

AUDITED FINANCIAL STATEMENTS
AND
REQUIRED SUPPLEMENTAL INFORMATION

*SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND*

June 30, 2011

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 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, 2011, was issued by The Hobbs Group, P.A., 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/cwc

TABLE OF CONTENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND
June 30, 2011

Independent Auditors' Report 1

REQUIRED SUPPLEMENTAL INFORMATION

Management's Discussion and Analysis (Unaudited) 3

BASIC FINANCIAL STATEMENTS

Statements of Net Assets 8

Statements of Revenues, Expenses, and Changes in Net Assets (Deficit) 9

Statements of Cash Flows 10

Notes to the Basic Financial Statements 11

COMPLIANCE AND INTERNAL CONTROL

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*..... 26

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INDEPENDENT AUDITORS' REPORT

Office of the State Auditor and Board of Governors
South Carolina Medical Malpractice Patients' Compensation Fund
Columbia, South Carolina

We have audited the accompanying financial statements of the 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 years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, 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, 2011 and 2010, and the changes in its financial positions, or, where applicable, its cash flows for the years 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 South Carolina Medical Malpractice Patients' Compensation Fund as of June 30, 2011 and 2010, and the changes in financial position and cash flows thereof for the years 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 October 14, 2011, 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

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compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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 response 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.

Columbia, South Carolina
October 14, 2011

The Hollis Group, P.A.

REQUIRED SUPPLEMENTAL INFORMATION

Management's Discussion and Analysis

Overview of the Financial Statement and Financial Analysis

This report is prepared in accordance with Governmental Accounting Standards Board Statement 34, *Basic Financial Statements and Management's Discussions and Analysis for State and Local Governments*. This financial statement is presented in three parts: Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows. This 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 Assets

The Statement of Net Assets presents the assets, liabilities and equity of the PCF as of the end of the fiscal year. The Statement of Net Assets 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 Statement of Net Assets

	FY 2011	FY 2010	Variance
Assets:			
Cash and investments	\$ 20,974,935	\$ 23,597,067	\$ (2,622,132)
Interest receivable and prepaid expenses	347,618	482,656	(135,038)
Construction in progress	465,748	389,485	76,263
TOTAL ASSETS	\$ 21,788,301	\$ 24,469,208	\$ (2,680,907)
Liabilities:			
Current liabilities	\$ 21,940,921	\$ 20,405,759	\$ 1,535,162
Non-current liabilities	105,554,000	125,600,166	(20,046,166)
Total Liabilities	127,494,921	146,005,925	(18,511,004)
Net Assets (Deficit)			
Invested in capital assets	465,748	389,485	76,263
Unrestricted	(106,172,368)	(121,926,202)	15,753,834
Total Net Deficit	(105,706,620)	(121,536,717)	15,830,097
TOTAL LIABILITIES & NET ASSETS (DEFICIT)	\$ 21,788,301	\$ 24,469,208	\$ (2,680,907)

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

Changes in total net assets as presented in the statement activities are based on the activity presented in the statement of revenues, expenses and changes in net assets. 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 Assets (deficit) 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 Assets

	FY 2011	FY 2010	Variance
Operating revenues	\$ 18,270,867	\$ 22,708,349	\$ (4,437,482)
Operating expenses	2,591,290	2,324,611	266,679
Operating Income	15,679,577	20,383,738	(4,170,803)
Non-operating revenues	150,520	715,248	(564,728)
Increase (Decrease) in Net Assets	15,830,097	21,098,986	(5,268,889)
Net Assets (Deficit) - Beginning of Year	(121,536,717)	(142,635,703)	21,098,986
Net Assets (Defecit) - End of Year	\$ (105,706,620)	\$ (121,536,717)	\$ 15,830,097

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 shows the net cash provided or used by the operating activities of the Fund. The second section shows the cash activity related to financing for non-capitalized items. The note was used to eliminate the need to draw down from the investment portfolio. 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 Assets.

