activities of the Fund. The second section reports the cash activity related to financing for capitalized items. The third section reflects cash flows from investing activities and shows the interest received from investing activities. The fourth section reconciles the net cash provided or used by operating activities to the operating income displayed on the Statement of Revenues, Expenses and Changes in Net Position.

Condensed Statement of Cash Flows

	Year Ended June 30,		
	2017	2016	Variance
Cash provided (used) by:			
Operating activities	\$ 3,110,865	\$ (952,410)	\$ 4,063,275
Capital and related financing activities	(129,037)	(192,150)	63,113
Investing activities	(1,899,160)	1,959,097	(3,858,257)
Net change in cash	1,082,668	814,537	268,131
Cash and cash equivalents - beginning of year	1,318,324	503,787	814,537
Cash and cash equivalents - end of year	<u>\$ 2,400,992</u>	<u>\$ 1,318,324</u>	<u>\$ 1,082,668</u>

Assessment and Rate Increases

The PCF Board of Governors determined that a membership deficit assessment was **not** necessary during this fiscal year. The last membership deficit assessment was in June 2000. The statute grants the Board the authority to make assessments under Section 38-79-450 of the Code of Laws of South Carolina, 1976. The PCF Board continues to maintain that no assessments will be necessary for the continued operation of the Fund.

In February 2017, an actuarial review was conducted for the purpose of determining rates for the 2017-2018 plan year. This review was done at the direction at the South Carolina Department of Insurance and the PCF Board of Governors. The PCF Board of Governors voted and approved an overall 2.5% increase in the rates for the 2017-2018 plan year.

These rate change considerations were based on the actuary's recommendation and were approved by the PCF Board of Governors. The Board of Governors considered a number of factors in their deliberations including but not limited to claims experience over this fiscal year, competitive place in the commercial market, and a miscellaneous actuarial review while keeping in mind our goal of providing affordable protection for the healthcare providers in the State of South Carolina. This minimal increase in the rates supports the PCF Board's belief that the PCF's financial condition continues to improve.

The PCF Board continues to surcharge any licensed healthcare providers who have had issues with regard to their State Board licensing. This surcharge applies where there are issues such as a loss of hospital privileges, criminal activity, sanctions, license revocation or restrictions of the physician's license to practice medicine. The surcharge will remain with the member for a ten (10) year period and is reduced after five (5) years assuming no additional issues have arisen during this time. An inquiry is made to the State Board of Medical Examiners on each new member who applies to the PCF.

The PCF Board of Governors reviews the surcharge for experience rating. A member is surcharge based on the frequency and amounts of settled claims. The surcharge for experience rating remains with the member for 10 years. A member can be experience rated up to 250% of their base rate.

The PCF uses independent agents to assist in the underwriting of its members. Agency Commissions were increased to 7% this year. The PCF Board believes that the use of independent agents helps to better serve our members. Higher commissions are offered for new and returning members.

Finally, the PCF Board has given the underwriting staff authority to offer credits up to 40% per membership to reward members for positive membership activity such as claims free, large group size, longevity with the PCF and unusual (positive) risk characteristic in an effort to be more competitive with the medical malpractice market. Underwriting staff are also authorized to use up to 15% charge for negative membership activity. The overall impact to the PCF cannot be more than 10% of the total membership revenue.

Business Overview

The Board of Governors is composed of three physicians, two dentists, two hospital representatives, two insurance representatives, two attorneys, and two representatives of the general public, all appointed by the Governor. The appointed members serve a term of six years. Currently, we are awaiting the replacement of one hospital member.

The Board continues to amend its Plan of Operation and Manual of Rules and Rates for efficient administration of the Fund, consistent with the provisions of the Plan of Operations and Article 5 of the enabling legislation.

The Executive Director is charged with the day-to-day operations of the Fund. Quarterly newsletters are sent to the members/stakeholders providing updates concerning underwriting changes, news, risk management initiatives and spotlights on our members.

The PCF functions with a staff of four full-time equivalent employees. Included is one Administrative Assistant, one Program Coordinator, one Program Manager and the Executive Director. One FTE position remains unfilled which is an administrative assistant position.

At the close of the fiscal year, the PCF had a membership total of 2,686. This includes 44 Clinics and Hospitals, 148 professional associations, 1,465 physicians, 708 dentists and oral surgeons, 312 Midlevel healthcare providers, 9 full time equivalent positions (shared memberships with 32 physicians). The PCF paid a total of \$4,790,000 for claims, settlements and judgments during the fiscal year. This represents 48% decrease in claims payments made from the prior fiscal year. The PCF collected \$9,634,641 in membership fees which constitutes an approximate decrease of 6% from the prior fiscal year.

The PCF is an organization that works extensively with legal counsel for claims defense, expert witnesses, and claims investigations, all in conjunction with the primary carrier. The effective selection, coordination and management of these professionals are critical to the success of the PCF. It requires professionals with special skills and a high work ethic. For all of the PCF claims that went to trial during this fiscal year, 90% of the claims resulted in defense verdicts. This fiscal year continued to show a downward trend in the total number of claims, however, the severity of the claims reported increased minimally. This appears to be in line with the national trend, which continues to show a soft market for Medical Malpractice insurance.

The PCF has maintained our membership numbers in spite of the continuing practice of South Carolina hospitals purchasing physician practices and to competitive pricing by other carriers coming into the state as a result of a soft medical malpractice market. Retirement has played a small part in the total number of cancellation of memberships. These factors, along with the increasing number of members choosing lower PCF limits, increased shared limit options, and increased use of credits on membership account for the decrease in membership fees.

