

**SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM**

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**AUDITED FINANCIAL STATEMENTS**

---

**YEAR ENDED JUNE 30, 2012**

**WITH**

**REPORT OF INDEPENDENT AUDITORS**

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EMPLOYEE INSURANCE PROGRAM

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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, Employee Insurance Program (the "Fund") as of and for the year ended June 30, 2012, 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, Employee Insurance Program. 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 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 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, Employee Insurance Program 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 Employee Insurance Program 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, 2012 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 previously present fairly, in all material respects, the respective financial position of the governmental activities of the South Carolina State Budget and Control Board, Employee Insurance Program, as of June 30, 2012, 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 October 1, 2012, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in accessing the results of our audit.

Accounting Principles Generally Accepted in the United States of America requires that the Management's Discussion and Analysis on pages 3 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*DeLoach & Williamson, C.C.P.A.*

October 1, 2012

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The financial statement presentation required under governmental accounting standards provides a comprehensive perspective of EIP's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows. This section of the South Carolina State Budget and Control Board, Employee Insurance Program (EIP) Audited Financial Statements and Other Financial Information presents management's discussion and analysis of EIP's financial performance during the fiscal year ended June 30, 2012. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

### **Financial Highlights:**

Business Type activities reported a decrease in net assets of \$33,130,066 and total net assets of \$178,862,488 for the year ended June 30, 2012. In comparison, an increase in net assets of \$118,654,817 was reported for the year ended June 30, 2011 with total net assets of \$211,992,554 at 2011 year-end.

### **Overview of Financial Statements:**

The Employee Insurance Program is an internal service fund proprietary type engaged in governmental activities. Following is a condensed Statement of Net Assets, a condensed Statement of Activities and a condensed Statement of Cash Flows.

The Statement of Net Assets presents the financial position of EIP at the end of the fiscal year and requires classification of assets and liabilities into current and noncurrent categories. The difference between total assets and total liabilities is reflected in the net assets section, which displays unrestricted net assets. Net assets are generally an indicator of the current financial condition of EIP, while the change in net assets is generally an indicator of the overall financial condition for the year.

In accordance with the provisions of the South Carolina Retiree Health Insurance Trust (Trust), excess Plan reserves above 140% of incurred but not reported claims as of December 31 each year will be transferred to the Trust the following January. This year, \$103,993,027 was transferred to the Trust. The increase in net assets before this transfer amounted to \$70,862,961, which is attributed to better than expected claims trend.

The Statement of Revenue, Expenses, and Changes in Net Assets present revenues and expenses as operating and are detailed by classification.

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 investing activities.

**Financial Analysis of EIP:**

This schedule is a condensed version of EIP's assets, liabilities, and net assets and is prepared from the Statement of Net Assets.

**Condensed Statements of Net Assets  
(in millions)**

	<b>June 30, 2012</b>	<b>June 30, 2011</b>
<b>Assets</b>		
Current assets	\$ 383.6	\$ 364.8
Noncurrent assets:	-	-
Total assets	<u>383.6</u>	<u>364.8</u>
<b>Liabilities</b>		
Current liabilities	204.5	152.5
Noncurrent liabilities	0.2	0.3
Total liabilities	<u>204.7</u>	<u>152.8</u>
<b>Net assets</b>		
Investment in capital assets	-	-
Unrestricted	165.3	184.8
Restricted	13.6	27.2
Total net assets	<u>\$ 178.9</u>	<u>\$ 212.0</u>

The following schedule is a summary of the EIP's operating results for the fiscal year.

**Condensed Statements of Activities**  
**Year Ended June 30,**  
**(in millions)**

	<u>2012</u>	<u>2011</u>
Governmental activities:		
Program revenue	\$ 2,005.1	\$ 1,906.7
Expenses	(1,942.5)	(1,777.8)
Total governmental activities	<u>62.6</u>	<u>128.9</u>
General revenue and transfers:		
Earnings on deposits	8.3	6.9
Transfer to other agencies and trusts	(104.0)	(17.1)
Total general revenue and transfers	<u>(95.7)</u>	<u>(10.2)</u>
Change in net assets	<u>(33.1)</u>	<u>118.7</u>
Net assets, beginning of the year	212.0	93.3
Net assets, end of the year	<u>\$ 178.9</u>	<u>\$ 212.0</u>

A condensed version of Statement of Cash Flows is presented as follows:

**Condensed Statements of Cash Flows**  
**Year Ended June 30,**  
**(in millions)**

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities	\$ 146.4	\$ 106.9
Cash flows from noncapital financing activities	(104.0)	(17.1)
Cash flows from investing activities	8.2	6.8
Net (decrease) increase in cash and cash equivalents	50.6	96.6
Cash and cash equivalents, beginning of year	298.7	202.1
Cash and cash equivalents, end of year	<u>\$ 349.3</u>	<u>\$ 298.7</u>



## **Overview of the Employee Insurance Program:**

The Employee Insurance Program (EIP) manages group health, dental, life, accidental death and dismemberment, and disability programs as authorized in § 1-11-710 and § 1-11-720 of the South Carolina Code of Laws, as well as the long-term care program authorized in § 1-11-740, the flexible benefits program (MoneyPlus) as authorized in § 9-1-60, and the employee adoption assistance program, pursuant to Proviso 80A.14 of the 20012-2013 General Appropriations Act.

Following is a list of benefits offered by EIP differentiated according to self-insured versus insured status.

### **Self-Insured Programs**

- State Health Plan:
  - Standard Plan (PPO)
  - Medicare Supplement
  - Savings Plan (HDHP)
- BlueChoice (HMO)
- CIGNA (HMO)
- State Dental Plan
- Basic Long Term Disability
- Adoption Assistance Program

### **Insured Programs**

- Dental Plus
- State Life
- Optional Life
- Dependent Life
- Long Term Care
- Supplemental Long Term Disability
- Vision

Benefits are offered to eligible employees and retirees of all state agencies and public school districts, and many local governments. As of June 2012, 676 employers participate in the program. The State Health Plan is EIP's "flagship" product, a "Preferred Provider Organization" model plan which encompasses medical, prescription drug, and behavioral health coverage. The State Health Plan is the most significant driver of EIP's financial activity, accounting for approximately 92% of all medical revenue.

## Overview of the State Health Plan:

The State Health Plan (Plan) consists of the Standard Plan, the Medicare Supplement Plan, and the Savings Plan. The majority of Plan subscribers (77%) are enrolled in the Standard Plan, a PPO option available to non-Medicare and Medicare enrollees. Of the remaining subscribers, 20% are enrolled in the Medicare Supplement, a retiree option for those enrolled in Medicare and 3% are enrolled in the Savings Plan. The Savings Plan is a qualified high deductible health plan (HDHP) available to non-Medicare enrollees.

