

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

AUDITED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2013

WITH

INDEPENDENT AUDITORS REPORT

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INDEPENDENT AUDITORS REPORT

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

We have audited the accompanying financial statements of the business-type activities of the South Carolina Public Employee Benefit Authority, Insurance Benefits (the “Fund”), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Fund’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Fund as of June 30, 2013, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in *Note 1*, the accompanying financial statements of the Fund are intended to present the financial position and results of operations and cash flows of its proprietary fund type of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the Insurance Benefits of the South Carolina Public Employee Benefit Authority. They do not purport to, and do not, present fairly the financial position of the State of South Carolina as of June 30, 2013 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.

Other Matters

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2013, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.



Columbia, South Carolina

October 1, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

The financial statement presentation required under governmental accounting standards provides a comprehensive perspective of the South Carolina Public Employee Benefit Authority – Insurance Benefit's assets, liabilities, net position, revenues, expenses, changes in net position and cash flows. This section of the South Carolina Public Employee Benefit Authority (PEBA), Insurance Benefits Audited Financial Statements and Other Financial Information presents management's discussion and analysis of PEBA – Insurance Benefit's financial performance during the fiscal year ended June 30, 2013. This discussion should be read in conjunction with the financial statements and the notes, which follow this section.

Financial Highlights:

Business Type activities reported an increase in net position of \$7,189,242 and total net position of \$186,051,730 for the year ended June 30, 2013. In comparison, a decrease in net position of \$33,130,065 was reported for the year ended June 30, 2012 with total net position of \$178,862,488 at 2012 year-end.

Overview of Financial Statements:

The PEBA – Insurance Benefits is an internal service fund proprietary type engaged in governmental activities. Following is a condensed Statement of Net Position, a condensed Statement of Activities and a condensed Statement of Cash Flows.

The Statement of Net Position presents the financial position of PEBA – Insurance Benefits 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 position section, which displays investment in capital assets, restricted net position and unrestricted net position. Net position is generally an indicator of the current financial condition of PEBA – Insurance Benefits, while the change in net position 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, \$64,626,715 was transferred to the Trust. The increase in net position before this transfer amounted to \$71,815,957, which is attributed to better than expected claims trend.

The Statement of Revenue, Expenses, and Changes in Net Position present revenue 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 PEBA – Insurance Benefits:

This schedule is a condensed version of PEBA – Insurance Benefit's assets, liabilities, and net position and is prepared from the Statement of Net Position.

Condensed Statements of Net Position
(in millions)

	June 30, 2013	June 30, 2012
Assets		
Current assets	\$ 424.5	\$ 383.6
Noncurrent assets:	0.1	-
Total assets	<u>424.6</u>	<u>383.6</u>
Liabilities		
Current liabilities	238.2	204.4
Noncurrent liabilities	0.3	0.3
Total liabilities	<u>238.5</u>	<u>204.7</u>
Net position		
Investment in capital assets	0.1	-
Restricted	-	13.6
Unrestricted	<u>186.0</u>	<u>165.3</u>
Total net position	<u><u>\$ 186.1</u></u>	<u><u>\$ 178.9</u></u>

The following schedule is a summary of the PEBA – Insurance Benefit's operating results for the fiscal year.

Condensed Statements of Revenues, Expenses, and Changes in Net Position
Year Ended June 30,
(in millions)

	2013	2012
Governmental activities:		
Program revenue	\$ 2,112.8	\$ 2,005.1
Expenses	<u>(2,047.5)</u>	<u>(1,942.5)</u>
Total governmental activities	<u>65.3</u>	<u>62.6</u>
General revenue and transfers:		
Earnings on investments	6.5	8.3
Transfer to other agencies and trusts	<u>(64.6)</u>	<u>(104.0)</u>
Total general revenue and transfers	<u>(58.1)</u>	<u>(95.7)</u>
Change in net position	<u>7.2</u>	<u>(33.1)</u>
Net position, beginning of the year	178.9	212.0
Net position, end of the year	<u>\$ 186.1</u>	<u>\$ 178.9</u>

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

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

	2013	2012
Cash flows from operating activities	\$ 69.4	\$ 146.4
Cash flows from noncapital financing activities	<u>(64.6)</u>	<u>(104.0)</u>
Cash flows from capital and related financing activities	<u>(0.2)</u>	-
Cash flows from investing activities	<u>6.6</u>	<u>8.2</u>
Net increase in cash and cash equivalents	<u>11.2</u>	<u>50.6</u>
Cash and cash equivalents, beginning of year	<u>349.3</u>	<u>298.7</u>
Cash and cash equivalents, end of year	<u><u>\$ 360.5</u></u>	<u><u>\$ 349.3</u></u>

Overview of PEBA – Insurance Benefits:

PEBA – Insurance Benefits 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 2012-2013 General Appropriations Act.