The Board has engaged in strategic planning efforts throughout the fiscal year, which included the continual review and revision of the PCF Plan of Operations, Underwriting Manual of Rules and Rates and claims handling procedures. The Plan of Operations details procedural information that provides for economic, fair and nondiscriminatory administration and for the prompt and efficient provision of excess medical malpractice insurance. The Plan contains other provisions including, but not limited to, assessment of all members for expenses, deficits, losses, reasonable underwriting standards, acceptance and cession of reinsurance, appointment of servicing carriers, and procedures for determining the amounts of insurance to be provided by the Fund. The Plan of Operations and any amendments to the Plan are subject to the approval of the Board and of the Director of Insurance or his designee. The Board continues to review and consider legislative changes that will allow for the more efficient operation and management of the Fund.

In 2008, the South Carolina Legislature has passed certain measures that have benefited the Fund (S.669). With the passage of S.669 the PCF Board is making significant strides toward stabilizing the Fund by capping its exposure. S.669 clarified the PCF Board’s authority to set limits of coverage. Prior unlimited exposure has resulted in excessively high incurred but not reported statistics. At the end of this fiscal year the PCF memberships consisted of the following limits:

\$10 Million per occurrence \$12 Million annual aggregate	28%
\$5 Million per occurrence \$7 Million annual aggregate	8%
\$3 Million per occurrence \$6 Million annual aggregate	18%
\$2 Million per occurrence \$4 Million annual aggregate	2%
\$1 Million per occurrence \$3 Million annual aggregate	44%

Active memberships with unlimited coverage ended with May 1, 2010 renewals.

The Fund provides a high level of customer services to its members through enrollment of new members, renewal of current members, collection of fees and payment of claims. It provides credentialing information to hospitals and managed care organizations. The Fund also provides free Locum Tenens coverage for up to 45 days per year for substitutions for our members.

The Board has authorized the revision of the membership agreement and the development of applications to better serve its members. The Board continues to allow its members to pay their annual membership fee on a quarterly basis, with a small administrative fee.

The PCF website now allows new members to apply on-line for a PCF membership, existing members to pay membership fees, and direct access to renewal information for hospitals and managed care organizations credentialing agents.

Physicians and dentists who attend the South Carolina Medical Association and the South Carolina Dental Association Risk Management Seminar, which is co-sponsored by the JUA, receive a discount in their annual membership fee. The new Dentists discount now includes a 40% discount for first year of practice with a 10% discount for the second year. If new dental graduates attend the Risk Management Seminar held at the MUSC Dental School they will also receive a 25% discount on their first year’s membership fees. It is a one-time discount. The discount does not apply to a physician’s professional association.

The PCF Board of Governors approved a new on-line Risk Management program in partnership with The MRM Group and The South Carolina Joint Underwriters Association. This program provides online modules to our member physicians, oral surgeons & allied healthcare provider. There are three modules

that when completed will provide our members CME credits at no charge to the members. The first year's topic is Electronic Health Records. The program began in June. Each provider who completes the online program will receive up to 6% credit on their next year's PCF renewal fees.

Economic Outlook

The principal challenge facing the PCF is to retain current members and at the same time, adjust membership fees appropriately to reduce the loss reserve liability. The other significant challenge the PCF faces is to manage the claims process effectively and coordinate with the primary carriers for satisfactory resolution of all claims. The PCF's ultimate goal is to provide medical professionals with effective medical malpractice liability coverage, while ensuring that the PCF is in a sound financial position to pay all of its liabilities. There are no pending judgments on appeal that affect the PCF.

Based on actuarial reviews and recommendations, the PCF Board of Governors feels confident that the rates established this fiscal year are appropriate. The PCF continues to rate members for claims experience as well as surcharge members for state licensing issues. New underwriting initiatives have been established to assist in maintaining and improving membership numbers such as discounts based on group size, number of years of continued coverage through the PCF and positive loss experience. Coverage enhancements have also been added which consists of nose coverage for converting a claims-made membership back to an occurrence membership. Step factors for claims-made memberships have been reduced to be more in line with other admitted medical malpractice insurers.

The South Carolina Medical Malpractice Patients' Compensation Fund shows an overall deficit on its books due to the fact that, since 2002, it has recorded the actuarial liability for unpaid claims as well claims that are "incurred but not reported." Prior to 2002, the Fund's accounts did not reflect such reserves operating on a cash basis. Over the past 13 years the PCF Board of Governors has taken steps to reduce the net deficit of the PCF by \$181,000,000. As a result, the PCF continues to show an upward trend in its overall financial outlook. During the fiscal year, the PCF met all its financial and legal obligations in a timely manner.

The Fund is not aware of any facts, decisions, or conditions that can reasonably be expected to have a material impact on the Fund's economic outlook during the fiscal year beginning July 1, 2017.