Condensed Statement of Cash Flows

	FY 2011	FY 2010	Variance
Cash provided (used) by:			
Operating activities	\$ (2,737,440)	\$ 703,734	\$ (3,441,174)
Capital & related financing activities	(76,263)	(102,129)	25,866
Investing activities	1,085,785	(4,639,824)	5,725,609
Net Change in Cash	(1,727,918)	(4,038,219)	2,310,301
Cash and Cash Equivalents - Beginning of Year	5,877,581	9,915,800	(4,038,219)
Cash and Cash Equivalents - End of Year	\$ 4,149,663	\$ 5,877,581	\$ (1,727,918)

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.

Following the previous actuarial review, which was conducted by a national actuarial firm, at the direction of the South Carolina Department of Insurance, the PCF Board of Governors voted to implement the following percentage of changes in membership fees to the varying limits of coverage:

10 million per claim/12 million per annual aggregate:	0%
5 million per claim/7 million per annual aggregate:	-0.8%
3 million per claim/6 million per annual aggregate:	-2.2%
2 million per claim/4 million per annual aggregate:	-3.6%
1 million per claim/3 million per annual aggregate:	-5.0%

This rate change was based on the actuary's recommendation. The Board of Governors considered a number of factors in their deliberations for a rate changes, including reducing the PCF deficit, the PCF's place in the commercial market, tort reform of 2005 and the 2010 actuarial review.

The PCF continues to use independent agents to assist it in the underwriting of its members. Agency Commissions are based on 5% of the paid member fees. The Board believes that establishing this partnership with independent agents in South Carolina helps to serve the PCF members.

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 physician member and the trial lawyer member. The Governor recently appointed the defense attorney 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.

Effective April 1, 2009, the PCF Board of Governors re-elected James E. Mercer, DDS as the new Chairman of the Board for a two-year term. Dr. Richard Kennedy was re-elected to the position of Vice Chairman and Bruce MacKay was re-elected as Secretary-Treasurer.

The PCF continues to function with a staff of five full-time equivalent employees. Included are two Administrative Assistants, one Program Coordinator, one Program Manager and the Executive Director.

At the close of the fiscal year, the PCF had a membership total of 3570. This includes one nursing home, 24 clinics, 17 hospitals and surgery centers, 236 professional associations, 2,205 physicians, 742 dentists and oral surgeons, 6 optometrists, 179 nurses and techs, 140 physicians' assistants, and 21 pharmacists and other healthcare providers. The PCF paid a total of \$17,517,056 for claims, settlements and judgments during the fiscal year. This is an estimated increase of only 1.6% from claims payments made during the prior fiscal year. The PCF collected \$18,764,571 in membership fees which constitutes an approximate decrease of 19.3% 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.

There has been a drop in our physician membership which we believe is due largely to 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. These factors, along with the increasing number of members choosing lower PCF limits and increased shared limit options, account for the decrease in membership fees.

The Board has engaged in extensive strategic planning efforts throughout the fiscal year, which included the continual review and revision of the PCF Plan of Operations, Underwriting Manual of Rules & 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 Operation 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.

With the passage of S.669 the PCF Board is beginning to work 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	34%
5 Million per occurrence/7 Million annual aggregate	8%
3 Million per occurrence/6 Million annual aggregate	17%
2 Million per occurrence/4 Million annual aggregate	1%
1 Million per occurrence/3 Million annual aggregate	40%

The PCF no longer offers unlimited coverage.

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 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 received 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.

As previously stated, the PCF consists of five full-time employees. The Executive Director, along with the Board of Governors, closely monitors the staff's ability to meet the demands and needs of its members, which continue to increase. The PCF is a highly complex 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 a staff with specialized skills and a high work ethic.

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 and sufficient excess 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 experience 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.

The PCF 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 nine years the PCF Board of Governors has successfully reduced the net deficit of the PCF by **\$109,797,478**. This clearly shows a very positive development in the overall financial outlook of the PCF. During the fiscal year, the PCF met all of 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, 2011.

