

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

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

WITH

REPORT OF INDEPENDENT AUDITORS

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

WITH

REPORT OF INDEPENDENT AUDITORS

State of South Carolina



Office of the State Auditor

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October 4, 2011

The Honorable Nikki R. Haley, Governor
and
Members of the South Carolina State Budget and Control Board
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina State Budget and Control Board – Insurance Reserve Fund for the fiscal year ended June 30, 2011, was issued by DeLoach & Williamson, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

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

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

RHGjr/trb

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

WITH

REPORT OF INDEPENDENT AUDITORS

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying basic financial statements of the governmental activities of the South Carolina State Budget and Control Board, Insurance Reserve Fund (the "Fund") as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the management of the South Carolina State Budget and Control Board, Insurance Reserve Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in *Note 1*, the accompanying financial statements of the South Carolina State Budget and Control Board, Insurance Reserve Fund are intended to present the financial position and results of operations and cash flows of its proprietary fund type of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the Insurance Reserve Fund of the South Carolina State Budget and Control Board. They do not purport to, and do not, present fairly the financial position of the State of South Carolina as of June 30, 2011 and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the South Carolina State Budget and Control Board, Insurance Reserve Fund, as of June 30, 2011, and the results of operations and cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2011, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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* and should be read in conjunction with this report in considering the results of our audit.

The Management's discussion and analysis is not a part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Releach & Williamson, L.L.P.

September 29, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the South Carolina State Budget and Control Board, Insurance Reserve Fund (IRF) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of IRF's financial performance during the fiscal year ended June 30, 2011. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

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

Financial Highlights:

- The assets of IRF exceeded its liabilities at June 30, 2011 by \$197,012,391;
- IRF's net assets increased by \$3,306,462 or 1.71 percent;
- IRF experienced an operating loss of \$11,306,197.

Overview of Financial Statements:

IRF is engaged only in Business-Type Activities (BTA) that are financed in part by premiums charged to governmental entities for insurance policies. Accordingly, its activities are reported using the three financial statements required for proprietary funds: Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; and Statement of Cash Flows.

The Statement of Net Assets presents the financial position of IRF at the end of the fiscal year and requires classification of assets and liabilities into current and non-current categories. The difference between total assets and total liabilities is reflected in the net assets section, which displays net assets in three broad categories: invested capital assets, restricted and unrestricted. Net assets are one indicator of the current financial condition of IRF, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year.

The Statement of Revenues, Expenses, and Changes in Net Assets categorizes revenues as operating and non operating revenues and expenses as operating and non-operating expenses.

The Statement of Cash Flows will aid readers in identifying the sources and uses of cash by the categories of operating, non-capital financing, and investment activities.

Financial Analysis of IRF

This schedule is a condensed version of IRF's assets, liabilities, and net assets and is prepared from the Statement of Net Assets as of June 30, 2011 and 2010.

Condensed Statements of Net Assets (In millions)

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Assets		
Current assets	\$ 63.7	\$ 104.8
Noncurrent assets:	432.4	379.4
Total assets	<u>496.1</u>	<u>484.2</u>
Liabilities		
Current liabilities	298.9	290.3
Noncurrent liabilities	0.2	0.2
Total liabilities	<u>299.1</u>	<u>290.5</u>
Net assets		
Investment in capital assets	-	-
Restricted for loans	20.0	20.0
Unrestricted	177.0	173.7
Total net assets	<u>\$ 197.0</u>	<u>\$ 193.7</u>

Net assets may serve over time as a useful indicator of an entity's financial position. Assets exceeded liabilities by \$193,705,929 at the close of the fiscal year ended June 30, 2010 and assets exceeded liabilities by \$197,012,391 at the close of fiscal year ended June 30, 2011.

The following schedule is a summary of the IRF's operating results for the fiscal years ended June 30, 2011 and 2010 .

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

	Year Ended June 30,	
	2011	2010
Operating		
Operating revenue:		
Insurance premiums	\$ 101.2	\$ 107.3
Operating expenses:		
Claims	49.4	51.4
Reinsurance and other premiums	36.1	36.7
Administrative	27.0	24.4
Total operating expenses	112.5	112.5
Net operating income (loss)	(11.3)	(5.2)
Non operating revenue:		
Income from deposits and investments	14.3	31.8
Notes receivable interest	0.3	0.3
Total non operating revenue	14.6	32.1
Special items:		
Transfer to State General Fund	-	36.9
Change in net assets	3.3	(10.0)
Net assets, beginning of the year	193.7	203.7
Net assets, end of the year	\$ 197.0	\$ 193.7

In fiscal year 2008-2009, IRF assets and net assets grew beyond target levels and IRF decreased rates for Tort Liability by 14.9%, IRF decreased rates for Automobile Physical Damage by 21.6%, and IRF decreased the premium for the School Bus Liability Policy by approximately 10%. These changes produced an operating loss which, combined with investment income allowed IRF to maintain target financial ratios.

Administrative expenses increased due to an increase in the hourly rate paid to defense attorneys and independent adjusters. These increases were implemented effective January 1, 2008 and were fully "earned" in Fiscal Year 2008-2009. The percentage increase varied by type of attorney and adjuster, but averaged a little less than 10%.