Contact Information

Questions related to the Management Discussion and Analysis and the accompanying financial statements should be directed to Terry Coston, Executive Director, at (803) 896-5294.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

STATEMENT OF NET POSITION

YEAR ENDED JUNE 30, 2017

Assets and Deferred Outflows of Resources:

Current assets:

Cash and cash equivalents	\$ 2,400,992
Investments	6,842,903
Prepaid expenses	299,424
Interest receivable	68,029
Total current assets	9,611,348

Non-current assets:

Capital assets, net of accumulated amortization	1,035,491
Total non-current assets	1,035,491

Deferred outflows of resources	83,167
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Total assets and deferred outflows of resources	10,730,006
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Liabilities and Deferred Inflows of Resources:

Current liabilities:

Accounts payable	225,000
Accrued liabilities	192,905
Unearned member fees	3,554,965
Current portion of claims payable	5,865,000
Total current liabilities	9,837,870

Other liabilities:

Claims payable, net of discount of \$2,688,000	42,496,947
Pension liability	575,007
Total long-term liabilities	43,071,954

Deferred inflows of resources	26,106
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Total liabilities and deferred inflows of resources	52,935,930
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Net Position (Deficit):

Net investment in capital assets	1,035,491
Unrestricted deficit	(43,241,415)
Total net position (deficit)	\$ (42,205,924)

See accompanying notes.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET POSITION

YEAR ENDED JUNE 30, 2017

Operating Revenues:

Membership fees, net of refunds (\$190,210)	\$ 9,634,641
Administrative fees	96,331
Miscellaneous income	170
Total operating revenues	<u>9,731,142</u>

Operating Expenses:

Claims	4,790,000
Change in claims reserves	(6,115,568)
Commissions	769,185
Personnel services	367,106
Operating and contractual services	622,849
Supplies and materials	24,134
Amortization	120,116
Total operating expenses	<u>577,822</u>

Operating income	<u>9,153,320</u>
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Non-Operating Revenue (Expenses):

Interest income	119,663
Investment account fees	(27,870)
Unrealized gain on investment	(130,620)
Net non-operating revenue (expense)	<u>(38,827)</u>

Change in net position	9,114,493
Net position (deficit), beginning of year	(51,320,417)
Net position (deficit), end of year	<u><u>\$ (42,205,924)</u></u>

See accompanying notes.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2017

Cash Flows From Operating Activities

Cash received from members	\$ 9,609,976
Cash payments for claims	(4,790,000)
Cash payments for personnel services	(370,669)
Cash payments for commissions	(776,122)
Cash payments for operating and contractual services	(538,186)
Cash payments for suppliers	(24,134)
Net cash flows from operating activities	<u>3,110,865</u>

Cash Flows From Capital and Related Financing Activities

Construction of capital asset - software	<u>(129,037)</u>
Net cash flows from capital and related financing activities	<u>(129,037)</u>

Cash Flows From Investing Activities

Purchase of investments	(3,048,356)
Proceeds from sale of investments	1,051,060
Interest and investment income	98,136
Net cash flows from investing activities	<u>(1,899,160)</u>

Net change in cash and cash equivalents	1,082,668
Cash and cash equivalents, beginning of year	<u>1,318,324</u>
Cash and cash equivalents, end of year	<u><u>\$ 2,400,992</u></u>

(CONTINUED)

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

STATEMENT OF CASH FLOWS

-CONTINUED-

Reconciliation of Operating Income to Net Cash Flows

From Operating Activities

Operating income	\$ 9,153,320
Adjustments to reconcile operating income to net cash flows from operating activities:	
Amortization	120,116
Changes in assets and liabilities	
Prepaid expenses	9,663
Deferred outflows	(42,862)
Deferred inflows	(8,531)
Pension liability	61,232
Accounts payable	75,000
Accrued expenses	(20,339)
Unearned member fees	(121,166)
Claims payable, net of discounts	(6,115,568)
Net cash flows from operating activities	<u>\$ 3,110,865</u>
Non-cash investing activities:	
Net increase in fair value of investments (unrealized gains)	<u>\$ (130,620)</u>

See accompanying notes.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017

1. **Basis of Presentation and Summary of Significant Accounting Policies**

The financial statements of the South Carolina Medical Malpractice Patients' Compensation Fund (the "*Fund*") have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to enterprise funds of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting principles and policies utilized by the Fund are described below:

Reporting Entity: The South Carolina Medical Malpractice Patients' Compensation Fund was established by Section 38-79-420 of the Code of Laws of South Carolina on July 1, 1976. The Fund 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 Board of Governors, whose members are appointed by the Governor of the State of South Carolina, is the governing body of the Fund. The Board was created to manage and operate the Fund. The Board has the authority to set annual membership fees and to make deficit assessments when insufficient money is available to pay the Fund's liabilities. The Board also has the authority to approve and pay claims liabilities and to actively defend the Fund against claims.

The coverage is available to any public or private health care provider in the State. The Fund is responsible for payment of that portion of any covered medical malpractice claim, settlement, or judgment, which is in excess of \$100,000 per incident or in excess of \$300,000 in the aggregate for one year. Effective November 26, 2000, excess coverage thresholds increased to \$200,000 and \$600,000. Beginning in 2009, the Fund began eliminating unlimited coverage from its offered limits. Although the reporting entity operates somewhat autonomously, it lacks full corporate powers. The accompanying financial statements present the financial position, results of operations, and cash flows solely of the Fund and do not include any component units or other agencies or funds of the State of South Carolina.

Measurement Focus, Basis of Accounting and Basis of Presentation: The Fund is presented as an enterprise fund of the State of South Carolina. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

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SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

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

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

The Fund was created by act of the General Assembly for the purpose of providing funds for payment of that portion of any medical malpractice claim, settlement or judgment against a health care provider in accordance with the limits previously defined. The Fund is liable only for payment of claims against "licensed health care providers", which includes physicians and surgeons, directors, officers, and trustees of hospitals; nurses; oral surgeons; dentists; pharmacists; chiropractors; hospitals; nursing homes; or any similar category of licensed health care providers. All providers licensed in South Carolina are eligible to participate in the Fund upon remitting the annual assessment fees in amounts as determined by the governing board of the Fund.