Following is a list of benefits offered by PEBA – Insurance Benefits differentiated according to self-insured versus insured status.

Self-Insured Programs

- State Health Plan:
 - Standard Plan (PPO)
 - Medicare Supplement
 - Savings Plan (HDHP)
- BlueChoice (HMO - ended December 31, 2012)
- CIGNA (HMO – ended December 31, 2012)
- State Dental Plan
- Basic Long Term Disability
- Adoption Assistance Program

Insured Programs

- BlueChoice (HMO – began January 1, 2013)
- 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 2013, 681 employers participate in the program. The State Health Plan is PEBA – Insurance Benefit'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 PEBA – Insurance Benefit's financial activity, accounting for approximately 94% 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 (76%) are enrolled in the Standard Plan, a PPO option available to non-Medicare and Medicare enrollees. Of the remaining subscribers, 21% 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 73% 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 2013).

	Program	State Health Plan
Total Insured Persons:	443,731	426,759
Subscribers:	254,363	242,262
Spouses:	71,726	70,765
Children:	117,642	113,732
Total Subscribers:	254,363	242,262
Employees:	174,937	164,130
Retirees:	75,823	74,568
Survivors:	2,722	2,708
COBRA:	881	856
Active Employees:	174,937	164,130
State Agencies:	57,195	53,268
School Districts:	80,537	76,120
Local Government	37,205	34,742

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, 2013, 52% of subscribers had Employee Only coverage, and the remaining 48% covered at least one dependent.

Premiums range from \$4,898.40 annually for Employee Only coverage to \$12,920.16 annually for Full Family coverage. Following are the monthly 2013 State Health Plan employee and employer rates.

2013 State Health Plan (Standard Plan) Monthly Premiums

ACTUAL RATES

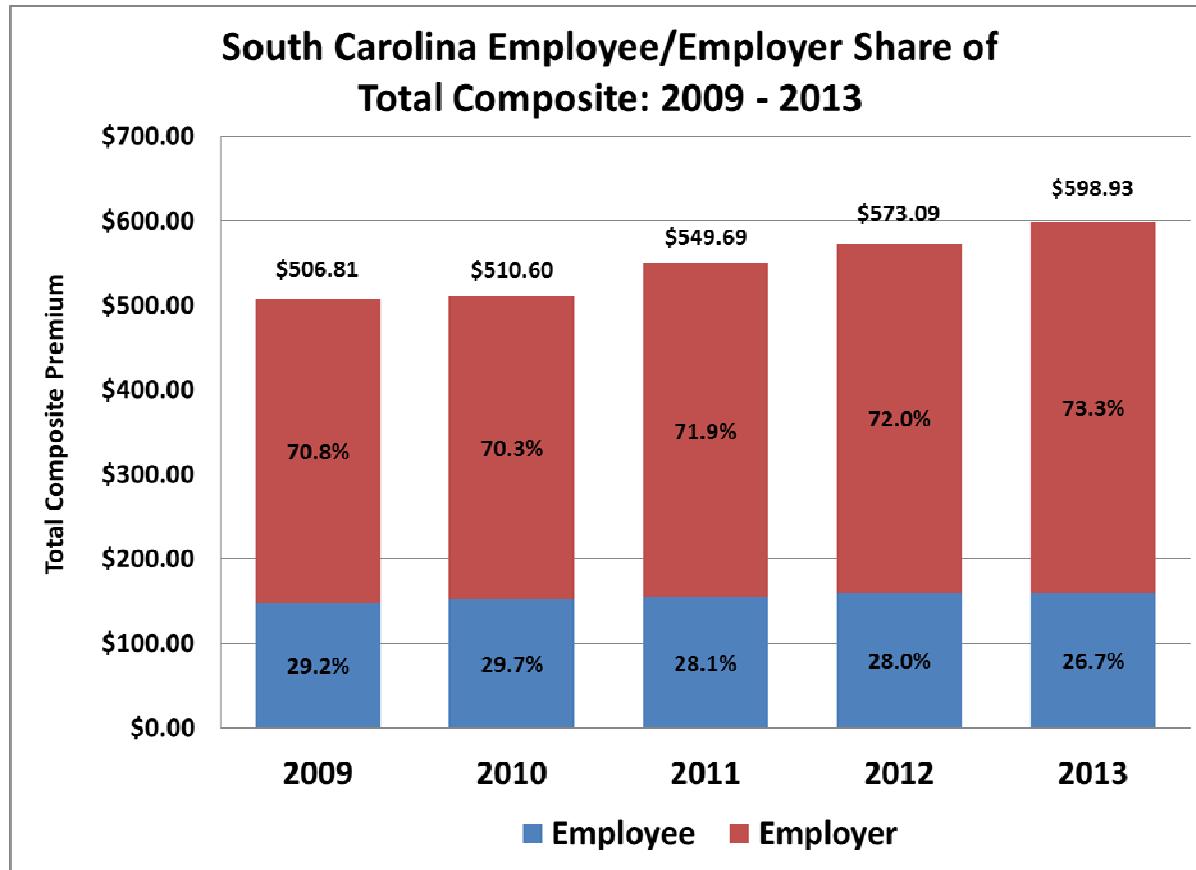
	Employee	Employer	Total
Employee Only	\$97.68	\$310.52	\$408.20
Employee / Spouse	\$253.36	\$615.08	\$868.44
Employee / Child(ren)	\$143.86	\$476.60	\$620.46
Full Family	\$306.56	\$770.12	\$1,076.68