The State Health Plan remains competitive with other southern state health plans in terms of plan deductibles, coinsurance, and prescription drug coverage. In aggregate, the employer contributes around 72% of the total contribution for State Health Plan coverage. The Plan self-contracts provider networks for hospitals and physicians. These networks continue to maintain extremely high participation rates. Following is a look at total enrollment in the State's medical insurance programs and enrollment in the State Health Plan (as of June 2012).

	<u>Program</u>	<u>State Health Plan</u>
<b>Total Insured Persons:</b>	<b>440,966</b>	<b>417,036</b>
Subscribers:	252,065	235,375
Spouses:	71,478	69,791
Children:	117,423	111,870
<b>Total Subscribers:</b>	<b>252,065</b>	<b>235,375</b>
Employees:	174,628	160,201
Retirees:	73,860	71,673
Survivors:	2,687	2,658
COBRA:	890	843
<b>Active Employees:</b>	<b>174,628</b>	<b>160,201</b>
State Agencies:	57,190	51,934
School Districts:	79,299	73,371
Local Government	38,139	34,896

**State Health Plan Premiums:**

The State Health Plan operates under a 4-tier premium structure, varying contribution levels according to level of coverage. The coverage levels include Employee Only, Employee/Spouse, Employee/Child, and Full Family. As of June 30, 2012, 56% of subscribers had Employee Only coverage, and the remaining 44% covered at least one dependent.

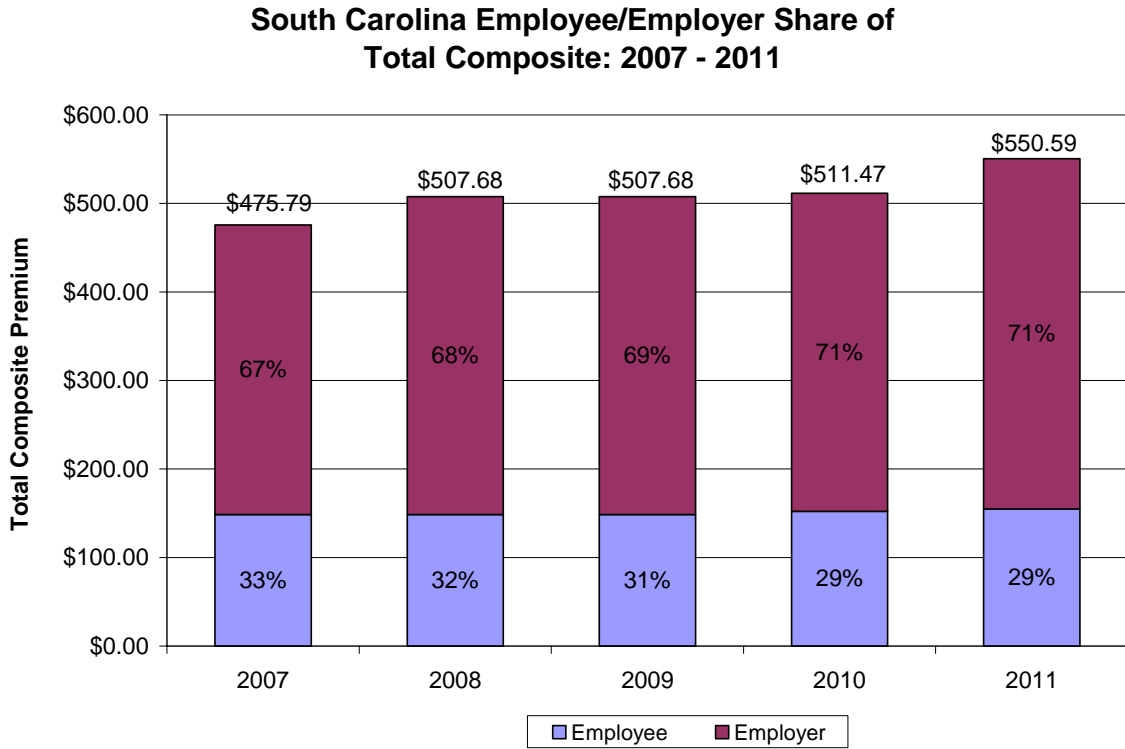
Premiums range from **\$4,675.20 annually** for Employee Only coverage to **\$12,366.72 annually** for Full Family coverage. Following are the monthly 2012 State Health Plan employee and employer rates.

**2012 State Health Plan  
(Standard Plan)  
Monthly Premiums**

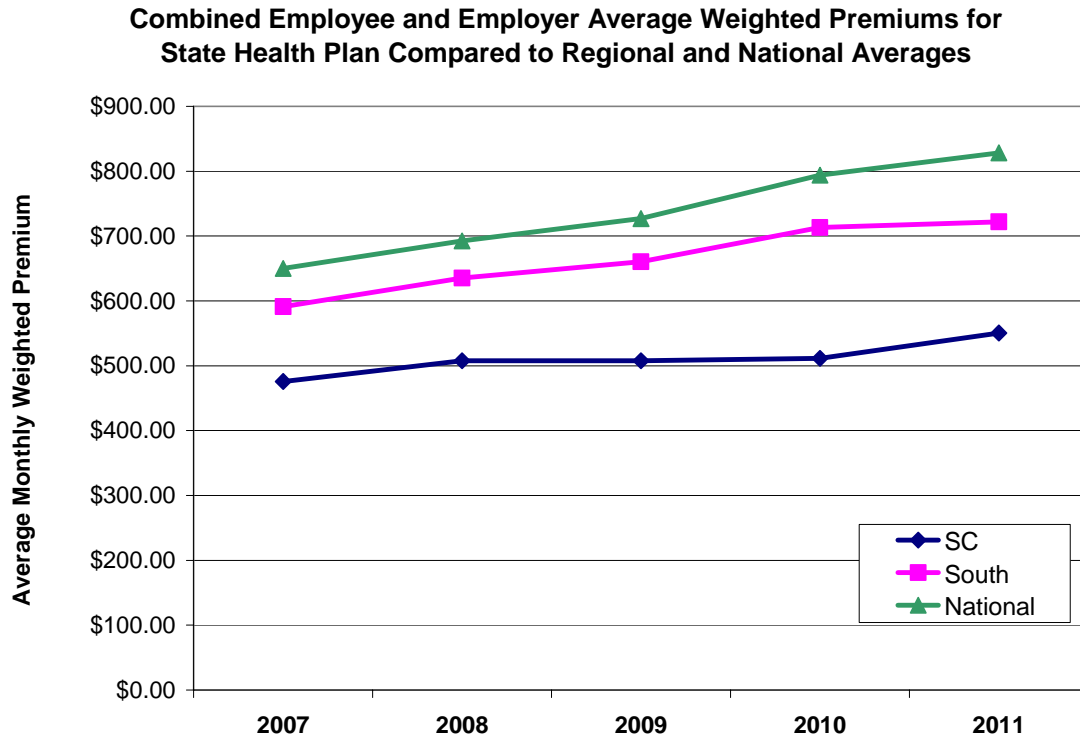
	<u>Employee</u>	<u>Employer</u>	<u>Total</u>
Employee Only	\$ 97.68	\$ 291.92	\$ 389.60
Employee/Spouse	\$ 253.36	\$ 578.24	\$ 831.60
Employee/Child	\$ 143.86	\$ 448.06	\$ 591.92
Full Family	\$ 306.56	\$ 724.00	\$ 1,030.56
<b>Composite Rate</b>	<b>\$ 160.72</b>	<b>\$ 413.65</b>	<b>\$ 574.37</b>