In fiscal year 2009-2010, the IRF was required, according to Proviso 90.19(C), to suspend the payment of annual premiums for all insurance lines that would otherwise be paid by State agencies up to an amount of \$36,920,921. This resulted in a \$10 million reduction of net assets.

In fiscal year 2010-2011, IRF experienced a decline in investment income due to Proviso 90.19 and a decline on the return on investment due to market conditions.

A condensed version of the Statement of Cash Flows is presented as follows for the years ended June 30, 2011 and 2010:

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

	Year Ended June 30,	
	2011	2010
Cash flows from operating activities	\$ 3.0	\$ (3.9)
Cash flows from noncapital financing activities	-	(36.9)
Cash flows from investing activities	(36.1)	81.9
Net change in cash	(33.1)	41.1
Cash and cash equivalents, beginning of year	62.2	21.1
Cash and cash equivalents, end of year	\$ 29.1	\$ 62.2

Overview of IRF

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

Economic Factors:

By statute, IRF assets are invested by the State Treasurer in repurchase agreements, bonds (US Treasury, US Government Agency, Governmental guaranteed mortgage backed, and Corporate), and financial paper. IRF has maintained adequate reinsurance, however, there have been substantial increases in reinsurance premiums over the years. In fiscal year 07-08, IRF increased its reinsurance program from \$300 million per occurrence to \$400 million per occurrence. The program is now \$475 million subject to a maximum self-insured retention of \$10 million per occurrence and in the annual aggregate with a \$1 million trailing per occurrence for subsequent claims.

The IRF has been impacted by two provisos as a part of the fiscal year 2002-2003 Appropriations Act. The first Proviso 72.98 directed the Fund to waive renewal premiums for all lines of insurance for all State agencies in the fiscal year 2002-2003. Proviso 72.97 instructed IRF to transfer \$22,937,800 of the Fund's assets to the General Fund. These provisos reduced net assets of almost \$51,000,000. The results of these two provisos had a significant financial impact on the Fund during fiscal year 2002-2003, 2003-2004, 2004-2005 and 2005-2006.

The reduction in assets caused by Provisos 72.97 and 72.98 reduced the amount available to invest in fiscal year 2003-2004 and this reduced investment income. The effect continued fiscal year 2005-2006. In fiscal year 2006-2007, the General Fund of the State of South Carolina returned those funds by appropriating approximately \$51 million to the Insurance Reserve Fund.

The rate increases which were taken in previous years were fully earned by the end of fiscal year 2006-2007, generating increased premium income. Fire Resistive Treated Wood recoveries are now virtually complete with approximately \$3.5 million in recoveries in fiscal year 2006-2007. The return of \$51 million in fiscal year 2006-2007 increased IRF assets, IRF net assets, and investment income.

Rate levels from previous years, combined with the return of money from the General Fund and fire resistive treated wood recoveries allowed IRF to return \$20 million to participants in fiscal year 2007-2008 and to decrease rates in Tort Liability, Automobile Physical Damage, and premium for School Bus Liability in fiscal year 2008-2009.

During fiscal year 2009-2010 Winthrop University suffered 6.7 million in fire damage and Proviso 90.19 (C) required to suspend payment of annual premiums by State agencies for all lines of business up to an amount of \$36,920,921.

IRF also experienced an unusual number of property claims caused by violent weather. The largest of these was a lightning strike on the Anderson County 911 system resulting in a claim of \$3.7 million. IRF changed its standard property deductible from \$250 to \$1,000 which should reduce small claims frequency in the future. IRF also expanded its rating definition of "coastal" property to correspond within industry standards.

Contact Information

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF NET ASSETS

JUNE 30, 2011

Assets

Current assets:

Cash and cash equivalents	\$ 29,122,403
Premiums receivable	11,555,078
Reinsurance recovery receivable	1,104,851
Accrued interest	4,176,371
Prepaid insurance	17,740,497
Total current assets	63,699,200

Non-current assets:

Investments	426,585,030
Long-term notes receivable	5,789,722
Capital assets, net of accumulated depreciation	15,938
Total non-current assets	432,390,690
Total assets	496,089,890

Liabilities

Current liabilities:

Accounts payable and accrued payroll	983,915
Accrued compensated absences-current portion	146,261
Due from other funds	909
Deferred premium revenue	59,921,010
Claims payable	135,152,563
Claims incurred but not reported	102,721,542
Total current liabilities	298,926,200

Long term liabilities:

Accrued compensated absences - long term	151,299
Contingencies (<i>Note 12</i>)	
Total long-term liabilities	151,299

Total liabilities

299,077,499

Net assets

Investment in capital assets	15,938
Restricted for:	
Savannah Valley Development Loans	20,000,000
Unrestricted	176,996,453
Total net assets	\$ 197,012,391

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2011

Operating Revenues	
Insurance premiums	\$ 101,155,498
Total operating revenues	<u>101,155,498</u>
Operating Expenses	
Claims	49,435,584
Reinsurance premiums	36,140,647
Professional services	21,166,609
Salaries and benefits	3,512,760
Other services	1,972,474
Other expenses	233,621
Total operating expenses	<u>112,461,695</u>
Operating loss	<u>(11,306,197)</u>
Non-operating revenue	
Income from deposits and investments	14,313,732
Notes receivable interest	279,983
Other non-operating revenue	18,944
Total non-operating revenue	<u>14,612,659</u>
Change in net assets	3,306,462
Net assets, beginning of year	193,705,929
Net assets, end of year	<u><u>\$ 197,012,391</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2011