BASIC FINANCIAL STATEMENTS

STATEMENTS OF NET ASSETS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

	June 30,	
	<u>2011</u>	<u>2010</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 4,149,663	\$ 5,877,581
Investments	16,825,272	17,719,486
Prepaid expenses	233,337	327,324
Interest receivable	114,281	155,332
Total Current Assets	<u>21,322,553</u>	<u>24,079,723</u>
Construction in progress	465,748	389,485
TOTAL ASSETS	<u>\$ 21,788,301</u>	<u>\$ 24,469,208</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	\$ 10,650	\$ 39,361
Accrued liabilities	141,339	410,134
Unearned fees	5,249,932	6,902,264
Current portion of claims payable	16,539,000	13,054,000
Total Current Liabilities	<u>21,940,921</u>	<u>20,405,759</u>
Claims:		
Claims payable	115,494,079	142,339,166
Claims discount	(9,940,079)	(16,739,000)
Total Liabilities	<u>127,494,921</u>	<u>146,005,925</u>
Net Assets (Deficit)		
Invested in capital assets	465,748	389,485
Unrestricted	(106,172,368)	(121,926,202)
Total Net Deficit	<u>(105,706,620)</u>	<u>(121,536,717)</u>
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	<u>\$ 21,788,301</u>	<u>\$ 24,469,208</u>

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

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (DEFICIT)
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

	For the Years Ended June 30,	
	2011	2010
Operating Revenues		
Membership fees, net of refunds (\$671,089 and \$767,822)	\$ 18,093,482	\$ 22,477,046
Administrative fees	176,241	231,081
Miscellaneous income	1,144	222
Total Operating Revenues	18,270,867	22,708,349
Operating Expenses		
Claims	17,517,056	17,236,049
Claims reserve	(16,561,170)	(16,919,549)
Commissions	728,597	1,098,735
Personnel services	370,856	365,459
Operating and contractual services	490,479	519,920
Supplies and materials	45,472	23,997
Total Operating Expenses	2,591,290	2,324,611
OPERATING INCOME	15,679,577	20,383,738
Nonoperating Revenues (Expenses)		
Interest income	544,714	716,971
Investment account fees	(91,716)	(85,004)
Realized gain (loss) on investment	(65,235)	16,532
Unrealized gain (loss) on investment	(237,243)	66,749
Total Nonoperating Revenues (Expenses)	150,520	715,248
Change in Net Assets	15,830,097	21,098,986
Net Deficit at beginning of year	(121,536,717)	(142,635,703)
NET DEFICIT AT END OF YEAR	\$ (105,706,620)	\$ (121,536,717)

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

STATEMENTS OF CASH FLOWS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

	For the Years Ended June 30,	
	2011	2010
Cash Flows From Operating Activities		
Cash received from members	\$ 16,618,535	\$ 19,819,663
Cash payments for commissions	(908,133)	(845,320)
Cash payments for claims	(17,517,052)	(17,236,049)
Cash payments for personnel services	(366,128)	(361,590)
Cash payments for operating and contractual services	(519,190)	(648,952)
Cash payments for suppliers	(45,472)	(24,018)
Net Cash Provided by (Used in) Operating Activities	(2,737,440)	703,734
Cash Flows from Capital and Related Financing Activities		
Construction of capital asset	(76,263)	(102,129)
Net Cash Used in Capital and Related Financing Activities	(76,263)	(102,129)
Cash Flows From Investing Activities		
Purchase of investments	(23,745,793)	(24,028,335)
Proceeds from sale of investments	24,337,530	18,821,802
Investment income	489,348	550,150
Interest income	4,700	16,559
Net Cash Provided by (Used in) Investing Activities	1,085,785	(4,639,824)
Net Decrease in Cash And Cash Equivalents	(1,727,918)	(4,038,219)
Cash and cash equivalents at beginning of year	5,877,581	9,915,800
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 4,149,663	\$ 5,877,581
Reconciliation of Operating Income to Net Cash Provided by (Used in)		
Operating Activities		
Operating Income	\$ 15,679,577	\$ 20,383,738
Change in Assets and Liabilities		
Decrease in prepaid expenses	93,987	180,738
Decrease in accounts payable	(28,711)	(129,053)
Increase (Decrease) in commissions payable	(273,523)	72,677
Increase in accrued salaries and benefits	449	535
Increase in accrued compensated absences	4,279	3,334
Decrease in unearned fees	(1,652,332)	(2,888,686)
Decrease in claims payable, net of discounts	(16,561,166)	(16,919,549)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	\$ (2,737,440)	\$ 703,734
Non-Cash Investing Activities:		
Net increase (decrease) in fair value of investments	\$ (237,243)	\$ 66,749

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

NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND
June 30, 2011

NOTE A -- 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, 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 operated 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.