Premium revenue is shared between the employer and the employee (or retiree).

For 2012, the employer and employee share of premiums increased 4.5%. The 2012 employee share reflects 29% of the total premium.

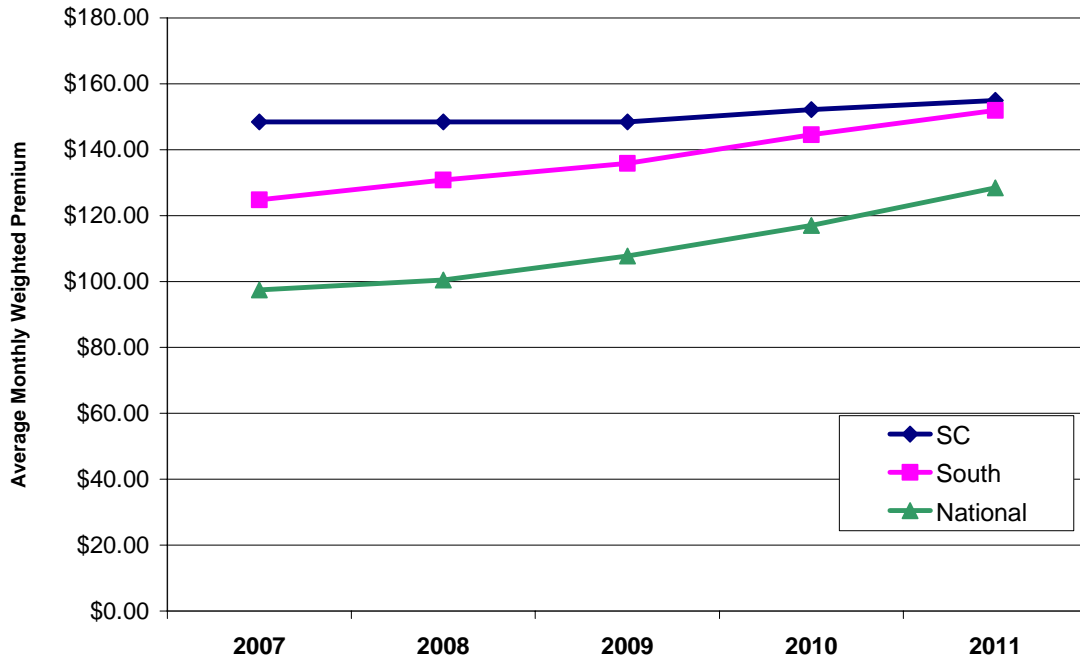


The 2011 composite total premium remains fairly well below both the southern and national levels. For 2012, the State Health Plan composite total premium was approximately 77% of the southern premium and 68% of the national premium.



Employees saw their first premium increase in 2012 after six consecutive years of no increases. Even so, the SHP employee composite remains above both the regional and national composite, due to prior years of employer contribution levels remaining either stagnant or increasing at levels insufficient to sustain claims expense.

**Average Weighted Employee Premiums for State Health Plan  
Compared to Regional and National Averages**



**State Health Plan Contribution Increases:**

Contribution increases since 1999 are outlined below.

**State Health Plan  
Contribution Increases**

	<b>Employer Rate Increase</b>	<b>Employee Rate Increase</b>	<b>Total</b>
1999	18.0%	0.0%	14.0%
2000	10.0%	0.0%	8.0%
2001	20.0%	10.4%	18.3%
2002	9.5%	22.6%	11.7%
2003	0.0%	36.9%	6.9%
2004	0.0%	27.6%	6.6%
2005	6.1%	29.7%	13.0%
2006	4.8%	0.0%	3.2%
2007	3.1%	0.0%	2.1%
2008	9.7%	0.0%	6.7%
2009	0.0%	0.0%	0.0%
2010	0.0%	0.0%	0.0%
2011	10.3%	0.0%	7.2%
2012	4.5%	4.5%	4.5%

**Status of the Plan:**

The State Health Plan continues to see improvement in its financial condition. For four consecutive years from 2000 through 2003, the Plan ended the year with either a deficit or a near zero cash balance. As a result of Budget & Control Board actions taken in August 2003 for a January 2004 effective date, as well as continuing management actions initiated by EIP, the Plan is currently in a stable financial position and has had been able to transfer excess cash reserves during this reporting period, as well as for the previous three reporting periods, to the South Carolina Retiree Trust Fund.

The Plan's stability can be attributed to the positive claims experience of recent years. Claims expenditure growth in each year since 2004 has been less than that commonly cited in the health insurance market. Following are the changes in growth rate in payments per subscriber since 2001.

<u>Plan Year</u>	<u>Change in Payout/Subscriber</u>
2001	+11.0%
2002	+8.3%
2003	+12.9%
2004	-0.7%
2005	+4.7%
2006	+7.0%
2007	+6.3%
2008	+3.9%
2009	+9.1%
2010	+0.5%
2011	+3.5%

While some of the reduction in Plan trend can be attributed to additional patient cost sharing, the majority of the positive impact is tied to overall healthcare spending reductions observed nationally, and more significantly, decreased utilization trends stemming from Plan design changes implemented in 2004. Positive outcomes from management actions taken in recent years to address Plan spending are also contributing to the reduction seen in Plan trend.