Cash Flows from Operating Activities

Insurance premiums from customers	\$ 108,351,526
Payments to employees	(3,514,250)
Payments to suppliers/claimants	(101,826,299)
Net cash flows provided by operating activities	<u>3,010,977</u>

Cash Flows from Investing Activities

Principal payments received on notes receivable	1,047,048
Purchases of investments	(105,989,502)
Proceeds from sales and maturity of investments	52,053,810
Interest received-deposits and investments	16,465,971
Interest received-notes receivable	301,502
Net cash used in investing activities	<u>(36,121,171)</u>

Net decrease in cash and cash equivalents	(33,110,194)
Cash and cash equivalents, beginning of year	62,232,597
Cash and cash equivalents, end of year	<u>\$ 29,122,403</u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2011

-CONTINUED-

**Reconciliation of operating loss to net cash
provided by operating activities**

Operating loss	\$ (11,306,197)
Adjustments to reconcile operating loss to net cash flows provided by operating activities:	
Depreciation expense	49,926
Change in assets:	
Premiums receivable	6,442,942
Reinsurance recovery receivable	(1,104,851)
Prepaid insurance	316,555
Change in liabilities:	
Accounts payable, accrued payroll and compensated absences	(4,881)
Deferred premium revenue	753,086
Amount due from others	910
Claims payable and claims incurred but not reported	7,863,487
Net cash provided by operating activities	<u><u>\$ 3,010,977</u></u>

Supplemental Information

Net changes in investments for amortization and accretion	<u><u>\$ (191,279)</u></u>
Net appreciation of investments	<u><u>\$ (1,756,149)</u></u>

See accompanying notes.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2011

1. Basis of Presentation and Summary of Significant Accounting Policies

The financial statements of all funds of the South Carolina State Budget and Control Board, Insurance Reserve Fund (the “Fund”) were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Fund’s accounting policies are described below.

Reporting Entity

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

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

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

- (1) Determine its budget without another government’s having the authority to approve and modify that budget.
- (2) Levy taxes or set rates or charges without approval by another government.
- (3) Issue bond debt without approval by another government.

-CONTINUED-

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Reporting Entity (Continued)

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

The South Carolina State Budget and Control Board, Insurance Reserve Fund is a fund of the South Carolina State Budget and Control Board, which is a part of the State of South Carolina primary government. This report contains only the Fund and no other Offices or funds of the South Carolina State Budget and Control Board or any other part of the State of South Carolina primary government are included. The Insurance Reserve Fund is under the control of the Division of Insurance and Grant Services of the South Carolina State Budget and Control Board (the Board). All of the divisions of the Board reporting entity are under the control of the Executive Director of the State Budget and Control Board. The Board is composed of the Governor; the State Treasurer; the Comptroller General; the Chairman of the Senate Finance Committee; and the Chairman of the House Ways and Means Committee; all of whom serve in an ex-officio capacity.

The South Carolina State Budget and Control Board, formerly the Budget Commission, was established and created by Reorganization Plan No. 2 adopted by the General Assembly in 1950 pursuant to the terms and provisions of Act 621, Acts of 1948. Under the Act, ten state agencies were abolished as separate entities and their functions and duties were brought under the supervision of the Budget and Control Board. The funds of the Budget and Control Board are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Fund operates as a unit under the Budget and Control Board and its Executive Director. The laws of the State and the policies and procedures specified by the State for State agencies are applicable to the Fund's activities. The accompanying financial statements present the financial position and results of operations solely of the Fund and do not include any other agencies or any component units of the State of South Carolina.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The Insurance Reserve Fund was created by the Budget and Control Board on June 5, 1989 to manage insurance programs provided by the State for its agencies, institutions, and political subdivisions. The Fund was formed as a section from the Office of General Services.

Programs managed by the Fund are authorized in the following sections of the South Carolina Code of Laws, 1976, as amended: Section 1-11-140 (tort liability, medical professional liability for individuals and entities and risk management section); Section 1-11-710 (A)(4) (risk management section); Regulation 19-612 (automobile liability); Section 10-7-10 et. seq. (property); Section 59-67-710 (school bus liability); and Section 59-67-790 (school bus pupil injury). Section 15-78-10 et. seq. (the S.C. Tort Claims Act) further defines parameters of coverage provided by the Insurance Reserve Fund.

The Insurance Reserve Fund insures state agencies, school districts, special purpose political subdivisions, county governments and municipal governments in South Carolina. The Insurance Reserve Fund provides property insurance on governmentally owned buildings, the contents of such buildings, equipment and automobiles. The Insurance Reserve Fund provides automobile liability insurance on governmentally owned vehicles and school buses, tort liability insurance for government premises and operations, and medical professional liability for hospitals. The Insurance Reserve Fund is a self-insurer and purchases reinsurance to limit losses in the areas of property insurance, boiler and machinery insurance, and automobile liability insurance. The Insurance Reserve Fund collects premiums from participating entities, issues policies, and pays claims incurred under the policies from accumulated premiums and earnings on investments and notes receivable. The premium rates are determined actuarially and approved by the South Carolina Budget and Control Board. The Insurance Reserve Fund allocates the costs of providing claims servicing and claims payments by charging each participant a premium. Interest income is considered in the premium rate setting process.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Basis of Presentation