Budget Policy: The Fund is granted an annual appropriation for administrative operating purposes by the General Assembly. The appropriation as enacted becomes the legal operating budget for the Fund for its budgeted activities. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and expenditures of total funds. None of the funding of the Fund is provided from State General Fund appropriations. The General Assembly enacts the budget through passage of line-item appropriations by program within budgetary unit. Budgetary control is maintained at the line-item level of the budgetary 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 Fiscal Accountability Authority under its authority or by the Fund as set forth in the Appropriation Act for fiscal year 2016-2017 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Revenue and Fiscal Affairs Office 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.

During the fiscal year-end closeout period in July, agencies may continue to charge vendor, interagency, and inter-fund payments for the fiscal year to that fiscal year's appropriation. For the Fund, any unexpended funds as of June 30, automatically carry over to the ensuing fiscal year. State law does not require the use of encumbrance accounting.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

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

State law does not precisely define the budgetary basis of accounting. The current Appropriation Act states that the General Assembly intends to appropriate all State funds and to authorize and/or appropriate the use of all other 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 disbursements basis for payroll expenditures.

Cash and Cash Equivalents: The amounts shown in the financial statements as "cash and cash equivalents" represent cash on hand, cash on deposit with the State Treasurer and local financial institutions, 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 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 agencies 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 included investments in short-term, highly liquid securities having a maturity at the time of purchase of three months or less.

The State's internal cash management pool consists of a 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 agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total 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. The Fund 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.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

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

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 2*.

Investments: In accordance with State Law, the Fund may invest in a variety of instruments including obligations of the United States and its agencies and securities fully guaranteed by the United States, certain corporate obligations, certain shares of Federal savings and loan associations and State chartered savings and loan associations, and collateralized repurchase agreements. Within these parameters, the Board of Governors authorizes the investment manager to invest up to 100% in U.S. Treasuries or Agencies, but no more than 40% in Corporate Bonds. No more than 5% of the assets of the Fund may be invested in the securities of any one issuer except securities issued or guaranteed by the U.S. Government or its agencies.

Prepaid Expenses: Prepaid expenses consist of commissions paid to agents in advance upon policy inception and are expensed as policy coverage expires.

Accrued Compensated Absences: Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's month are entitled to accrue and carry forward at calendar year-end a maximum of 180 days sick leave and 45 days annual vacation leave. The Fund calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded as a current liability. The net change in the liability is recorded in the current year in the applicable administrative expense categories.

Unpaid Claims Liabilities: The Fund is considered an insurance enterprise which follows the guidance of *Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 944, Financial Services - Insurance*.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

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

The Fund actuarially establishes 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 Fund, because it carries only excess liability coverage, does not incur claim adjustment expenses. The length of time for which claims costs must be estimated varies depending on the coverage involved. Because actual claims costs depend on such complex factors as medical technology, changes in doctrines 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 using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

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 reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. An independent actuary performs an actuarial study annually with the latest completed in August 2017 for the current year. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made. Claims liabilities are discounted based upon the Fund's payment experience and interest rates on cash equivalents held. The discounted liabilities provide the amount needed, at the date of computation, to fund liabilities that are expected to be paid in future years.

Deferred Outflows/Inflows of Resources:

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Fund currently reports deferred outflows of resources in the amount of \$83,167 as of June 30, 2017.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Fund currently reports deferred inflows of resources in the amount of \$26,106 as of June 30, 2017.

Revenue Recognition: The Fund receives fees from members; the fee pays for coverage for a year. Due to the various effective anniversary dates, a provision for unearned fees at the end of every year is estimated. The fees may be paid annually or quarterly. The computation of unearned fees is based upon the amount of the fees, period of payment, and the effective membership dates for participants. This is done to recognize revenue during the coverage period.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

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

When warranted, the Fund may make deficit assessments, which are recognized as revenue on the date of the assessment.

Due to the nature of the coverage of the members, refunds are often warranted. These occur because of policyholder change of personnel and/or change of information provided by the policyholders relating to employees and their ratings. Refunds are recognized in the year of the refund. These adjustments are taken into consideration in computation of the unearned fees liability.

Operating Revenues and Expenses: Operating revenues and expenses for proprietary funds are those that result from providing services and producing and delivering goods and/or services. It also includes all revenue and expenses not related to capital and related financing, non-capital financing, or investing activities.

Estimates: The preparation of the Fund's basic financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates by management. Actual results could differ from those estimates.

Fair Value: The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The Fund has the following recurring fair value measurements as of June 30, 2017:

- Investments are valued using quoted market prices (Level 1 inputs).

2. Investments and Deposits

Deposits: State law requires that a bank or savings and loan association receiving State funds must secure the deposits by deposit insurance, surety bonds, collateral securities, or letters of credit to protect the State against loss.

Custodial Credit Risk: Custodial credit risk for deposits is that, in the event of the failure of a depository financial institution, the Fund will not be able to recover collateral securities that are in possession of an outside party. The Fund's Deposit and Investment policy states that for bank obligations and obligations of savings institutions, deposits shall not exceed the limits of the Federal Deposit Insurance Corporation unless collateralized as stated in Title 38, Chapter 12 of the South Carolina Code of Laws.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

2. Investments and Deposits (Continued)

The carrying amounts of the deposits for the Fund at June 30, 2017 at local financial institutions were \$1,893,261. Bank balances were \$1,907,008 at June 30, 2017 and insured as follows:

Amount insured by FDIC	\$ 250,000
Amount collateralized by United States Government or Agency Securities	1,657,008
Total	\$ 1,907,008

The remaining deposits of the Fund in the amount of \$507,731 at June 30, 2017 consist of deposits held by the State Treasurer (\$59,553) and deposits held in an investment account held by a financial institution (\$448,178). Please refer to the Comprehensive Annual Financial Report of the State of South Carolina for the deposits held by the State Treasurer.