Following are the medical utilization rates (and growth rates) per 1000 insured persons (SHP primary) from 2000 through 2009 for office visits, ER visits, inpatient cases, and outpatient surgery.

	Office Visits		ER Visits		I/P Cases		O/P Surgery	
	Utilization	Growth	Utilization	Growth	Utilization	Growth	Utilization	Growth
2000	\$5,492.54		\$ 253.76		\$ 67.76		\$ 105.54	
2001	5,856.76	+6.6%	254.99	+0.5%	69.27	+2.2%	101.11	-4.2%
2002	5,936.99	+1.4%	251.34	-1.4%	68.99	-0.4%	102.66	+1.5%
2003	6,230.36	+4.9%	253.66	+0.9%	69.03	+0.1%	114.39	+11.4%
2004	6,119.04	-1.8%	235.97	-7.0%	68.88	-0.2%	115.19	+0.7%
2005	6,287.92	+2.8%	240.27	+1.8%	63.93	-7.2%	106.87	-7.2%
2006	6,391.54	+1.6%	239.22	-0.4%	62.82	-1.7%	99.57	-6.8%
2007*	6,519.21		184.15		63.23		205.58	
2008	6,495.30	-0.4%	181.69	-1.3%	61.29	-3.1%	208.18	+1.3%
2009	6,798.85	+4.7%	189.44	+4.3%	60.40	-1.5%	209.76	+0.8%
2010	6,365.96	-6.4%	181.97	-3.9%	58.44	-3.2%	219.12	+4.5%
2011	6,279.88	-1.4%	184.17	1.2%	56.39	-3.5%	226.47	+3.4%

\* Improved data collection methods beginning in 2007 more accurately capture place of service.

Prescription drug utilization has also moderated, as well as shifted to more cost effective delivery channels, as indicated below.

	Rx/Insured		Generic Share	Mail Service Share
	Utilization	Growth		
2000	\$ 13.12		34.9%	n/a
2001	14.75	+12.5%	34.8%	n/a
2002	15.75	+6.9%	37.1%	3.8%
2003	17.10	+8.5%	39.1%	4.7%
2004	16.81	-1.7%	43.3%	9.6%
2005	17.46	+3.9%	47.1%	9.5%
2006	17.99	+3.0%	50.5%	9.8%
2007	18.41	+2.3%	55.2%	9.9%
2008	18.22	-1.0%	61.3%	9.9%
2009	18.31	+0.5%	62.9%	9.2%
2010	18.10	-1.4%	67.4%	8.9%
2011	17.95	-0.6%	70.2%	8.5%

Cost containment initiatives continue to influence the Plan's positive trend and include:

- Provider reimbursement pricing policy with provider networks (inpatient and outpatient hospital settings, professional fee schedules and pharmacy pricing)
- Utilization review and management (precertification of inpatient cases and certain outpatient procedures, disease management of specified conditions, complex care management and chronic kidney disease management)
- Chiropractic limit of \$2,000/person/year and limit of one manual therapy unit per visit (implemented 2010)
- Pre-authorization process for high-end radiology procedures (implemented 2010)
- Tobacco surcharge of \$40/contract/month for members with single coverage who use tobacco and \$60/contract/month for members with dependent coverage who use tobacco or cover a family member that does
- "Evidence-based medicine" initiative involving analysis of claims data and communications with doctors regarding best practices
- Mail service pharmacy through Pharmacy Benefits Manager
- Prior authorization/step therapy requirements for specified medications, including "preferred step therapy" program to steer business to "front-line" generics
- Preferred drug list
- "Pay-the-difference" policy for brand drugs with generic equivalents
- Managed care approach for behavioral health services
- "Gold standard" smoking cessation program
- Health education, disease management workshops, and preventive screenings provided through office wellness staff
- Voluntary Data Sharing Agreement with Medicare (maintain current Medicare eligibility on all subscribers)
- Coordination of benefits (COB) with Medicare for 2011 totaled \$1.397 B. through the third quarter (efforts to maintain accurate Medicare eligibility for retirees continue to produce significant savings)
- Self-funding of all HMO business
- Significant patient cost sharing for all service types
- Pharmaceutical manufacturer rebates (for all health plans); the Plan received about \$62 M. in rebates during 2011
- Medicare Part D prescription drug subsidies; the Plan received about \$41 M. in subsidies during 2011
- A Wellness Incentive, which provides free generic drugs for participants with cardiovascular disease or diabetes who participate in a wellness program for these conditions (implemented 2010)

## **Going Forward:**

Several points of interest going into 2012 include:

- EIP will retain its “grandfathered” status under the Patient Protection and Affordable Care Act for 2013
- This year’s legislative session provided for a 4.6% increase in the employer and employee contribution rates beginning January 2013
- The dependent audit that was implemented in the spring of 2011, continues to yield results in line with estimates of an ineligibility rate of 4% to 8% (audit will continue into 2013)
- HMO changes for 2013, include no longer offering CIGNA as an option, and offering BlueChoice on a fully insured basis
- Effective July 1, 2012, the South Carolina Public Benefit Authority (PEBA) was created by the South Carolina General Assembly as part of Act No. 278. PEBA is responsible for the administration and management of the state’s employee insurance programs and retirement systems.

Always a significant challenge is the anticipation of re-acceleration of health care trend. Although we continue to experience stable growth, the dynamics that drive health care expenditure growth remain present, including an aging population, advances in medical technology, third-party payment, and government regulations.

## **Contact Information:**

Please direct questions related to the Management Discussion and Analysis and the accompanying financial statements to Phyllis Buie, Chief Financial Officer, at (803) 734-0326.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

STATEMENT OF NET ASSETS

JUNE 30, 2012

**Assets**

Current assets:

Cash and cash equivalents	\$ 349,317,213
Premiums receivable	3,379,597
Prescription drug rebate receivable	23,983,941
Medicare Part D Subsidy receivable	6,693,110
Other receivables	19,374
Accrued interest	61,601
Due from South Carolina Retiree Health Insurance Trust Fund	90,847
Due from South Carolina Long Term Disability Trust Fund	26,200
Total current assets	383,571,883

Non-current assets:

Capital assets, net of accumulated depreciation	17,284
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Total assets	383,589,167
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**Liabilities**

Current liabilities:

Accounts payable and accrued payroll	852,348
Accrued compensated absences - current portion	176,157
Deferred premium revenue	26,650,398
Claims payable	41,856,329
Claims incurred but not reported	134,944,687
Total current liabilities	204,479,919

Long-term liabilities:

Accrued compensated absences - long term	246,760
Total long-term liabilities	246,760

Total liabilities	204,726,679
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Contingencies (*Note 10*)

**Net Assets**

Investment in capital assets	17,284
Unrestricted	165,273,953
Restricted for USDHHS Early Retiree Reinsurance Program	13,571,251
Total net assets	\$ 178,862,488

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

STATEMENT OF REVENUE, EXPENSES,  
AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2012

**Operating Revenue**

Insurance premiums:	
Active employees	\$ 1,383,051,933
Retirees	505,044,180
Total insurance premiums	1,888,096,113
Prescription drug rebates	69,851,431
Medicare Part D Subsidy	35,201,405
Administrative fees and other	11,927,653
Total operating revenue	2,005,076,602

**Operating Expenses:**

Claims	1,771,543,326
Premiums	104,363,218
Third party administrative fees	57,030,894
Salaries and benefits	5,122,797
Other services	2,724,535
Professional services	799,244
Adoption assistance program	249,626
Supplies	216,233
Telephone and utilities	71,209
Other operating expenses	351,194
Total operating expenses	1,942,472,276

Operating income	62,604,326
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Non-operating revenue:

Income from deposits	8,258,635
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Transfers:

Transfers to/from other state agencies and OPEB trusts	(103,993,027)
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Change in net assets	(33,130,066)
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Net assets, beginning of year	211,992,554
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Net assets, end of year	\$ 178,862,488
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*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

**Cash Flows from Operating Activities**

Insurance premiums from customers	\$ 1,909,319,146
Other receipts	148,021,915
Payments to employees	(5,167,194)
Payments to providers, suppliers and others	<u>(1,905,792,726)</u>
Net cash provided by operating activities	<u>146,381,141</u>

**Cash Flows from Noncapital Financing Activities**

Transfers to other state agencies and interfund transfers	<u>(103,993,027)</u>
Net cash used in noncapital financing activities	<u>(103,993,027)</u>

**Cash Flows from Investing Activities**

Interest received-deposits and investments	8,290,196
Purchase of capital assets	<u>(60,233)</u>
Net cash provided by investing activities	<u>8,229,963</u>

Net increase in cash and cash equivalents	50,618,077
Cash and cash equivalents, beginning of year	<u>298,699,136</u>
Cash and cash equivalents, end of year	<u><u>\$ 349,317,213</u></u>

(CONTINUED)

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

(CONTINUED)

<b>Reconciliation of operating income to net cash provided by operating activities</b>	
Operating income	\$ 62,604,326
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	58,675
Change in assets:	
Premiums receivable	(573,050)
Prescription drug rebate receivable	(6,061,825)
Medicare Part D Subsidy receivable	(791,409)
Due from South Carolina Retiree Health Trust	39,182,301
Due from South Carolina Long Term Disability Trust	(5,000)
Change in liabilities:	
Accounts payable, accrued payroll and compensated absences	(466,739)
Deferred premium revenue	20,512,381
Claims payable and incurred but not reported	31,921,481
Net cash provided by operating activities	<u>\$ 146,381,141</u>

*See accompanying notes.*

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012

**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, Employee Insurance Program (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.

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SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

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 (the “Board”), Employee Insurance Program 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.

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 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.

The group health, dental, life, accidental death and dismemberment and disability programs managed by the Fund are authorized in Sections 1-11-710 and 1-11-720 of the South Carolina Code of Laws of 1976, as amended.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

The Employee Insurance Program provides health insurance to eligible employees and retirees of State agencies and its political subdivisions who elect coverage. Coverage elections include four self-insured health plans. The State Health Plan offers a High Deductible Health Plan (SHP Savings Plan), a Preferred Provider Organization (SHP Standard Plan) and Medicare Supplement. The Traditional HMOs offered are the BlueChoice HMO and CIGNA HMO. The HMO with the Point of Service Option was MUSC Options, which ended December 31, 2008. All dental coverage is through the State's self-insured plan, which is available to eligible employees and retirees. An additional dental option is offered to subscribers, Dental Plus, which is a fully insured product. The Basic Long-Term Disability Plan is a self-insured group long-term disability plan available to eligible active employees enrolled in a State health plan. Supplemental long-term disability, a fully insured product, is also offered to subscribers. Optional Life and Dependent Life are fully insured products offered to eligible employees. Long-term care insurance, a fully insured program, is also available to eligible employees. For active employees, the employee share of premiums is paid through payroll deductions. The respective employer pays the employer's premium portion for active employees. For retirees of the State and School Districts, the employee portion of the premiums is withheld from the individual retirement check. The employer premium share for retirees of the State and School Districts is paid through retiree insurance surcharge. For Local Subdivisions, the employer is responsible for collecting the retiree premium and remitting the entire premium to the Employee Insurance Program. Effective May 2008, Basic Long Term Disability premiums were transferred to the Long Term Disability Insurance Trust Fund in accordance with Act 195. Basic Long Term Disability Claims are transferred each month out of this Trust.

The South Carolina Retirement System began transferring the surcharge for state agencies and school districts effective with the May 2008 surcharge in accordance with Act 195. Effective May 2008, the Fund began transferring the employer portion of retiree premiums from the South Carolina Retiree Health Insurance Trust Fund for claims payment.

Details on eligibility requirements and coverage for all plans are contained in the *Insurance Benefits Guide*. Premium rates for all plans are reviewed on a calendar year basis and adjusted as considered necessary after actuarial calculation.

The State as the predominant participant retains the risk of loss for the self-insured health, dental and basic long-term disability coverages.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Basis of Presentation

The financial statements present all proprietary funds of the South Carolina State Budget and Control Board, Employee Insurance Program.

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

Employee Insurance Program 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. Revenues are 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  
EMPLOYEE INSURANCE PROGRAM

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 and proprietary activities as prescribed by GASB. Accordingly, the Fund applies all applicable GASB pronouncements and its predecessors those applicable standards issued by the Financial Accounting Standards Board 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 internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. 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. For credit risk information pertaining to the internal cash management pool, see the deposits disclosures in *Note 2*.

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. 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.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Premium Revenue

Premiums billed to employers, employees and retirees (premiums receivable) for insurance coverage are recorded as revenue when earned on a monthly basis. The retiree surcharge on employees is recognized as the liability is incurred by the various State agencies and school districts.

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.

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 assets, 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, award trends, and estimates of health care trend (cost, utilization and intensity of services) changes. 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. Amounts for allocated and unallocated claims adjustment expenses have been included in the calculation of IBNR.