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

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

Financial Statements

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

Basis of Accounting

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

The Fund uses the accrual basis of accounting. Revenue is recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable. The Fund reports claims liabilities when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The accounting policies of the Fund conform to accounting principles generally accepted in the United States of America applicable to governmental proprietary activities as prescribed by GASB. Accordingly, the Fund applies all applicable GASB pronouncements and those applicable standards issued by the Financial Accounting Standards Board, and its predecessors on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Fund considers all highly liquid securities with a maturity of three months or less at the time of purchase to be cash equivalents. Most State agencies including the Fund participate in the State's internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 2*. Because the State's internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Deposits in the general deposit account are recorded and reported at cost. However, the Fund reports its deposits in the special deposit accounts at fair value. Investments in the pool are recorded and reported at fair value. Interest earned by the agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total income receivable of the pool.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The amounts shown in the financial statements as “cash and cash equivalents” represent cash on deposit with the State Treasurer as a part of the State’s internal cash management pool, and cash invested in various short-term instruments by the State Treasurer and held in separate agency accounts.

Investments

Investments, in accordance with Governmental Accounting Standards Board (GASB) Statement Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price.

Investment income consists of interest earned during the year, amortization of premiums and accretion of discounts, realized gains/losses on securities, and unrealized gains/losses resulting from changes in fair value. Earnings are posted to the agency’s account at the end of each month. Securities and securities transactions are reflected in the financial statements on a trade-date basis. Realized gains/losses are calculated independent of the change in fair value therefore amounts reported as realized gain/loss in the current year may have been included as unrealized gains/losses in prior years.

Premium Revenue

Premiums billed to agencies (premiums receivable) for insurance coverage are deferred and amortized into income over the term of the insurance policy.

Deferred Premium Revenue

Premiums billed in advance of coverage, payments received in advance of coverage, or in excess of amounts billed and premiums collected but unearned are recorded as deferred premium revenue.

Reinsurance Recovery Receivable

Reinsurance Recovery Receivable represents claims that have been paid which are recoverable from reinsurers. Reinsurance permits partial recovery of losses from reinsurance; however, the Fund, as direct insurer remains primarily liable. Amounts deemed recoverable from reinsurance are deducted from claims expenses.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Prepaid Insurance

Payments made to insurers and reinsurers for services that will benefit future periods are recorded as Prepaid expenses and other assets. The related expense is recognized prorata over the policy periods.

Capital Assets

Capital assets are capitalized at cost if purchased. Capital assets contributed by other State agencies or funds are recorded at the State's original acquisition cost less accumulated depreciation from the purchase date. Assets donated by other parties are valued at fair market value at the date of gift. The Fund has one class of capital asset, equipment, which is depreciated on a straight-line basis over the estimated useful lives of 3-10 years. The capitalization dollar threshold limit for capital assets is \$5,000.

Claims Incurred but not Reported (IBNR)

Losses are recorded at estimated amounts at the time they are reported and include a provision for expenses associated with claim settlements. Insurance claims are expensed as incurred over the period of coverage. The Fund establishes an unpaid claim liability for claims in the process of review, and for IBNR claims. The liability for IBNR claims is actuarially estimated based on the most current historical claims experience of previous payments, changes in number of members and participants, inflation, and award trends. Estimates of liabilities for incurred claims are continually reviewed and revised as changes in these factors occur and revisions are reflected in the current year's operating statement in the applicable claims expense. The liability is reported net of estimated receivables for salvage, subrogation, and reinsurance. Amounts for allocated and unallocated claims adjustment expenses have been included in the calculation of IBNR.

Claims Payable

Claims payable represents claims resulting from losses that have been incurred and not paid at June 30. The claims payable balance is based on actual losses incurred and settled and estimated losses for claims in the final stages of review and settlement.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least twenty hours per workweek are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for unused sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances. The Fund calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in the fund.

Net Assets

Net assets are reported in three categories:

Investment in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets which do not meet the definition of restricted net assets or investment in capital assets, net of related debt.

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Classification of Revenue

The Fund has established the following criteria for reporting operating revenue or nonoperating revenue:

Operating revenue generally results from exchange transactions to provide the services authorized by State statute. These revenues include (1) premiums for insurance coverage, (2) administrative fees, and (3) other receipts arising from services provided.

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

2. Investments and Deposits

As prescribed by Statute, the State Treasurer is the custodian and investment manager of all investments and deposits of the Fund.

Investments

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

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

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

The following table presents the amortized cost and fair values of the investments of the Fund at June 30, 2011:

	Amortized	Unrealized		Fair
	Cost	Gains	Losses	Value
Municipal bonds	\$ 1,000,000	\$ 136,050	\$ -	\$ 1,136,050
Collateralized mortgage-backed obligations	35,758,361	3,754,024	-	39,512,385
Other Governmental guaranteed investments	16,817,801	256,416	(6,560)	17,067,657
SC State political subdivision bonds	101,858,663	8,055,810	(28,183)	109,886,290
Repurchase agreement	29,720,000	-	-	29,720,000
Corporate bonds	211,699,961	13,262,302	(151,765)	224,810,498
Financial paper	27,295,515	1,877,085	-	29,172,600
Commercial paper	4,996,150	3,400	-	4,999,550
Total	<u>\$ 429,146,451</u>	<u>\$ 27,345,087</u>	<u>\$ (186,508)</u>	<u>\$ 456,305,030</u>