The Fund follows all pronouncements of the Governmental Accounting Standards Board, and has elected not to follow Financial Accounting Standards Board pronouncements issued after November 30, 1989.

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.

NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES – Continued

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 which until November 26, 2000, was in excess of \$100,000 per incident, and \$300,000 in the aggregate, and which thereafter is in excess of \$200,000 per incident or in excess of \$600,000 in the aggregate for one year. 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 Budget and Control Board under its authority or by the agency as set forth in the Appropriation Act for fiscal year 2010-2011 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

During the fiscal year-end closeout period in July, agencies may continue to charge vendor, interagency, and interfund 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.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

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 B.

Investments: The Board of Directors authorizes the investment manager to invest up to 100% in US Treasuries or Agencies, but no more than 40% in Corporate Bonds. No more than 7% 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. Effective August 15, 2011, 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 workweek are entitled to accrue and carry forward at calendar year-end a maximum of 180 days sick leave and 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum of 45 days, but are not entitled to any payment for unused sick leave. 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.

NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES - Continued

Unpaid Claims Liabilities: In years prior to July 1, 1993, the Fund had been classified as risk sharing, public entity risk pool (PERP), Governmental Accounting Standards Board's Statement Number 10 *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*. Effective July 1, 1993, 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*. This change was due to the fact that the Fund is primarily composed of non-governmental entities, and one of the key characteristics of (PERP) is that it is composed of primarily governmental entities. This change had no effect on the method of accounting for unpaid claims liabilities. Certain supplemental disclosures required by GASB 10 are not required under FASB 60; therefore, they are not included in this report.

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 done in August 2010 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.

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.

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.

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

NOTE B -- DEPOSITS AND INVESTMENTS

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 Transaction Account Guarantee Program unless collateralized as stated in Title 38, Chapter 12 of the South Carolina Code of Laws.

The carrying amounts of the deposits for the Fund at June 30, 2011 at local financial institutions were \$3,967,137; and \$5,703,302 at June 30, 2010. Bank balances were \$5,311,631 and \$6,578,608 at June 30, 2011 and 2010, respectively, and are insured as follows:

	2011	2010
Amount insured by FDIC TAG Program	\$ 0	\$ 2,113,473
Amount collateralized by US Government or Agency Securities	5,311,631	4,465,135
	<u>\$ 5,311,631</u>	<u>\$ 6,578,608</u>

The remaining deposits of the Fund in the amounts of \$182,526 and \$174,279 at June 30, 2011 and 2010, respectively, are deposits held by the State Treasurer. Please refer to the Comprehensive Annual Financial Report of the State of South Carolina.

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.

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE B -- DEPOSITS AND INVESTMENTS - Continued

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.

The Fund's investments at local financial institutions are in United States Government Agency Securities.

As of June 30, 2011 the Fund had the following investments and maturities:

<u>Investment</u>	<u>Fair Value</u>	<u>Less Than 1 Year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>	<u>More Than 10 Years</u>
Federal Home Loan Mortgage Corp.	\$ 1,999,535		\$ 1,999,535		
Federal Home Loan Bank	2,062,529				\$ 2,062,529
Federal Agricultural Mortgage Corp.	1,079,670				1,079,670
Federal National Mortgage Assoc.	11,094,961			\$ 1,703,314	9,391,647
Municipal Bond	588,577				588,577
	<u>\$ 16,825,272</u>	<u>\$ 0</u>	<u>\$ 1,999,535</u>	<u>\$ 1,703,314</u>	<u>\$ 13,122,423</u>

As of June 30, 2010 the Fund had the following investments and maturities:

<u>Investment</u>	<u>Fair Value</u>	<u>Less Than 1 Year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>	<u>More Than 10 Years</u>
Federal Home Loan Mortgage Corp.	\$ 3,005,200		\$ 1,002,040		\$ 2,003,160
Federal Home Loan Bank	1,203,124			\$ 1,203,124	
Federal Farm Credit Bank	1,001,250		1,001,250		
Federal Agricultural Mortgage Corp.	1,156,970				1,156,970
Federal National Mortgage Assoc.	10,741,760		347,917	2,509,850	7,883,993
Municipal Bond	611,182				611,182
	<u>\$ 17,719,486</u>	<u>\$ 0</u>	<u>\$ 2,351,207</u>	<u>\$ 3,712,974</u>	<u>\$ 11,655,305</u>