SMOKER ADJUSTED RATES FOR COMPOSITE CALCULATION

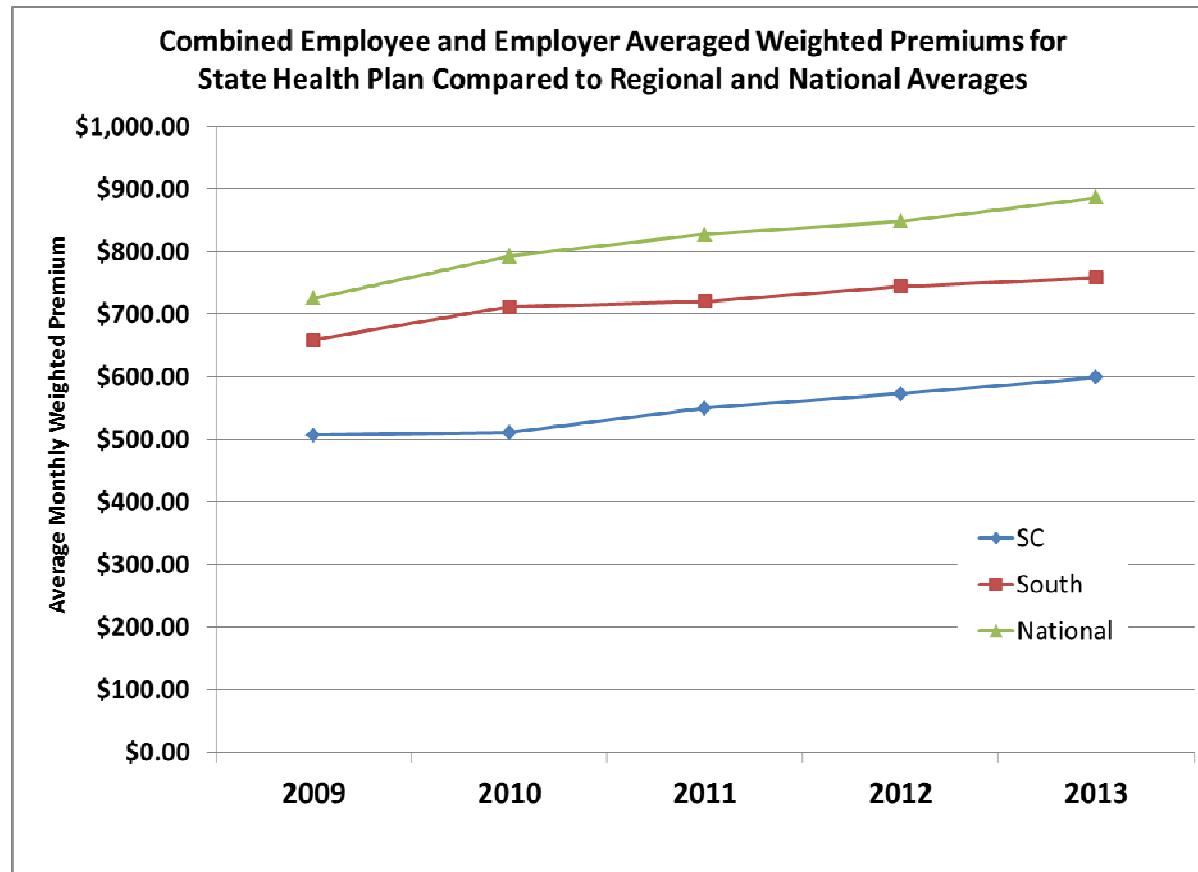
	Employee	Employer	Total
Employee Only	\$101.89	\$310.52	\$412.41
Employee / Spouse	\$259.67	\$615.08	\$874.75
Employee / Child(ren)	\$150.17	\$476.60	\$626.77
Full Family	\$312.87	\$770.12	\$1,082.99
Composite Rate	\$159.85	\$439.08	\$598.93