At June 30, 2011, the amortized cost of the above investments was comprised of the following:

	Par Value	Unamortized Premiums	Unaccreted Discounts	Amortized Cost
Municipal bonds	\$ 1,000,000	\$ -	\$ -	\$ 1,000,000
Collateralized mortgage-backed obligations	35,951,865	-	(193,504)	35,758,361
Other Governmental guaranteed investments	16,843,266	-	(25,465)	16,817,801
SC State political subdivision bonds	102,230,939	-	(372,276)	101,858,663
Repurchase agreement	29,720,000	-	-	29,720,000
Corporate bonds	212,300,311	156,672	(757,022)	211,699,961
Financial paper	27,500,000	-	(204,485)	27,295,515
Commercial paper	5,000,000	-	(3,850)	4,996,150
Total	<u>\$ 430,546,381</u>	<u>\$ 156,672</u>	<u>\$ (1,556,602)</u>	<u>\$ 429,146,451</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

Deposits

For cash and cash equivalents, the fair values are equal to the bank balances, which approximate the carrying amount. The cash and cash equivalents reported consist of the following as of June 30, 2011:

Deposits held by Third Party Administrators	\$ 178,971
Cash overdraft at the South Carolina Treasurer's Office	<u>(776,568)</u>
	<u><u>\$ (597,597)</u></u>

Balances held by the third party administrator are exposed to custodial credit risk. In the case of deposits, this is the risk that in the event of a bank failure, the Fund's deposits may not be returned. The Fund does not have a deposit policy for custodial credit risk. As of June 30, 2011, \$178,971 of the Fund's bank balance was uninsured or collateralized with securities held by the pledging financial institution's trust department or agent, but not in the Fund's name.

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

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

	Statements	Note Disclosure
Cash and cash equivalents	\$ 29,122,403	\$ -
Deposits held by Third Party Administrators	-	178,971
Held by the State Treasurer:		
Cash overdraft	-	(776,568)
Specifically identified investments	-	456,305,030
Investments	<u>426,585,030</u>	<u>-</u>
Total	<u><u>\$ 455,707,433</u></u>	<u><u>\$ 455,707,433</u></u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Investments and Deposits (Continued)

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

Interest earned	\$ 12,366,304
Accretion of discount	(195,476)
Amortization of premium	386,755
Change in unrealized gains (losses)	1,756,149
	<u>\$ 14,313,732</u>

3. Premiums Receivable

Premiums receivable at June 30, 2011, consist of the following:

Local government	\$ 6,110,121
State government (<i>Note 11</i>)	2,435,934
Other	3,009,023
	<u>\$ 11,555,078</u>

Premiums receivable and deferred premium revenue include approximately \$4,846,160 attributable to premiums billed in advance of coverage as of June 30, 2011.

As of June 30, 2011, all of the receivables are deemed by management to be collectible. Therefore, no allowance for doubtful accounts has been recognized. In addition, the Fund has applied no discounts to its receivables as of June 30, 2011.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Notes Receivable

Amounts due from notes receivable in the Insurance Reserve Fund at June 30, 2011, consist of the following:

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

One note in the original principal amount of \$14,983,215 with interest at 4.41%; maturity date is January 31, 2031. Current portion is prepaid at June 30, 2011.

Long-term notes receivable

	\$ 5,789,722
	\$ 5,789,722

5. Capital Assets

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

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011
Furniture and equipment	\$ 293,682	\$ -	\$ -	\$ 293,682
Accumulated depreciation	(227,818)	(49,926)	-	(277,744)
Capital assets, net	\$ 65,864	\$ (49,926)	\$ -	\$ 15,938

Depreciation expense for the year ended June 30, 2011, was \$49,926.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

6. Lease Obligations

The Fund leases office space from a party outside of State government and this lease is accounted for as an operating lease. Rental expense under this lease for the year ended June 30, 2011 was \$256,686.

The future minimum lease payments due under this leases is:

<u>Year Ending June 30,</u>	
2012	\$ 256,686
2013	256,686
2014	256,686
2015	256,686
2016	276,646
Thereafter	<u>1,106,584</u>
	<u><u>\$ 2,409,974</u></u>

The Fund has also entered into an operating lease from a party outside the state government, for office equipment, which contains a cancellation provision and is subject to annual appropriation. In the normal course of business, operating leases are generally renewed or replaced by other leases. Operating leases are generally payable on a monthly basis. For the year ended June 30, 2011, expenses under these leases were approximately \$14,400.

7. Restricted Net Assets – Savannah Valley Development Program

At June 30, 2011, \$20,000,000 of the Fund’s net assets is restricted for loans to the Savannah Valley Development Division of the Department of Commerce, as authorized under South Carolina State Code 13-9-10, formerly the Clark’s Hill-Russell Authority (a Joint Resolution; R-22, H2516; of the State, approved March 12, 1987, and R-755, H2680; of the State, approved June 20, 1988). As of June 30, 2011, \$5,789,722 was outstanding on loans made under this program.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. Pension Plans

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

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees. The State Optional Retirement Program (ORP) is a defined contribution plan that is offered as an alternative to certain state, public school, and higher education employees. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. The SCRS assumes no liability for State ORP benefits, as they are the liability of the investment providers. New employees have the option of choosing the State Optional Retirement Program.