Claims Payable

Claims payable represents claims related to health claims, dental claims and long-term disability claims payable at June 30, 2012. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Fund.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

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 Board'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 recorded 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 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 use both restricted and unrestricted resources against restricted resources then unrestricted resources.

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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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. Deposits**

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

Deposits

All deposits with financial institutions are required to be insured or collateralized with securities held by the State or its agent in the State Treasurer's name as custodian. At June 30, 2012, the Fund had no deposits with financial institutions. The Fund had cash of \$349,317,213 held by the State Treasurer as of June 30, 2012.

Fair market value for cash and cash equivalents reported approximate the carrying value.

During the year, the following amounts were included in income from deposits:

Interest earned	<u><u>\$ 8,258,635</u></u>
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SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**2. Deposits (Continued)**

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

	Statements	Note Disclosure
Held by State Treasurer:		
Cash and cash equivalents	\$ 349,317,213	\$ -
Deposits	-	349,317,213
Total	\$ 349,317,213	\$ 349,317,213

**3. Premiums Receivable**

Premiums receivable at June 30, 2012, consist of the following:

Local government	\$ 1,273,435
State government ( <i>Note 9</i> )	1,235,251
Individuals	382,859
School districts	401,455
Other	86,597
	\$ 3,379,597

As of June 30, 2012, all of the receivables are considered 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, 2012.



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**4. Capital Assets**

The following summarizes changes in capital assets for the year.

	<b>Balance July 1, 2011</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2012</b>
Furniture and equipment	\$ 276,177	\$ 60,233	\$ -	\$ 336,410
Accumulated depreciation	(260,451)	(58,675)	-	(319,126)
Capital assets, net	\$ 15,726	\$ 1,558	\$ -	\$ 17,284

Depreciation expense for the year ended June 30, 2012 was \$58,675.

**5. Lease Obligations**

The Fund leases office space from a party outside of State government and is accounted for as an operating lease. The office space lease was amended effective July 1, 2010, with a monthly charge of \$21,392. This lease expires on June 30, 2020. Rental expense under this lease for the year ended June 30, 2012 was \$196,516.

The future minimum lease payments due under this lease is:

<b>Year Ending June 30,</b>	
2013	\$ 256,698
2014	256,698
2015	256,698
2016	256,698
2017	276,659
Thereafter	829,978
	\$ 2,133,429

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**5. Lease Obligations (Continued)**

The Fund has also entered into an operating lease from a party outside of 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, 2012, expenses under this lease was approximately \$31,589.

**6. Pension Plans**

The Retirement Division (the “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 is publicly available on the South Carolina Retirement Systems website at [www.retirement.sc.gov](http://www.retirement.sc.gov). Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina. The South Carolina Retirement System also administers the State Optional Retirement Program (ORP) which is a defined contribution plan.

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 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**6. Pension Plans (Continued)**

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 five 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.

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 eligible 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, 2012, the employer contribution rate was 9.385 percent (before a surcharge to fund retiree health and dental insurance coverage). For the years ended June 30, 2011 and 2010, the rate was 9.24 percent. The Fund's actual contributions to the SCRS for the years ended June 30, 2012, 2011 and 2010 were approximately \$534,798, \$558,053 and \$535,477 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 0.15 percent of compensation.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**6. Pension Plans (Continued)**

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).

The Systems do 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 in which appropriations were included 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.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**7. 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.

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 contribution to this trust fund for the fiscal year ended June 30, 2012, 2011 and 2010 were \$167,766, \$162,207 and \$145,230, which equaled the required contribution rates of 4.30%, 3.90% 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, \$3.22 and \$3.23 for the fiscal years ended June 30, 2012, 2011 and 2010, respectively.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**7. Post Employment and Other Employee Benefits (Continued)**

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.

*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 \$421,969, \$383,684 and \$349,366 for the years ended June 30, 2012, 2011 and 2010, respectively.

**8. 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, 2012.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities**

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

Services received at no cost include payroll processing, disbursement processing and maintenance of certain accounting records from the Comptroller General; check preparation, banking and investment functions from the State Treasurer; and legal services from the Attorney General.

The following services are 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.

Insurance coverage for state agencies and local governments:

- Health
- Dental
- Vision
- Life
- Long-Term Disability

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

The following details the insurance premiums charged by the Fund to other state agencies and divisions of the South Carolina State Budget and Control Board during the year ended June 30, 2012:

Adjutant General's Office	\$ 1,388,695
Aid to Subdivisions	466,940
Aiken Technical College	993,789
Attorney General's Office	1,024,631
Budget and Control Board - State Auditor	181,595
Central Carolina Technical College	1,644,591
Clemson University	29,736,511
Coastal Carolina University	7,409,561
College of Charleston	10,053,909
Commission on Higher Education	283,619
Comptroller General's Office	181,291
Denmark Technical College	658,490
Department of Agriculture	919,371
Archives and History Department	296,389
Department of Education	6,992,579
Department of Health and Environmental Control	24,725,782
Department of Labor, Licensing and Regulations	2,421,653
Department of Mental Health	25,953,904
Department of Parks, Recreation and Tourism	2,711,778
Department of Revenue	4,666,768
Department of Social Services	21,554,513
Department of Transportation	32,501,857
Department of Employment and Workforce	6,846,405
Florence-Darlington Technical College	1,698,799
Forestry Commission	2,397,187
Francis Marion University	3,613,610
Governor's Office - Executive Control of State	103,897
Governor's Office - Executive Policy and Programs	1,691,450
Governor's Office - Mansions and Grounds	43,960
Greenville Technical College	5,231,677
Department of Health and Human Services	7,712,199
Higher Education Tuition Grants Commission	34,622
Horry-Georgetown Technical College	2,291,556
House of Representatives - Clerical	1,390,407
John De La Howe School	432,467
Lander University	2,703,648
Legislative Audit Council	113,400