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

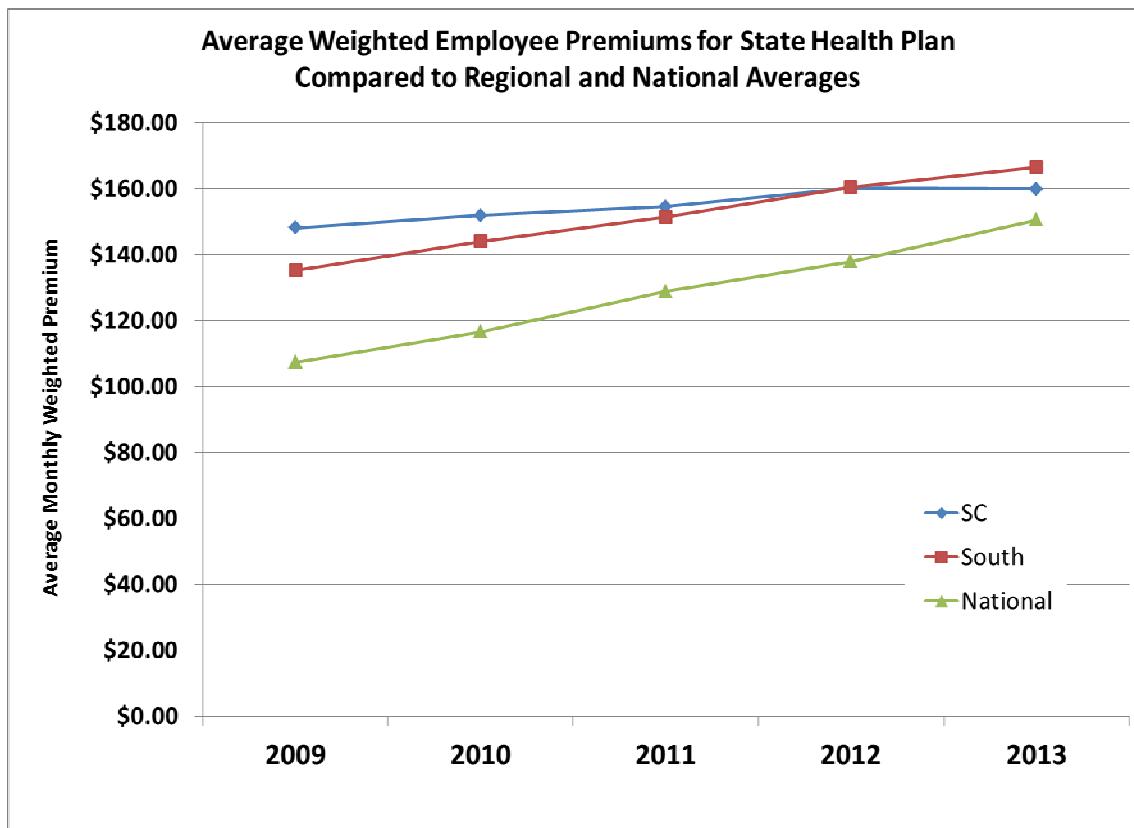
For 2013, the employer share of premiums increased 6.37% and the employee share remained constant. The 2013 employee share reflects 27% of the total premium.