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 5 years credited service. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service (this requirement does not apply if the disability is the result of a job-related injury). A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. Pension Plans (Continued)

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (TERI) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period. TERI participants with an effective TERI date prior to July 1, 2005 do not make employee contributions to SCRS. TERI participants with an effective TERI date on or after July 1, 2005 make employee contributions to SCRS. All TERI participants do not earn service credit and are ineligible to receive group life insurance benefits and are not eligible for disability retirement benefits.

Beginning July 1, 2006, employees participating in the SCRS have been required to contribute 6.50 percent of all compensation. For the year ended June 30, 2011, the employer contribution rate was 9.24 percent (before a surcharge to fund retiree health and dental insurance coverage). For the year ended June 30, 2010 and 2009, this rate was 9.24 percent and 9.06 percent, respectively. The Fund's actual contributions to the SCRS for the years ended June 30, 2011, 2010 and 2009 were approximately \$362,716, \$354,893, and \$371,432 respectively and equaled the required contributions (excluding the surcharge) in the percentages outlined above. Also, the Fund paid employer group-life insurance contributions at the rate of 0.15 percent of compensation.

The amounts paid by the Fund for pension and group-life benefits are reported as employer contribution expenditures within the applicable administrative expenditure categories to which the related salaries are charged.

Article X, Section 16 of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of compensation).

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

8. Pension Plans (Continued)

The SCRS does not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Fund's liability under the pension plans is limited to the amounts appropriated therefore in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Fund recognizes no contingent liability for unfunded costs associated with participation in the plans.

At retirement, employees participating in the SCRS receive additional service credit (at a rate of 20 days equals one month of services) for up to 90 days for accumulated unused sick leave.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from Systems' earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS benefits.

9. Post-Employment and Other Employee Benefits

Post Employment Benefits

The State provides post employment health and dental benefits to retired employees and their covered dependents through a plan which has been determined to be a cost-sharing multiple-employer defined benefit post employment healthcare plan by the Comptroller General's Office of the State of South Carolina. The State Budget and Control Board (SBCB) is the Trustee and the plan is administered by the Employee Insurance Program (EIP), a part of the State Budget and Control Board. A retiree's eligibility for the health and dental benefits is based on his hire date and years of earned retirement service credit. Generally, ten years of service credit with the SC Retirement System is required for full funding of employees enrolled in the system prior to May 2, 2008. For all others who may become enrolled, eligibility requires fifteen years of service for partial funding and twenty-five years for full funding.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

In addition the State provides long-term disability benefits to active employees through the Long-Term Disability Plan which has been determined to be a cost sharing multiple-employer plan by the Comptroller General's Office of the State of South Carolina. The State Budget and Control Board is the Trustee and the plan is administered by the Employee Insurance Program (EIP), a part of the State Budget and Control Board (SBCB). Benefits under this plan are provided to the employee upon approval of the disability by the South Carolina Retirement System.

Section 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended, requires the post-employment benefits be funded through annually established employer's contribution rates, also known as the pension surcharge. Funding for the employer's payment of the surcharge is provided through General Appropriations from the State and other sources. Effective May 1, 2008 through Act 195, the State established the South Carolina Retiree Health Insurance Trust Fund and the Long-Term Disability Insurance Trust Fund for the purpose of funding and accounting for the employer costs of retiree health and dental insurance benefits and employee long-term disability benefits. The Retiree Health Insurance Trust Fund is primarily funded through the payroll surcharge. Other sources of funding may include additional State appropriated dollars, accumulated EIP reserves, and income generated from investments. The Fund's actual contribution to this trust fund for the fiscal years ended June 30, 2011, 2010 and 2009 were \$95,494, \$91,679 and \$96,065, which equaled the required contribution rates of 3.90%, 3.50% and 3.50%, respectively. The Long-Term Disability Insurance Trust Fund is funded through a per person premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee contributed to the trust was \$3.22, \$3.23 and \$3.23 for the fiscal years ended June 30, 2011, 2010 and 2009, respectively.

By state law, the State is liable for the employer share of retiree premiums. Accordingly, an annual required contribution and related liability for the Fund, as employer, is not included in the accompanying financial statements.

Audited financial statements of the trust funds may be obtained by written request to Employee Insurance Program, SC Budget and Control Board, 1201 Main Street, Suite 360, Columbia, South Carolina 29201.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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 all permanent full-time and certain permanent part-time employees of the Fund. These benefits are provided on a reimbursement basis by the employer agency based on rates established at the beginning of the service period by the Employee Insurance Program within the SC Budget and Control Board.

The Fund recorded benefit expenses for these insurance benefits for active employees in the amount of \$228,759 for the year ended June 30, 2011.

10. Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Fund have elected to participate.