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Fund does not maintain deposits that are denominated in a currency other than the United States dollar; therefore, the Fund is not exposed to this risk.

Investments: The Fund's investments that are in the State's internal cash management pool and operate as a demand deposit are classified as deposits. The deposits are held by the State Treasurer. Please refer to the Comprehensive Annual Financial Report of the State of South Carolina.

As of June 30, 2017, the Fund had the following investments (and maturities) at local financial institutions:

	Investment Maturities (in Years)				Weighted Average Interest Rate
	Fair Value	Less Than 1 Year	1-5 Years	6-10 Years	
Corporate Bonds	\$ 2,912,161	\$ 789,827	\$ 1,664,383	\$ 457,951	3.66%
Federal Agencies	712,771	-	421,411	291,360	4.36%
U.S. Treasuries	3,217,971	993,237	1,749,813	474,921	2.68%
Total	\$ 6,842,903	\$ 1,783,064	\$ 3,835,607	\$ 1,224,232	

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

2. Investments and Deposits (Continued)

The Fund invests in various fixed income debt securities such as U.S. treasuries, U.S. government backed mortgage securities, state and municipal bonds, and corporate bonds. These fixed income debt securities are reported at fair value (quoted prices in active markets – level 1 inputs), as required by generally accepted accounting principles. Credit risks for the Funds' total investments are as follows at June 30, 2017:

S&P Rating	
Treasury/Agency	\$ 3,930,742
AAA	406,953
AA	721,561
A	1,783,647
	\$ 6,842,903

Reconciliation of Cash, Cash Equivalents and Investments: The following schedule reconciles cash, cash equivalents and investments as reported on the Statements of Net Position to footnote disclosures provided for deposits and investments.

Per Notes to Financial Statements:

Carrying value of deposits:	
Held by State Treasurer	\$ 59,553
Other	1,893,261
Money Funds	448,178
Carrying value of investments:	
Corporate Bonds	2,912,161
Federal Agencies	712,771
U.S. Treasuries	3,217,971
Total disclosure, deposits and investments, plus reconciling items	\$ 9,243,895

Per Statements of Net Position:

Cash and Cash Equivalents	\$ 2,400,992
Investments	6,842,903
	\$ 9,243,895

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

3. Capital Assets

The following is a schedule of capital asset activity for the year ended June 30, 2017:

	July 1, 2016	Increase	Decrease	June 30, 2017
Software	\$ 1,136,638	\$ 129,037	\$ -	\$ 1,265,675
Less: accumulated amortization software	(110,068)	(120,116)	-	(230,184)
	<u>\$ 1,026,570</u>	<u>\$ 8,921</u>	<u>\$ -</u>	<u>\$ 1,035,491</u>

4. Claims Liabilities

Because medical malpractice liability insurance covers claims occurring during the coverage period and claims emerging over a long period of time and because the Fund has limited claims experience history, provisions for estimated losses incurred but not reported and claims reported but not settled are based on an actuarial formula which is used to estimate the ultimate incurred losses. An independent actuary does an actuarial study each year to determine these liabilities. As a result of the actuarial study as of June 30, 2017, net discounted liabilities for claims were \$6,115,568 less than those at June 30, 2016.

The actuarial study establishes a low, medium and high range for the estimated net claims liability. Management's best judgment is that the low range is the best representation of the Fund's net claims liability. The high, medium and low ranges of the actuary's estimate of net claims liabilities are as follows at June 30, 2017:

	Undiscounted	Discounted
High	\$ 58,600,000	\$ 55,480,000
Medium	54,825,000	51,921,000
Low	51,049,947	48,361,947

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

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4. Claims Liabilities (Continued)

As discussed in *Note 1*, the Fund establishes a liability for both reported and unreported insured events, which includes estimates of future payment of losses. The following represents changes in those aggregate liabilities for the year ended June 30, 2017.

	Reconciliation of Claims Liabilities
Unpaid claims at beginning of the fiscal year	<u>\$ 54,477,515</u>
Incurred claims:	
Provision for insured events of the current fiscal year	6,000,000
Increase (Decreases) in provision for insured events of prior fiscal years	(4,637,568)
Total incurred claims	1,362,432
Payment of claims:	
Attributable to events of prior fiscal years	(4,790,000)
Unpaid claims at end of the fiscal year	51,049,947
Less: claims discount	(2,688,000)
Net claims liabilities	<u>\$ 48,361,947</u>

5. Long Term Liabilities

The following is a summary of changes in long-term liabilities of the Fund:

	<u>July 1, 2016</u>	<u>Increase</u>	<u>Decrease</u>	<u>June 30, 2017</u>	<u>Due Within One Year</u>
Claims, net	\$ 54,477,515	\$ 6,000,000	\$ (12,115,568)	\$ 48,361,947	\$ 5,865,000

6. Accrued Compensated Absences

The following is a summary of the net changes in accrued compensated absences of the Fund:

	<u>July 1, 2016</u>	<u>Increase</u>	<u>Decrease</u>	<u>June 30, 2017</u>	<u>Due Within One Year</u>
Compensated absences	\$ 23,703	\$ 10,320	\$ (23,703)	\$ 10,320	\$ 10,320