The 2013 composite total premium remains fairly well below both the southern and national levels. For 2013, the State Health Plan composite total premium was approximately 79% of the southern premium and 68% of the national premium.



For 2013, the SHP employee composite dropped slightly below the regional composite, although still remains above the national composite, due to prior years of employer contribution levels remaining either stagnant or increasing at levels insufficient to sustain claims expense.



State Health Plan Contribution Increases:

Contribution increases since 2000 are outlined below.

State Health Plan Contribution Increases

	Employer Rate Increase	Employee Rate Increase	Total
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%
2013	6.37%	0.0%	4.6%

Status of the Plan:

The State Health Plan is currently in a stable financial position and has been able to transfer excess cash reserves during this reporting period, as well as for the previous four reporting periods, to the South Carolina Retiree Health Insurance Trust Fund.

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	+8.8%
2010	+0.5%
2011	+3.5%
2012	+6.3%

Following are the medical utilization rates (and growth rates) per 1000 insured persons (SHP primary) from 2000 through 2012 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	6,319.44	-0.7%	183.43	+0.8%	55.94	-4.3%	232.18	+6.0%
2012	6,816.70	+7.9%	190.90	+4.1%	59.17	+5.8%	236.20	+1.7%

* 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	18.06	-1.4%	67.4%	8.9%
2011	17.95	-0.6%	70.2%	8.5%
2012	18.21	+1.4%	74.2%	8.1%

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 yielding significant cost 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 \$75.3 M. in rebates during 2013
- Medicare Part D prescription drug subsidies; the Plan received about \$44.4 M. in subsidies during 2013
- 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 forward include:

- PEBA – Insurance Benefits will retain its “grandfathered” status under the Patient Protection and Affordable Care Act for 2014
- This year’s legislative session provided for a 6.8% increase in the employer contribution rates beginning January 2014. Also, deductibles and copayments will be increased 20% beginning January 2014 to meet projected Plan obligations through 2014
- 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 is approximately 46% complete, and a total of 5,604 ineligible dependents have been removed from health coverage with an estimated annual savings of \$15.365 million.)
- BlueChoice will be the only HMO option for 2014, offered again on a fully insured basis
- A Tricare supplement will be offered effective January 1, 2014 to non-Medicare subscribers on an employee pay all basis
- A patient centered heath plan will be offered as a pilot to employees and dependents of MUSC and the Medical University Hospital Authority beginning January 2014 (to reduce health care costs while improving the health of an entire population)

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 PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

STATEMENT OF NET POSITION

JUNE 30, 2013

Assets

Current assets:

Cash and cash equivalents	\$ 360,522,155
Premiums receivable	2,293,296
Prescription drug rebate receivable	54,041,350
Medicare Part D Subsidy receivable	7,370,529
Accrued interest	15,516
Due from South Carolina Retiree Health Insurance Trust Fund	174,046
Due from South Carolina Long Term Disability Trust Fund	31,200
Total current assets	<u>424,448,092</u>

Non-current assets:

Capital assets, net of accumulated depreciation	145,900
Total assets	<u>424,593,992</u>

Liabilities

Current liabilities:

Accounts payable and accrued payroll	660,083
Accrued compensated absences - current portion	197,893
Deferred premium revenue	22,837,428
Claims payable	70,963,228
Claims incurred but not reported	143,533,697
Total current liabilities	<u>238,192,329</u>

Long-term liabilities:

Accrued compensated absences - long term	349,933
Total long-term liabilities	<u>349,933</u>
Total liabilities	<u>238,542,262</u>

Contingencies (*Note 10*)

Net Position

Investment in capital assets	145,900
Unrestricted	185,905,830
Total net position	<u>\$ 186,051,730</u>

See accompanying notes.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

**STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET POSITION**

YEAR ENDED JUNE 30, 2013

Operating Revenue

Insurance premiums:

Active employees	\$ 1,438,229,179
Retirees	<u>541,871,753</u>
Total insurance premiums	1,980,100,932
Prescription drug rebates	75,307,895
Medicare Part D Subsidy	44,429,193
Administrative fees and other	<u>12,982,432</u>
Total operating revenue	<u>2,112,820,452</u>

Operating Expenses:

Claims	1,817,587,525
Premiums	165,911,690
Third party administrative fees	54,469,069
Salaries and benefits	5,685,825
Other services	2,325,901
Professional services	626,133
Adoption assistance program	271,275
Supplies	126,585
Telephone and utilities	112,698
Other operating expenses	<u>383,092</u>
Total operating expenses	<u>2,047,499,793</u>
Operating income	<u>65,320,659</u>
Non-operating revenue:	
Income from deposits	6,495,298
Transfers:	
Transfers to OPEB trust	(64,626,715)
Change in net position	7,189,242
Net position, beginning of year	<u>178,862,488</u>
Net position, end of year	<u>\$ 186,051,730</u>

See accompanying notes.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2013

Cash Flows from Operating Activities

Insurance premiums from customers	\$ 1,978,944,809
Other receipts	100,344,258
Payments to employees	(5,495,264)
Payments to providers, suppliers and others	(2,004,354,671)
Net cash from operating activities	<u>69,439,132</u>

Cash Flows from Noncapital Financing Activities

Transfers to OPEB Trust	(64,626,715)
Net cash from noncapital financing activities	<u>(64,626,715)</u>

Cash Flows from Capital and Related Financing Activities

Purchase of capital assets	(148,860)
Net cash from capital and related financing activities	<u>(148,860)</u>

Cash Flows from Investing Activities

Interest received-deposits and investments	6,541,385
Net cash from investing activities	<u>6,541,385</u>

Net increase in cash and cash equivalents	11,204,942
Cash and cash equivalents, beginning of year	349,317,213
Cash and cash equivalents, end of year	<u>\$ 360,522,155</u>

(CONTINUED)

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2013

(CONTINUED)

Reconciliation of operating income to net cash from operating activities

Operating income	\$ 65,320,659
Adjustments to reconcile operating income to net cash from operating activities:	
Depreciation expense	20,244
Change in assets:	
Premiums receivable	1,085,240
Prescription drug rebate receivable	(30,057,409)
Medicare Part D Subsidy receivable	(677,419)
Other receivable	19,372
Due from South Carolina Retiree Health Trust	(83,200)
Due from South Carolina Long Term Disability Trust	(5,000)
Change in liabilities:	
Accounts payable, accrued payroll and compensated absences	(66,294)
Deferred premium revenue	(3,812,970)
Claims payable and incurred but not reported	37,695,909
Net cash from operating activities	<u><u>\$ 69,439,132</u></u>

See accompanying notes.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2013

1. Basis of Presentation and Summary of Significant Accounting Policies

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

Reporting Entity

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

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

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

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

-CONTINUED-

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

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 Fund is a fund of the South Carolina Public Employee Benefit Authority (“PEBA”), 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 Public Employee Benefit Authority or any other part of the State of South Carolina primary government are included.

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.

This act amends Chapter 4, Title 9, relating to retirement law, so as to establish the 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 PEBA.

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

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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.

The Fund 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 BlueChoice HMO changed from self-insured to fully-insured effective January 1, 2013 and CIGNA HMO ended December 31, 2012. 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 South Carolina 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.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

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

Basis of Presentation

The financial statements present all proprietary funds of the Fund.

The financial statement presentation for the Fund meets the requirements of governmental accounting standards. Additionally, the Trust has adopted the provisions of GASB 63 *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Trust has determined that no amounts were required to be reclassified or otherwise recognized as deferred inflows or outflows resources for the year ended June 30, 2013.

As an internal service fund, the Fund in its stand-alone financial statements is considered a proprietary fund. However, the applicable 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 position, revenue, expenses and changes in net position and cash flows that replaces the fund-group perspective previously required.

Financial Statements

The Fund is an internal service fund within PEBA 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 position. Net position is segregated into investment in capital assets, net of related debt, restricted net position and unrestricted net position 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 PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

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.

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.

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 PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

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, 2013. The claims payable balance is based on claims that have been paid by the third party administrators on behalf of the Fund.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

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 Fund'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.

Deferred Outflows/Inflows of Resources:

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Fund does not currently have any items that qualify for reporting in this category.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Fund does not currently have any items that qualify for reporting in this category.

Net Position

The Fund's net position is recorded in three categories:

Investment in capital assets 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.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

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

Restricted net position results when constraints placed on the use of net position are either imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net position consists of net position that does not meet the definition of restricted net position or investment in capital assets.

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.

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, 2013, the Fund had no deposits with financial institutions. The Fund had cash of \$360,522,155 held by the State Treasurer as of June 30, 2013.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

2. Deposits (Continued)

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>\$ 6,495,298</u>
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The following schedule reconciles investments and deposits as reported in the statement of net position to disclosures included in this note.