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

Legislative Audit Council	184,986
Legislative Printing, Information and Technology Systems	153,627
Lieutenant Governor's Office	264,118
Medical University Hospital Authority	39,075,472
Medical University of South Carolina	31,611,282
Midlands Technical College	3,915,923
Northeastern Technical College	647,004
Office of Regulatory Staff	459,267
Orangeburg-Calhoun Technical College	1,327,093
Patients' Compensation Fund	45,699
Patriot's Point Development Authority	493,647
Piedmont Technical College	2,018,653
Procurement Review Panel	4,998
Public Service Commission	317,007
Retirement System Investment Commission	180,922
Arts Commission	129,456
Department of Consumer Affairs	179,291
Department of Insurance	541,489
Department of Motor Vehicles	7,547,993
Department of Natural Resources	5,146,833
Department of Probation, Parole and Pardon Services	4,089,429
Education Oversight Committee	33,743
Educational Television Commission	1,113,999
Human Affairs Commission	127,677
Jobs-Economic Development Authority	12,306
South Carolina School for the Deaf and Blind	2,599,677
State Library	236,034
State Senate - Clerical	1,182,287
South Carolina State University	5,028,081
South Carolina Workers' Compensation Commission	387,921
Department of Public Safety	10,094,026
Administrative Law Court	216,132
Commission for the Blind	675,181
Commission for Indigent Defense	468,708
Commission on Prosecution Coordination	316,977
Department of Commerce	477,987
Department of Juvenile Justice	8,779,056
Department of Alcohol and Other Drug Abuse Services	243,951

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

Department of Disabilities and Special Needs	11,647,508
Housing Finance and Development Authority	844,048
Sea Grant Consortium	98,787
Second Injury Fund	163,660
Secretary of State's Office	184,681
Aeronautics Commission	71,618
Budget and Control Board	6,938,240
South Carolina Conservation Bank	6,783
Criminal Justice Academy	868,813
Department of Corrections	35,783,616
First Steps to School Readiness	98,624
Judicial Department	3,975,482
State Museum Commission	200,775
Spartanburg Community College	2,208,613
State Accident Fund	480,564
Technical and Comprehensive Education	472,593
Board of Financial Institutions	271,948
Commission for Minority Affairs	59,638
State Election Commission	88,484
State Ethics Commission	45,660
State Law Enforcement Division	3,045,173
State Treasurer's Office	444,236
Technical College of Lowcountry	1,012,523
The Citadel	4,386,858
Tri County Technical College	2,434,017
Trident Technical College	5,047,761
University of South Carolina	48,151,251
Department of Vocational Rehabilitation	7,661,158
Wil Lou Gray School	373,369
Williamsburg Technical College	428,850
Winthrop University	6,037,813
York Technical College	2,198,015
	\$ 489,132,591

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

The South Carolina Retiree Health Insurance Trust Fund was established by the State of South Carolina through Act 195 on May 1, 2008. In accordance with Act 195, the Trust was created to provide for the employer costs of retiree post-employment health and dental insurance benefits for retired state employees and retired employees of public school districts. The Employee Insurance Program administers the Trust and the State Budget and Control Board is the Trustee. The State Treasurer is the custodian of the funds held in the Trust and invests those funds in accordance with the statutes of the State. The primary sources which finance the health and dental benefits the Trust provides are the collection of Employer Contributions, additional State appropriations, accumulated Employee Insurance Program reserve balances, and income generated from investments. In accordance with the Act, an annual transfer is based on an actuarial calculation of the amount of cash reserves available over 140% of the incurred but not reported claims. The amount of this transfer was \$103,993,027 in 2012.

The South Carolina Long Term Disability Trust Fund was established by the State of South Carolina through Act 195 on May 1, 2008. In accordance with Act 195, the Trust was created to fund and account for the employer costs of the State's Basic Long-Term Disability Income Benefit Plan. The Employee Insurance Program administers the Trust and the State Budget and Control Board is the Trustee. The State Treasurer is the custodian of the funds held in the Trust and invests those funds in accordance with the statutes of the State. The primary sources which finance the long-term disability benefits the Trust provides are investment income and the collection of employer contributions.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

The Fund had financial transactions with various State agencies during the fiscal year. Significant payments were made to Divisions (Funds) 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, personnel services, unemployment, and workers' compensation coverage for employees. The identifiable amounts of 2012 expenses applicable to related party transactions are as follows:

South Carolina Retirement Division	\$ 534,798
South Carolina State Accident Fund	16,348
South Carolina Department of Employment and Workforce	<u>5,248</u>
	<u>\$ 556,394</u>

In addition, transfers include the following:

Transfer of funds to the South Carolina Retiree Health Insurance Trust Fund	\$ 103,993,027
Total transfers	<u>\$ 103,993,027</u>

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

A significant portion of the Fund's total insurance premium revenue is for insurance premiums charged to other state agencies and divisions of the South Carolina State Budget and Control Board. Premiums owed from these entities at June 30, 2012 were:

Adjutant General's Office	\$ 1,431
Attorney General's Office	1,287
Central Carolina Technical College	404
Clemson University	4,086
College of Charleston	129
Commission on Higher Education	1,801
Department of Agriculture	1,350
Department of Archives and History	12
Department of Education	98
Department of Health and Environmental Control	1,272
Department of Labor, Licensing and Regulation	261,750
Department of Mental Health	37,807
Department of Parks, Recreation and Tourism	149,991
Department of Revenue	210,652
Department of Social Services	7,782
Department of Transportation	35,344
Department of Employment and Workforce	12,099
Forestry Commission	2,870
Governor's Office - Executive Policy and Programs	21,270
Governor's Office - Mansions and Grounds	31
Greenville Technical College	1,987
Department of Health and Human Resources	7,478
John D. La Howe School	426
Lieutenant Governor's Office	65
Medical University of South Carolina	20
Patients' Compensation Fund	58
Patriot's Point Development Authority	30,933
Public Service Commission	48
Retirement System Investment Commission	25
Arts Commission	200
Department of Probation, Parole and Pardon Services	235,946
Educational Television Commission	8,886
South Carolina School for the Deaf and Blind	1,073
State Library	192
South Carolina Worker's Compensation Fund	1,818
Department of Public Safety	782

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**9. Transactions with State Entities (Continued)**

Department of Consumer Affairs	6,902
Department of Insurance	423
Department of Motor Vehicles	34,859
Department of Natural Resources	9,036
Administrative Law Court	4,279
South Carolina Commission of the Blind	103
Commission on Indigent Defense	1,852
South Carolina Commission of Prosecution Coordination	93
Department of Commerce	52
Department of Juvenile Justice	932
Department of Alcohol and Other Drug Abuse Services	1,350
Department of Disabilities and Special Needs	84,496
Sea Grant Consortium	13,434
Second Injury Fund	1,342
Secretary of State's Office	799
Aeronautics Division	228
Budget and Control Board	44
South Carolina Criminal Justice Academy	150
Department of Corrections	8,506
Judicial Department	32
State Museum Commission	1,288
State Accident Fund	750
Technical and Comprehensive Education	150
Board of Financial Institutions	1,474
State Treasurer's Office	343
Department of Vocational Rehabilitation	85
Wil Lou Gray Opportunity School	983
York Technical College	4,110
	13,905
	1,848
	1,235,251
	\$ 1,235,251

The fund acted as a fiduciary for premiums collected from state agencies for State Life and Long-Term Disability. During the year ended June 30, 2012, \$6,749,141 was collected from state agencies and disbursed to the State Life and Long-Term Disability carrier.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**10. 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 insurance 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.