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

7. Accrued Liabilities

Accrued liabilities consist of the following at June 30, 2017:

Accrued salaries and benefits	\$ 26,513
Accrued compensated absences	10,320
Commissions payable to agents	156,072
	<u>\$ 192,905</u>

8. Pension Plans

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Benefits Division of the South Carolina Public Employee Benefit Authority (PEBA), 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 eligible 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 Division and the five pension plans are included in the State of South Carolina's CAFR.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

8. Pension 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 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 available 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 can apply for disability annuity benefits provided they have a permanent incapacity to perform the regular duties of the member's job and they have a minimum of eight years of credited service. For disability applications received after December 31, 2013, a member of SCRS will have to be approved for disability benefits from the Social Security Administration in order to be eligible for SCRS disability retirement benefits. An incidental death benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service or to a working retired contributing member. There is no service requirement for death resulting from actual performance of duties for an active member. For eligible retired members, a lump-sum payment is made to the retiree's beneficiary of up to \$6,000 based on years of service at retirement. TERI participants and retired contributing members are eligible for the increased death benefit equal to their annual salary in lieu of the standard retired member benefit.

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (TERI) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

8. Pension Plans (Continued)

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 end effective June 30, 2018 and a member's participation may not continue after this date.

Effective July 1, 2016, employees participating in the SCRS were required to contribute 8.66% of all earnable compensation. The employer contribution rate for SCRS was 16.89%. Included in the total SCRS employer contribution rate is a base retirement contribution of 11.41%, .15% for the incidental death benefit program and a 5.33% surcharge that will fund retiree health and dental insurance coverage. The Fund's actual contributions to the SCRS for the years ended June 30, 2017, 2016, and 2015 were \$28,829, \$27,738 and \$27,945, respectively, and equaled the required retirement contribution rate, including surcharge, of 16.89% for 2017, 16.39% for 2016 and 15.90% for 2015. Also, the Fund paid employer incidental death program contributions of approximately \$379, \$391 and, \$381, at the rate of .15% of compensation for the fiscal years ended June 30, 2017, 2016, and 2015, respectively.

As an alternative to membership in the SCRS, newly hired employees of the Fund may elect to participate in the State Optional Retirement Program (ORP), a defined contribution retirement plan. The Fund did not have any employees participating in the ORP during the 2017, 2016 or 2015 fiscal years.

Article X, Section 16, of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit, and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS are actuarially determined.

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

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

8. Pension Plans (Continued)

At June 30, 2017 the Fund reported \$575,007 for its proportionate share of the net pension liabilities of SCRS. The net pension liability defined of the SCRS defined benefit pension plan was determined based on the July 1, 2015 actuarial valuations, using membership data as of July 1, 2015, projected forward to June 30, 2016, and financial information of the pension trust funds as of June 30, 2016, using generally accepted actuarial procedures. The Fund's portion of the net pension liability was based on the Fund's share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2016, the Fund's SCRS proportion was 0.002692%. For the year ended June 30, 2017 the fund recognized pension expenses of \$54,468 for SCRS.

At June 30, 2017 the state reported deferred outflows of resources and deferred inflows of resources to pensions from the following sources:

	Deferred Outflows	Deferred Inflows	Net
Differences between expected and actual experience	\$ 5,961	\$ (624)	\$ 5,337
Changes in proportionate share and differences between employer Contributions and proportion share of total plan employer contributions	-	(25,482)	(25,482)
Net difference between projected and actual earnings on investments	48,377	-	48,377
Current year employer contributions	28,829	-	28,829
Total	\$ 83,167	\$ (26,106)	\$ 57,061

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expenses as follows:

Year ended June 30,	Net
2018	\$(33,205)
2019	(1,260)
2020	(10,324)
2021	(12,272)
	<u>\$ (57,061)</u>

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

8. Pension Plans (Continued)

The total pension liabilities in the July 1, 2015 actuarial valuation was determined using the following actuarial assumptions applied to all periods included in the measurement:

Actuarial Cost Method	Entry Age
Actuarial Assumptions:	
Investment Rate or Return	7.50%
Projected Salary Increases	Levels Off 3.5% to 12.5%
Inflation Rate	2.75%
Benefit Adjustments	Lesser of 1% or \$500

South Carolina state statute requires that an actuarial experience study be completed at least once in each five-year period. The last experience study was performed on data through June 30, 2015.

The post-retiree mortality assumption is dependent upon the member's job category and gender. This assumption includes base rates which are automatically adjusted for future improvement in mortality using published Scale AA projected from the year 2000. Assumptions used in the July 1, 2015, valuations for SCRS are as follows:

Former Job Class	Males	Females
Educators and Judges	RP-2000 Males (with White Collar Adjustment) Multiplied by 110%	RP-2000 Females (with White Collar Adjustment) Multiplied by 95%
General Employees and Members of the General Assembly	RP-2000 Males multiplied by 100%	RP-2000 Females multiplied by 90%
Public Safety, Firefighters and Members of the South Carolina National Guard	RP-2000 Males (with Blue Collar adjustment) multiplied by 115%	RP-2000 Females (with Blue Collar adjustment) multiplied by 115%

The long-term expected rate of return on pension plan investments for actuarial purposes is based upon the 30-year capital market outlook at the end of the third quarter 2015. The actuarial long-term expected rates of return represent best estimates of arithmetic real rates of return for each major asset class and were developed using a building block approach, primarily based on consensus expectations and market based inputs. Expected returns are net of investment fees.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