	<u>Statements</u>	<u>Note Disclosure</u>
Held by State Treasurer:		
Cash and cash equivalents	\$ 360,522,155	\$ -
Deposits	<u>-</u>	<u>360,522,155</u>
Total	<u>\$ 360,522,155</u>	<u>\$ 360,522,155</u>

3. Premiums Receivable

Premiums receivable at June 30, 2013, consist of the following:

Local government	\$ 860,478
State government (<i>Note 9</i>)	876,218
Individuals	505,008
School districts	51,553
Other	39
	<u>\$ 2,293,296</u>

As of June 30, 2013, 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, 2013.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

4. Capital Assets

The following summarizes changes in capital assets for the year.

	Balance July 1, 2012	Additions	Deletions	Balance June 30, 2013
Furniture and equipment	\$ 336,410	\$ 148,860	\$ -	\$ 485,270
Accumulated depreciation	(319,126)	(20,244)	-	(339,370)
Capital assets, net	<u>\$ 17,284</u>	<u>\$ 128,616</u>	<u>\$ -</u>	<u>\$ 145,900</u>

Depreciation expense for the year ended June 30, 2013 was \$20,244.

5. Lease Obligations

The Fund leases office space from a party outside of State government and is accounted for as an operating lease. During the current year, the Fund was under a lease with the SC Budget and Control Board. The office space lease was amended effective July 1, 2010, with a monthly charge of \$21,392. Rental expense under this lease for the year ended June 30, 2013 was \$264,367. Effective July 1, 2013, a new lease was signed with PEBA that expires on June 30, 2018. The payment details and the future minimum lease payments due under this lease are:

Year Ending June 30,	Required Number of Payments	Payment Amount	Total
2014	9	\$ 17,379	\$ 156,411
2015	11	17,726	194,986
2016	11	18,087	198,957
2017	11	18,448	202,928
2018	11	18,809	206,899
			<u>\$ 960,181</u>

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

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, 2013, expenses under this lease was approximately \$27,811.

6. Pension Plans

The majority of employees of the Fund are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the PEBA, a public employee retirement system. Generally, all full-time or part-time equivalent State employees in a permanent position are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws, as amended, or are eligible and elect to participate in the State Optional Retirement Program (ORP). The SCRS plan provides a life-time monthly retirement annuity benefits to members as well as disability, survivor options, annual benefit adjustments, death benefits, and incidental benefits to eligible employees and retired members.

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

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

6. Pension Plans (Continued)

Under the SCRS, Class II members are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years of credited service regardless of age. Employees who first became members of the System after June 30, 2012 are considered Class III members and are eligible for a full service retirement annuity upon reaching age 65 or upon meeting the rule of 90 requirement (i.e., the members age plus the years of service add up to a total of at least 90). The benefit formula for full benefits effective since July 1, 1989 for the SCRS is 1.82 percent of an employee's average final compensation (AFC) multiplied by the number of years of credited service. For Class II members, AFC is the average annual earnable compensation during 12 consecutive quarters and includes an amount for up to 45 days termination pay at retirement for unused annual leave. For Class III members, AFC is the average annual earnable compensation during 20 consecutive quarters and termination pay for unused annual leave at retirement is not included. Early retirement options with reduced benefits are available as early as age 55 for Class II members and age 60 for Class III members. Class II members are vested for a deferred annuity after five years of earned service. Class III members are vested for a deferred annuity after eight years of earned service. Members qualify for a survivor's benefit upon completion of 15 years of credited service (five years effective January 1, 2002).

Disability annuity benefits are payable to Class II members if they have permanent incapacity to perform regular duties of the member's job and they have at least 5 years of earned service (this requirement does not apply if the disability is a result of a job related injury). Class III members qualify for disability annuity benefits provided they have a minimum of eight years of credited service. An incidental death benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service or to a working retired contributing member. There is no service requirement for death resulting from actual performance of duties for an active member. For eligible retired members, a lump-sum payment is made to the retiree's beneficiary of up to \$6,000 based on years of service at retirement. TERI participants and retired contributing members are eligible for the increased death benefit equal to their annual salary in lieu of the standard retired member benefit.

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

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

6. Pension Plans (Continued)

Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits. The TERI program will end effective June 30, 2018.