The multiple-employer plans, created under Internal Revenue Code Sections 457, 401(k), and 403(b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

This Fund made no contributions for the fiscal year ending June 30, 2011.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Transactions with State Entities

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

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

The following details the insurance premiums received by the Fund from other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2011:

The Senate	\$ 31,552
House of Representatives	126,078
Codification of Laws and Legislative Council	6,457
Legislative Printing, Information and Technology Systems	12,405
Legislative Audit Council	4,414
Education Oversight Committee	3,531
Judicial Department	72,269
Administrative Law Court	1,933
Governor's Office - Executive Control of State	31,634
Governor's Office - SLED	375,577
Governor's Office - Office of Executive Policy and Programs	3,553
Governor's Office - Mansion & Grounds	21,774
Lieutenant Governor's Office	10,216
Secretary of State's Office	5,824
Comptroller General's Office	11,497
State Treasurer's Office	16,614
Tobacco Settlement Revenue Management Authority	2,490
Retirement System Investment Commission	9,795
Attorney General's Office	27,046
South Carolina Commission on Prosecution Coordination	10,688
Commission on Indigent Defense	10,826
Adjutant General's Office	202,013
State Election Commission	8,016

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Transactions with State Entities (Continued)

Budget and Control Board	1,631,989
State Auditor	5,024
Higher Education Commission	11,394
Higher Education Tuition Grant Commission	1,311
The Citadel	569,944
Clemson University	2,360,943
College of Charleston	1,285,840
Coastal Carolina University	596,597
Francis Marion University	296,999
Lander University	253,163
South Carolina State University	349,775
University of South Carolina - Columbia Campus	4,528,453
University of South Carolina - Upstate Campus	179,671
University of South Carolina - Beaufort Campus	67,512
Winthrop University	546,896
Medical University of South Carolina	7,967,207
MUSC Hospital Authority	2,497,884
Technical and Comprehensive Education Board	44,459
Education Department	3,934,792
Educational Television Commission	266,188
Wil Lou Gray Opportunity School	35,217
Vocational Rehabilitation	399,048
Deaf and Blind School	191,982
Archives and History Department	5,837
State Library	14,644
Arts Commission	13,761
Museum Commission	27,409
Department of Health and Human Services	154,675
Health and Environmental Control Department	1,132,907
Mental Health	1,832,623
Disabilities and Special Needs	447,606

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Transactions with State Entities (Continued)

Department of Alcohol and Other Drug Abuse Services	8,024
Department of Public Safety	706,213
Social Services Department	338,935
John De La Howe School	72,600
Blind Commission	19,843
Housing, Finance & Development Authority	27,966
Human Affairs Commission	7,139
State Commission for Minority Affairs	4,214
Department of Corrections	1,801,003
Department of Probation, Parole, and Pardon Services	207,552
Department of Juvenile Justice	414,634
Law Enforcement Training Council	74,932
Forestry Commission	220,013
Agriculture Department	81,466
Department of Natural Resources	726,472
Sea Grant Consortium	3,720
Parks, Recreation and Tourism Department	555,521
Patriot's Point Development Authority	103,849
Department of Commerce	18,411
Public Service Commission	11,584
Office of Regulatory Staff	15,499
South Carolina Workers' Compensation Commission	22,406
State Accident Fund	9,092
Patients' Compensation Fund	8,045
Second Injury Fund	4,810
Insurance Department	18,180
Board of Financial Institutions	12,880
Department of Consumer Affairs	3,095
Department of Labor, Licensing, and Regulation	130,944
Department of Motor Vehicles	125,472
Department of Revenue	93,433

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Transactions with State Entities (Continued)

State Ethics Commission	3,086
Department of Employment and Workforce	155,898
Procurement Review Panel	2,854
Department of Transportation	7,109,330
South Carolina Transportation Infrastructure Bank Board	3,866
Aeronautics Division	48,774
Public Railways Division, Department of Commerce	73,834
South Carolina Public Service Authority (Santee Cooper)	373,698
Education Lottery Commission	84,260
Aiken Technical College	63,254
Technical College of the Lowcountry	86,744
Northeastern Technical College	56,732
Denmark Technical College	48,137
Florence-Darlington Technical College	180,487
Greenville Technical College	310,227
Horry-Georgetown Technical College	139,300
Midlands Technical College	293,820
Orangeburg-Calhoun Technical College	73,407
Piedmont Technical College	175,830
Spartanburg Community College	184,116
Central Carolina Technical College	77,810
Tri-County Technical College	159,279
Trident Technical College	362,410
Williamsburg Technical College	28,277
York Technical College	140,129
	<u>\$ 48,741,458</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Transactions with State Entities (Continued)

Premiums owed from these entities at June 30, 2011 were:

Arts Commission	\$	10,854
CIO Deputy Operations		6,324
Budget and Control Board - DSIT		40
Budget and Control Board - Hunley Commission		4,482
Budget and Control Board - Retirement System		49,962
Budget and Control Board - State Energy Office		51,695
Berkeley County Mental Health		3,242
Central Carolina Technical College		83,727
Clemson University		6,356
College of Charleston		3,567
Department of Corrections		105,299
Department of Transportation		2,250
Department of Social Services		12,450
Department of Transportation		7,643
Disabilities and Special Needs		42,112
Education Department		7,357
Educational Television/SDN		255,425
Florence Darlington Technical College		192,501
Francis Marion University		758
Health and Human Services		149,543
Horry-Georgetown Technical College		155,492
John De La Howe School		72,600
Midlands Technical College		301,477
Office of Regulatory Staff		15,058
Patriot's Point Development Authority		105,103
South Carolina Criminal Justice Academy		91,373
South Carolina Department of Consumer Affairs		1
Malpractice Patients Comprehensive Fund		8,010
Sea Grant Consortium, South Carolina		3,720
State Auditor's Office		5,024