8. Pension Plans (Continued)

For actuarial purposes, the long-term expected rate of return is calculated by weighting the expected future real rates of return by the target allocation percentage and then adding the actuarial expected inflation which is summarized in the table below. For actuarial purposes, the 7.50 percent assumed annual investment rate of return used in the calculated of the total pension liability includes a 4.75 percent real rate of return and a 2.75 percent inflation component. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Asset Allocation</u>	<u>Expected Arithmetic Real Rate of Return</u>	<u>Long Term Expected Portfolio Real Rate of Return</u>
Global Equity	43.0%		
Global Public Equity	34.0%	6.52%	2.22%
Private Equity	9.0%	9.30%	0.84%
Real Assets	8.0%		
Real Estate	5.0%	4.32%	0.22%
Commodities	3.0%	4.53%	0.13%
Opportunistic	20.0%		
GTAA/Risk Parity	10.0%	3.90%	0.39%
HF (Low Beta)	10.0%	3.87%	0.39%
Diversified Credit	17.0%		
Mixed Credit	5.0%	3.52%	0.17%
Emerging Markets Debt	5.0%	4.91%	0.25%
Private Debt	7.0%	4.47%	0.31%
Conservative Fixed Income	12.0%		
Core Fixed Income	10.0%	1.72%	0.17%
Cash and Short Duration (Net)	2.0%	0.71%	0.01%
Total Expected Real Return	100%		5.10%
Inflation for Actuarial Puposes			2.75%
Total Expected Nominal Return			7.85%

The projection of cash flows used to determine the discount rate assumed that the funding policy specified in the South Carolina State Code of Laws will remain unchanged in future years. Based on those assumptions, the plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

8. Pension Plans (Continued)

The following table represents the Fund's proportionate share of the net SCRS pension liabilities calculated using the discount rate of 7.50 percent, as well as what the Fund's respective net pension liabilities would be if it were calculated using a discount rate of 1.00 percent lower (6.50 percent) or 1.00 percent higher (8.50 percent) than the current rate.

Plan	1% Decrease 6.50%	Current Rate 7.50%	1% Increase 8.50%
SCRS	\$ 717,306	\$ 575,007	\$ 456,549

9. Post-Employment Benefits Other than Pensions

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

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

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

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

9. Post-Employment Benefits Other than Pensions (Continued)

Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the IB and participating retirees to the PEBA, except for the portion funded through the pension surcharge and provided from the other applicable sources of the IB, for its active employees who are not funded by State General Fund appropriations. Employers participating in the RMP are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 5.50% of annual covered payroll for 2017 and 5.33% of annual covered payroll for 2016. The IB sets the employer contribution rate based on a pay-as-you-go basis. The Fund paid approximately \$13,936 and \$13,923 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2017 and 2016, respectively. BLTD benefits are funded through a person's premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to IB was \$3.22 for the fiscal years ended June 30, 2017 and 2016.

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

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

10. Related Party

The South Carolina Medical Malpractice Patients' Compensation Fund has significant transactions with the State of South Carolina and various other 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; check preparation, banking functions from the State Treasurer, and legal services from the Attorney General.

Other services received at no cost from the various divisions of the State Fiscal Accountability Authority include retirement and health plan administration, audit services, personnel management, assistance in the preparation of the State Budget, procurement services, property management and record keeping, review and approval of certain budget amendments and other centralized functions.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

10. Related Party (Continued)

The Fund also had financial transactions with various State agencies during the fiscal year for technical support, office supplies, telephone, interagency mail, and data processing services. The totals paid for these supplies and services were immaterial, individually and in the aggregate, for the years ended June 30, 2017. The Fund provided no services free of charge to other State agencies during the fiscal year.

The Fund is related to the South Carolina Medical Malpractice Liability Joint Underwriting Association as both were created by South Carolina Statute and substantially all members of the JUA are also Fund members. The JUA is responsible for payment of that portion of any covered medical malpractice claim, settlement, or judgment up to \$200,000 per incident or up to \$600,000 in the aggregate for one year.

The Fund is responsible for payments exceeding those thresholds up to the limits established by the Board. JUA by state law is responsible for defense costs of all claims, however the Fund has the right to review and approve all awards that are ultimately made on cases. The Fund reimburses JUA for management oversight per an annual agreement. The fee for this service for fiscal year 2017 was \$150,000. This fee may be adjusted annually for increases in the consumer price index. The fund has \$225,000 in service fees payable to JUA as of June 30, 2017. JUA is considered a discrete component unit of the State of South Carolina and is included in the State's CAFR.

11. Restriction on Payment of Claims

In the event the Fund incurs a liability exceeding \$200,000 to any person under a single occurrence, the Fund may elect not to pay more than \$200,000 per year until the claim has been paid in full. However, the Board of Governors of the Fund may authorize payments in excess of \$200,000 per year so as to avoid payment of interest.

12. Operating Lease

The Fund leases office space from a party outside of State government and this lease is accounted for as an operating lease. Rental expense under this lease for the year ended June 30, 2017 was \$35,006.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

12. Operating Lease (Continued)

The Fund agreed to a new lease for office space from a party outside of State government during the year ended June 30, 2017. This lease is accounted for as an operating lease. The obligations under this lease are of as follows:

<u>Year Ending June 30,</u>	
2018	\$ 30,945
2019	31,873
2020	32,822
2021	33,813
2022	34,823
2023	35,876
2024	36,948
	<u>\$ 237,100</u>

13. Unearned Member Fees

Unearned fees liability at June 30, 2017 was \$3,554,965, on advance payment of membership fees and open credits. The Fund allows members to pay their fees quarterly, with a 3% administrative charge on the unpaid balance. The administrative fee is due up front and is non-refundable.