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE B -- DEPOSITS AND INVESTMENTS - Continued

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

	<u>2011</u>	<u>2010</u>
Statement of Net Assets:		
Cash and Cash Equivalents	\$ 4,149,663	\$ 5,877,581
Investments	16,825,272	17,719,486
Total Per Statement of Net Assets	<u>\$ 20,974,935</u>	<u>\$ 23,597,067</u>

Disclosure, Deposits and Investments Plus Reconciling Items:

	<u>2011</u>	<u>2010</u>
Carrying value of deposits:		
Held by State Treasurer	\$ 182,526	\$ 174,279
Other	3,967,137	5,703,302
Carrying value of investments:		
Federal Home Loan Mortgage Corp.	1,999,535	3,005,200
Federal Home Loan Bank	2,062,529	1,203,124
Federal Farm Credit Bank		1,001,250
Municipal Bond	588,577	611,182
Federal Agriculture Mortgage Corp.	1,079,670	1,156,970
Federal National Mortgage Assn.	11,094,961	10,741,760
Total Disclosure, Deposits and Investments	<u>20,974,935</u>	<u>23,597,067</u>
Plus Reconciling Items:	<u>\$ 20,974,935</u>	<u>\$ 23,597,067</u>

NOTE C -- 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, 2011 net discounted liabilities for claims were \$16,561,166 less than those at June 30, 2010.

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 and medium ranges are \$139,908,000 and \$131,000,000, respectively as opposed to the low of \$122,093,000.

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE C -- CLAIMS LIABILITIES – Continued

As discussed in Note A, 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 last two years.

Reconciliation of Claims Liabilities		
	<u>2011</u>	<u>2010</u>
Unpaid claims at beginning of the fiscal year	\$ 155,393,166	\$ 175,766,715
Incurred Claims:		
Provision for insured events of the current fiscal year	13,500,000	20,000,000
Decreases in provisions for insured events of prior fiscal years	<u>(19,343,000)</u>	<u>(22,750,000)</u>
Total Incurred Claims	(5,843,000)	(2,750,000)
Payment of Claims:		
Attributable to events of prior fiscal years	<u>(17,517,087)</u>	<u>(17,623,549)</u>
Unpaid claims at end of the fiscal year	<u>\$ 132,033,079</u>	<u>\$ 155,393,166</u>

The schedule above is the undiscounted liabilities for both years. The total discount in 2011 was \$9,940,079 and was \$16,739,000 in 2010. The claims liabilities were discounted at a 3% and 4% discount factor for 2011 and 2010, respectively.

NOTE D -- LONG TERM LIABILITIES

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

	<u>July 1, 2010</u>	<u>Increase</u>	<u>Decrease</u>	<u>June 30, 2011</u>	<u>Due Within One Year</u>
Claims, net	\$ 138,654,166	\$ 0	\$ 16,561,166	\$ 122,093,000	\$ 16,539,000

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE E -- ACCRUED COMPENSATED ABSENCES

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

	<u>July 1, 2010</u>	<u>Increase</u>	<u>Decrease</u>	<u>June 30, 2011</u>	<u>Due Within One Year</u>
Compensated Absences	\$ 13,196	\$ 18,942	\$ 14,663	\$ 17,475	\$ 17,475

NOTE F -- ACCRUED LIABILITES

Accrued liabilities consist of the following at June 30:

	<u>2011</u>	<u>2010</u>
Accrued salaries and benefits	\$ 26,923	\$ 26,474
Accrued compensated absences	17,475	13,196
Commissions payable to agents	96,941	370,464
	<u>\$ 141,339</u>	<u>\$ 410,134</u>

NOTE G -- EMPLOYEE RETIREMENT SYSTEM

The Fund contributes to the South Carolina Retirement System ("SCRS") cost sharing multiple-employer defined benefit plan which is administered by the Retirement Division of the State Budget and Control Board along with four other independent pension plans.