**11. 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. Settled claims have not exceeded this coverage in any of the past three years.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Risk Management/Reinsurance (Continued)**

The Fund pays insurance premiums to itself and 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 (Employee Insurance Program).
5. Claims of covered property damage, theft, collision (automobile), liability, and general tort (Insurance Reserve Fund).

Employees elect health coverage through the State Health Plan or a health maintenance organization. All health plans offered through the Fund are self-insured products.

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

The Fund obtains coverage of up to \$750,000 per loss through a commercial carrier for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation.

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



SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**11. Risk Management/Reinsurance (Continued)**

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, 2012, based on the requirements of GASB 10 because information at June 30 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 Fund self-insures health and dental insurance for all participating governmental employees, including those of the Fund. The Fund also offers HMO products through BlueChoice and Cigna, which are self-insured. The basic long-term disability product is a self-insured product. The Fund also offers Dental Plus and State Life products, which are fully insured. The Fund purchases coverage for basic life, optional life, dependent life, supplemental long-term disability, and long-term care from commercial carriers.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**12. Reconciliation of Claims Liabilities by Fund**

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

	(in thousands)	
	2012	2011
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 144,880	\$ 156,969
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	1,139,562	1,069,615
Increases in provision for insured events of prior fiscal years	631,981	545,528
Total incurred claims and claim adjustment expenses	1,771,543	1,615,143
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	1,037,653	986,580
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	701,969	640,652
Total payments	1,739,622	1,627,232
Total unpaid claims and claim adjustment expenses at end of the fiscal year	\$ 176,801	\$ 144,880
The above totals are comprised of the following:		
Claims payable	\$ 41,856	\$ 32,681
Claims incurred but not reported	134,945	112,199
Total	\$ 176,801	\$ 144,880

The HMO self-insured managed care plan liability at June 30, 2012 and 2011 was \$6,031,088 and \$7,678,610, respectively, and is included in the claims liability listed above.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**13. Changes in Long-Term Liabilities**

Changes in long-term obligations for the year ended June 30, 2012, were as follows:

	<b>Beginning Balance July 1, 2011</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending Balance June 30, 2012</b>	<b>Due Within One Year</b>
Compensated absences payable	\$ 464,469	\$ 41,554	\$ (83,106)	\$ 422,917	\$ 176,157

**14. Medicare Part D Subsidy**

The new Medicare Part D prescription drug benefit became effective in January 2006. The Plan elected to maintain primary coverage for pharmaceuticals for its Medicare eligible retirees. By providing drug coverage at least as valuable as that in the standard Medicare Part D program, the Plan qualifies for the Retiree Drug Subsidy (RDS), an incentive provided in the federal Part D law to encourage employers to retain good prescription benefits for retirees. The Plan earned and recorded \$35,201,405 in RDS funding for the year ended June 30, 2012. As of June 30, 2012, the Plan had a receivable of \$6,693,110.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**15. Direct Premium Revenues and Insurance Related Expenses**

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

	Premium Revenues			Expenses		
	Active Employees	Retirees	Total Premium Revenue	Claims Expenses	Premium Expenses	Third Party Administrative Expenses
Medical-PPO	\$ 1,133,068,713	\$ 462,571,972	\$ 1,595,640,685	\$ 1,061,234,181	\$ -	\$ 45,582,055
Medical-HMO	117,466,906	15,850,963	133,317,869	135,502,088	-	7,170,939
Dental	73,875,850	24,491,100	98,366,950	50,758,732	43,612,645	2,241,067
Prescription drug (1)	-	-	-	524,039,325	-	2,036,833
Life and optional dependent life	40,482,892	-	40,482,892	9,000	40,463,406	-
Vision	11,679,825	2,130,145	13,809,970	-	13,809,420	-
Long-term disability	6,477,747	-	6,477,747	-	6,477,747	-
	<u>\$ 1,383,051,933</u>	<u>\$ 505,044,180</u>	<u>\$ 1,888,096,113</u>	<u>\$ 1,771,543,326</u>	<u>\$ 104,363,218</u>	<u>\$ 57,030,894</u>

(a) Prescription drug claims relate to the individual lines but are presented here in aggregate.

**16. USDHHS Early Retiree Reinsurance Program**

The Fund received funds from the United States Department of Health and Human Services to initially fund the “Early Retiree Reinsurance Program.” In the application for these Funds, the Employee Insurance Program stated that a portion of these Funds would be used to reduce premiums charged to plan participants in the 2012 calendar year. As a result, \$13,571,251 of these Funds are presented as restricted net assets at June 30, 2012.

SOUTH CAROLINA STATE BUDGET AND CONTROL BOARD  
EMPLOYEE INSURANCE PROGRAM

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

**17. Subsequent events**

The South Carolina Public Employee Benefit Authority (PEBA) was created July 1, 2012, by the South Carolina General Assembly as part of Act No. 278. PEBA is a state agency responsible for the administration and management of the state's employee insurance programs and retirement systems.

A portion of this legislation relating to EIP is as follows:

“To amend Chapter 4, Title 9, relating to retirement law, so as to establish the South Carolina Public Benefit Employee Authority (PEBA), provide for its membership and their compensation, devolve from the State Budget and Control Board to PEBA the administration of the Employee Insurance Program (EIP), administration of the Retirement Division, cotrusteeship of the State Retirement System, and the duties of the South Carolina Deferred Compensation Commission (SCDCC), to provide those actions of PEBA requiring approval by the State Budget and Control Board or its successor, to require PEBA to maintain a public transaction register, and to require an annual fiduciary audit of PEBA.

To amend Chapter 2, Title 9, relating to various elements of the Employee Insurance Program, State Retirement system, and the South Carolina Deferred Compensation Commission, so as to conform these provisions to PEBA governance.”

Consequently, effective July 1, 2012, the operations of the Employee Insurance Program were transferred from the South Carolina Budget and Control Board to the newly formed Public Employee Benefit Authority.

Subsequent events were evaluated through October 1, 2012, 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, Employee Insurance Program (the "Fund") as of and for the year ended June 30, 2012, and have issued our report thereon dated October 1, 2012. 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 previously.

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*.

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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 those specified parties.

*Releach & Williamson, L.L.P.*

October 1, 2012