14. Risk Management

The Fund 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 Fund. The Fund has not had any claims in recent years. There were no significant reductions in insurance coverage from coverage in the prior year. The Fund pays insurance premiums to certain other State agencies and commercial insurers to cover risk that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered premium losses sustained during the policy period in accord with the insurance policy and benefit program limits.

Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

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

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

14. Risk Management (Continued)

3. Claims of covered public employees for workers' compensation insurance benefits (State Accident Fund).
4. Claims of covered public employees for unemployment compensation insurance benefits (Department of Employment and Workforce).

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

1. Personal property and equipment - Eighty percent of each loss is covered by the IRF. Losses are subject to a \$250 deductible.
2. Data processing equipment- Coverage is up to \$100,000 per loss with a \$250 deductible.
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 State's Health and Disability Insurance Fund and in the IRF.

The Fund also purchases insurance coverage for employee fidelity bond insurance coverage arising from theft or misappropriations.

15. Net Deficit

The Fund has experienced operating losses in prior years, which has resulted in a net deficit of \$42,205,924. The operating losses were attributable to large amounts of paid and reported claims, which have substantially affected the actuarial determination of claims liabilities. Also, other contributing factors are that: (1) until recently, the Fund's coverage was unlimited, (2) prior to 2001, the Fund did not maintain reserves for unreported claims, and (3) the Fund does not purchase reinsurance to help defray the effect of large individual claims.

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTES TO FINANCIAL STATEMENTS

-CONTINUED-

15. Net Deficit (Continued)

There are certain factors that help to mitigate the effects of the large deficit. The first is that the Fund can assess members' additional fees if needed. This authority to assess has been exercised in the past such as an April 1998 special assessment which approximated \$7,450,000. Also in September 2000, the Fund exercised a special assessment, which amounted to approximately \$16,000,000. Additionally, to conserve cash, if necessary, the Fund can restrict payment of claims as discussed in *Note 10*. Also as noted in *Note 1*, the threshold for covered losses has increased to \$200,000 and \$600,000. Also, in 2003 the fund began allowing members to purchase, at lower rates, policies with reduced coverage limits of up to \$10,000,000 instead of unlimited coverage. Finally, during 2009, the Board voted to discontinue offering unlimited coverage.

Due to the actions above, the Fund has successfully reduced the deficit by over \$181,000,000 over the last 13 years.

16. Enterprise Fund Information

Charges for services	\$	9,731,142
Non-operating expenditures, net		(38,827)
Less: expenses		(577,822)
Change in net position (deficit)		9,114,493
Net position (deficit) - beginning		(51,320,417)
Net position (deficit) - ending	\$	<u>(42,205,924)</u>

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.

17. Subsequent Events

Subsequent events were evaluated through August 23, 2017, which is the date the financial statements were available for issue. Events occurring after that date have not been evaluated to determine whether a change in the financial statements would be required.

REQUIRED SUPPLEMENTARY INFORMATION

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND
SCHEDULE OF PROPORTIONATE SHARE OF
THE SOUTH CAROLINA RETIREMENT SYSTEM
NET PENSION LIABILITIES

LAST TEN FISCAL YEARS*

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Fund's proportion of the net pension liability	0.002692%	0.002709%	0.002953%	0.002953%
Fund's proportionate share of the net pension liability	\$ 575,007	\$ 513,775	\$ 508,409	\$ 529,663
Fund's covered payroll	\$ 252,664	\$ 254,243	\$ 259,958	\$ 263,131
Fund's proportionate share of the net pension liability as a percentage of its covered payroll	227.58%	202.08%	195.57%	201.29%
Plan fiduciary net position as a percentage of the total pension liability	52.90%	56.99%	59.92%	56.39%

* - The amounts presented for each fiscal year were determined as of July 1 of two years prior, using membership data as of the day, projected forward to June 30 of the previous year. Additionally, the Fund implemented GASB 68 during fiscal year 2015. As such, only the last four years of information is available

SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND
SCHEDULE OF SOUTH CAROLINA RETIREMENT SYSTEM CONTRIBUTIONS

LAST TEN FISCAL YEARS

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Contractually required contributions	\$ 28,829	\$ 27,738	\$ 27,945	\$ 27,497	\$ 30,278	\$ 26,702	\$ 26,287	\$ 25,858	\$ 25,355	\$ 24,757
Contributions in relation to the contractually required contribution	(28,829)	(27,738)	(27,945)	(27,497)	(30,278)	(26,702)	(26,287)	(25,858)	(25,355)	(24,757)
Contribution deficiency/(excess)	<u>\$ -</u>									
Fund covered payroll	\$ 252,664	\$ 254,243	\$ 259,958	\$ 263,131	\$ 289,737	\$ 280,196	\$ 279,944	\$ 275,374	\$ 270,018	\$ 268,808
Contributions as a percentage of covered payroll	11.41%	10.91%	10.75%	10.45%	10.45%	9.53%	9.39%	9.39%	9.39%	9.21%

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

Mr. George L. Kennedy, III, CPA
State Auditor
Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, South Carolina 29201

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 business-type activities, of South Carolina Medical Malpractice Patients' Compensation Fund (the "Fund"), a non-major enterprise fund of the State of South Carolina as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated August 23, 2017.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control 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 Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

The Brittingham Group LLP

West Columbia, South Carolina
August 23, 2017