A comprehensive annual financial report ("CAFR") containing financial statements and required supplementary information for the SCRS is issued and publicly available by writing to the South Carolina Retirement System, 202 Arbor Lake Drive, Columbia, South Carolina 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

As established by Title 9-1-480 Code of Laws of South Carolina, 1976 (as amended), all eligible persons, except those specifically excluded, shall become members of the retirement system as a condition of their employment. The responsibility of the administration of the system is assigned by law to the State Budget & Control Board.

SCRS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 9 of the SC Code of Laws.

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE G -- EMPLOYEE RETIREMENT SYSTEM - 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. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits. Beginning July 1, 2005, TERI participants are required by state law to make SCRS contributions. Due to the South Carolina Supreme Court decision in Layman et al v. South Carolina Retirement System and the State of South Carolina, employees who chose to participate in the TERI Program prior to July 1, 2005 will not be required to make SCRS contributions.

The following is a recap of the mandated contribution rates for the current fiscal year:

	<u>SCRS</u>
Employee Contributions	6.50% of salary
Employer Contributions	
Retirement	9.24% of salary
Insurance surcharge	3.90% of salary
Group life insurance	0.15% of salary

For the years ending June 30, 2011, 2010, and 2009 the Fund contributions to SCRS were \$36,785, \$35,083, and \$34,483 respectively.

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the agency have elected to participate. The multiple-employer plans, created under Internal Revenue Code section 457, 401(k), and 403(b) are administered by third parties and are not included in the CAFR of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employee. Employees may withdraw the current value of their contributions prior to termination if they meet requirements specified by the applicable plan. The State has no liability for losses under the plans.

NOTE H -- POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS

Plan Description: In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State provides post-employment health and dental and long-term disability benefits to retired State and school district employees and their covered dependents. The Fund contributes to the Retiree Medical Plan (RMP) and the Long-term Disability Plan (LTDP), cost-sharing multiple-employer defined benefit postemployment healthcare and long-term disability plans administered by the Employee Insurance Program (EIP), a part of the State Budget and Control Board (SBCB). 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 May 2, 2008 and after, retirees

NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE H -- POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS - Continued

are eligible for benefits if they have established twenty-five years of service for 100% employer funding and fifteen through twenty-four years of service for 50% employer funding. Benefits become effective when the former employee retires under a State retirement system. Basic long-term disability (BLTD) benefits are provided to active state, public school district and participating local government employees approved for disability.

Funding Policies: Section 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment healthcare and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the EIP and participating retirees to the SBCB except the portion funded through the pension surcharge and provided from other applicable sources of the EIP 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, 3.90% and 3.50% of annual covered payroll for 2011 and 2010, respectively. The EIP sets the employer contribution rate based on a pay-as-you-go basis. The Fund paid approximately \$10,918 and \$9,638 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2011 and 2010, respectively. BLTD benefits are funded through a per person premium charged to State agencies, public school districts, and other participating local governments.

The monthly premium per active employee paid to EIP was \$3.23 for the fiscal years ended June 30, 2011 and 2010.

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 South Carolina Retiree Health Insurance Trust Fund is primarily funded through the payroll surcharge. Other sources of funding include additional State appropriated dollars, accumulated EIP reserves, and income generated from investments. The Long Term Disability Insurance Trust Fund is primarily funded through investment income and employer contributions.

One may obtain complete financial statements for the benefit plans and the trust funds from Employee Insurance Program, 1201 Main Street, Suite 360, Columbia, South Carolina 29201.

NOTE I -- 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.

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE I -- RELATED PARTY - Continued

Other services received at no cost from the various divisions of the State Budget and Control Board 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.

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, 2011 and 2010. 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 ("*the JUA*") 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 years 2011 and 2010 was \$150,000 and \$200,000, respectively. This fee may be adjusted annually for increases in the consumer price index. The JUA is considered a discrete component unit of the State of South Carolina and is included in the State's CAFR.

NOTE J -- 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.