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Transactions with State Entities (Continued)

State Library	14,106
State Museum Commission	27,122
Tri-County Community Mental Health	5,490
University of South Carolina - Aiken Campus	114,824
Vocational Rehabilitation Department	381,538
York Technical College	139,409
	\$ 2,435,934
	\$ 2,435,934

The Fund had financial transactions with various State agencies during the fiscal year. Significant payments were made to Divisions (Offices) of the State Budget and Control Board for retirement and insurance plans contributions, vehicle rental, printing, and telephone, interagency mail, data processing services, purchasing, record maintenance, internal audit and personnel services. Significant payments were also made for unemployment and workers' compensation coverage for employees to other agencies. The amounts of 2011 expenses applicable to related party transactions not disclosed elsewhere are approximately:

South Carolina Department of Employment and Workforce	\$ 2,382
South Carolina State Accident Fund	11,658
	\$ 14,040
	\$ 14,040

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

12. Contingencies

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

As a result of the 2004-2005 Appropriations Act Proviso 63.47, the Fund is to provide funds to cover legal defense costs of the State associated with the Abbeville School Funding litigation case. During the year ended June 30, 2011, the Fund incurred no legal defense costs associated with the case. However, the amount of this liability is not known as of the date of our report.

As a result of the 2007-2008 Appropriations Act Proviso 63.51, the Fund is to provide funds to cover legal defense costs of the State associated with the State Ethics Commission Litigation did not incur any legal defense costs associated with the case. During the year ended June 30, 2011, the Fund incurred \$9,628 in legal defense costs associated with the case. However, the amount of this liability is not known as of the date of our report.

As a result of the 2006-2007 Appropriations Act Proviso 63.33, the Fund is to provide funds to cover legal defense costs of the State associated with the Prison Mental Health Care litigation case. During the year ended June 30, 2011, the Fund did not incur any legal defense costs associated with the case. However, the amount of this liability is not known as of the date of our report.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

13. Risk Management/Reinsurance

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks except for certain types of risks for which it is self-insured (these risks are further described herein). Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage in the prior year other than the Fund did not renew reinsurance for Medical Professional Liability. Settled claims have not exceeded this coverage in any of the past three years.

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

State management believes it is more economical to manage certain risks internally and set aside assets for claim settlement. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of State employees for unemployment compensation benefits (Department of Employment and Workforce);
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Employee Insurance Program); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Employee Insurance Program).

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

13. Risk Management/Reinsurance (Continued)

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

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

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

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

The Fund has not transferred the portion of the risk of loss related to insurance policy deductibles and limits. The Fund has not reported an estimated claims loss expense, and the related liability at June 30, 2011, based on the requirements of GASB 10 because information at June 30, 2011 did not indicate that an asset had been impaired or a liability had been incurred. GASB 10 states that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30 and the amount of loss is reasonably estimable.

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

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

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

Property - \$10,000,000 per occurrence

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

14. Reconciliation of Claims Liabilities by Fund

The schedule below presents the changes in claims liabilities for the past two years for the Fund.

	2011	2010
	<u>(in thousands)</u>	<u>(in thousands)</u>
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 230,011	\$ 226,834
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	42,565	43,589
Increases (decreases) in provision for insured events of prior fiscal years	<u>6,870</u>	<u>7,877</u>
Total incurred claims and claim adjustment expenses	<u>49,435</u>	<u>51,466</u>
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	8,875	7,203
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	<u>32,698</u>	<u>41,086</u>
Total payments	<u>41,573</u>	<u>48,289</u>
Total unpaid claims and claim adjustment expenses at end of the fiscal year	<u>\$ 237,873</u>	<u>\$ 230,011</u>
The above totals are comprised of the following:		
Claims payable	\$ 135,152	\$ 134,514
Claims incurred but not reported	<u>102,721</u>	<u>95,497</u>
Total	<u>\$ 237,873</u>	<u>\$ 230,011</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD
INSURANCE RESERVE FUND

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

15. Changes in Long-Term Liabilities

Changes in long-term obligations for the year ended June 30, 2011 were as follows:

	Beginning Balance July 1, 2010	Increases	Decreases	Ending Balance June 30, 2011	Due Within 1 Year
Compensated absences payable	\$ 298,582	\$ 162,356	\$ (163,378)	\$ 297,560	\$ 146,261

16. Insurance Premiums and Claims Expense

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

	Insurance Premiums	Claims Expenses
Tort liability	\$ 31,869,996	\$ 18,688,917
Auto, school bus, and inland marine	28,253,790	7,920,062
Professional liability	15,538,063	10,203,003
Fire	13,402,868	11,385,212
Extended coverage	12,090,781	1,238,390
	<u>\$ 101,155,498</u>	<u>\$ 49,435,584</u>

17. Subsequent Events

Subsequent events were evaluated through September 29, 2011, 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.

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

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

Dear Mr. Gilbert:

We have audited the financial statements of the South Carolina State Budget and Control Board, Insurance Reserve Fund (the "Fund") as of and for the year ended June 30, 2011, and have issued our report thereon dated September 29, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Fund is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

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 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

* * * * *

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

Rebeck & Williamson, L.L.P.

September 29, 2011