NOTE K -- OPERATING LEASE

The Fund leases its office space under an operating lease. In June 2007 a lease was extended obligating the Fund to a five year rental for commercial office space. The obligations under this lease as of June 30, 2011 are as follows:

For the Year	
Ending June 30	Annual Rent
<u>2012</u>	<u>\$ 41,991</u>

The Fund recorded payments under this operating lease of \$44,986 and \$44,103 for fiscal years 2011 and 2010, respectively.

NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE L -- UNEARNED MEMBERS FEES

Unearned fees liability at June 30, 2011 and 2010 were \$5,018,007 and \$6,546,498, respectively, on advance payment of membership fees. 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.

The Fund also had open credits on membership fees of \$231,925 and \$355,766 at June 30, 2011 and 2010, respectively.

NOTE M -- 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 (Office of Insurance Services).
2. Claims of covered public employees for long-term disability and group-life insurance benefits (Office of Insurance Services).
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 (Employment Security Commission).

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

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE M -- RISK MANAGEMENT - Continued

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 does not purchase insurance coverage for employee fidelity bond insurance coverage arising from theft or misappropriations.

Management believes based on exposure and likelihood of loss that this coverage is not necessary. The Fund has not incurred any expenditure over the past three years for losses from employee theft or misappropriations. The Fund has not recorded any estimated losses or expenses related to the deductible or policy limits because there is no evidence of asset impairment or other information to indicate a loss should be recorded.

NOTE N -- NET DEFICIT

The Fund has experienced large operating losses in prior years, which has resulted in a net deficit. The operating losses have been attributable to large increases in paid and reported claims, which have substantially affected the actuarial determination of claims liabilities. Contributing factors are that the Fund's coverage was unlimited, prior to 2001, the Fund did not maintain reserves for unreported claims, and the Fund does not purchase reinsurance to help defray the effect of large individual claims. Also, the Fund if needed can assess members' additional fees. This authority was exercised in April, 1998. The April 1998 special assessment approximated \$7,450,000. Also in September 2000, the Fund exercised a special assessment, which amounted to approximately \$16,000,000. To conserve cash, if necessary, the Fund can restrict payment of claims as discussed in Note J. Also as noted in Note A, the threshold for covered losses has increased to \$200,000 and \$600,000. 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. During 2009, the Board voted to discontinue offering unlimited coverage.

NOTE O -- CONSTRUCTION IN PROGRESS

Capital assets for the Fund at June 30, 2011 consist of costs related to the development of a claims based software program. The project was not complete at year end and has been classified as construction in progress. Therefore, no depreciation expense was taken during the year. The project is near completion and there are no outstanding commitments. The software is expected to be fully operational during fiscal year 2012. The following is a schedule of capital asset activity for the year ended June 30, 2011:

	July 1, 2010	Increase	Decrease	June 30, 2011
Construction in progress	\$ 389,485	\$ 76,263	\$ 0	\$ 465,748

NOTES TO THE BASIC FINANCIAL STATEMENTS
 SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND

NOTE P -- ENTERPRISE FUND INFORMATION

	<u>2011</u>	<u>2010</u>
Charges for services	\$ 18,270,867	\$ 22,708,349
Operating contributions	150,520	715,248
Less: expenses	<u>(2,591,290)</u>	<u>(2,324,611)</u>
Change in Net Assets	15,830,097	21,098,986
 Net deficit - beginning	 <u>(121,536,717)</u>	 <u>(142,635,703)</u>
Net Deficit - Ending	<u><u>\$ (105,706,620)</u></u>	<u><u>\$ (121,536,717)</u></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.

NOTE Q -- SUBSEQUENT EVENTS

Subsequent events have been evaluated through October 14, 2011, which represents the date the financial statements were available to be issued.

COMPLIANCE AND INTERNAL CONTROL

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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*

Office of the State Auditor and Board of Governors
South Carolina Medical Malpractice Patients' Compensation Fund
Columbia, South Carolina

We have audited the financial statements of the 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, 2011 as listed in the table of contents and have issued our report thereon dated October 14, 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

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 opinions 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.

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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 Governor of the State of South Carolina, the State Auditor and the Fund's Board of Governors and management and is not intended to be and should not be used by anyone other than these specified parties.

Columbia, South Carolina
October 14, 2011

The Halle Group, P.A.