Effective July 1, 2012, employees participating in the SCRS were required to contribute 7.00% of all earnable compensation. The employee contribution rate for SCRS was 15.15%. Included in the total SCRS employer contribution rate is a base retirement contribution of 10.45%, .15% for the incidental death program and a 4.55% surcharge that will fund retiree health and dental insurance coverage. Employer contributions for State ORP include a 5.45% employer retirement contribution, 4.55% retiree insurance surcharge and .15% incidental death benefit. The Fund's actual contributions to the SCRS for the years ended June 30, 2013, 2012, and 2011 were approximately \$624,065, \$534,798, and \$558,053, respectively, and equaled the required retirement contribution rate, including surcharge, of 10.45 % for 2013, 9.385% for 2012 and 9.24% for 2011. Also, the Fund paid employer incidental death program contributions of approximately \$6,053, \$5,852 and, \$6,239, at the rate of .15% of compensation for the current fiscal years ended June 30, 2013, 2012, and 2011, respectively.

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 and PORS are actuarially determined.

The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

6. Pension Plans (Continued)

For the current fiscal year, the SCRS did not make separate measurements of assets and pension obligations for individual employers within the cost-sharing plan. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plans is limited to the amount of required employer contributions (stated as a percentage of covered payroll) as established by the PEBA and as appropriated in the South Carolina Appropriation Act and from other applicable revenue sources. Accordingly, the Fund recognizes no contingent liability for unfunded costs associated with participation in the plans.

7. Post Employment and Other Employee Benefits

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

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

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

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

7. Post Employment and Other Employee Benefits (Continued)

Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the Fund and participating retirees to PEBA, except for the portion funded through the pension surcharge and provided from the other applicable sources of the Fund, for its active employees who are not funded by State General Fund appropriations participating employers are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 4.55% of annual covered payroll for 2013 and 4.30% of annual covered payroll for 2012. The Fund sets the employer contribution rate based on a pay-as-you-go basis. The Fund paid approximately \$198,539 and \$167,766 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2013 and 2012, respectively. BLTD benefits are funded through a person's premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to Fund was \$3.22 for the fiscal years ended June 30, 2013 and 2012.

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

A copy of the complete financial statements for the benefit plans and the trust funds from PEBA Retirement Benefits and Insurance Benefits, 202 Arbor Lake Drive, Suite 360, Columbia, SC 29223.

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 Fund within the PEBA.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

7. Post Employment and Other Employee Benefits (Continued)

The Fund recorded benefit expenses for these insurance benefits for active employees in the amount of \$417,637, \$421,969 and \$383,684 for the years ended June 30, 2013, 2012 and 2011, 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, 2013.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

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 Public Employee Benefit Authority. 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 PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

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 PEBA during the year ended June 30, 2013:

Adjutant General's Office	\$ 1,560,821
Aid to Subdivisions	487,239
Aiken Technical College	1,057,461
Attorney General's Office	1,146,946
Budget and Control Board - State Auditor	225,033
Central Carolina Technical College	1,762,635
Clemson University	31,559,510
Coastal Carolina University	8,450,331
College of Charleston	10,535,604
Commission on Higher Education	275,225
Comptroller General's Office	187,704
Denmark Technical College	701,040
Department of Agriculture	892,989
Department Archives and History	283,251
Department of Education	7,247,386
Department of Health and Environmental Control	24,394,953
Department of Labor, Licensing and Regulations	2,526,240
Department of Mental Health	26,010,722
Department of Parks, Recreation and Tourism	2,810,617
Department of Revenue	4,840,354
Department of Social Services	22,033,404
Department of Transportation	32,538,538
Department of Employment and Workforce	6,460,009
Florence-Darlington Technical College	1,858,464
Forestry Commission	2,448,123
Francis Marion University	3,790,922
Governor's Office	1,842,284
Greenville Technical College	5,507,902
Health and Human Services	7,544,625
Higher Education Tuition Grants Commission	33,728
Horry-Georgetown Technical College	2,439,716
House of Representatives	1,516,806
John de la Howe School	395,969
Lander University	2,958,792
Legislative Audit Council	145,989
Legislative Council	215,319
Legislative Printing, Information and Technology Systems	171,827
Lieutenant Governor's Office	266,252
Medical University Hospital Authority	41,322,002
Medical University of South Carolina	33,168,823

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Transactions with State Entities (Continued)

Midlands Technical College	4,183,518
Northeastern Technical College	692,097
Office of the Inspector General	13,632
Office of Regulatory Staff	476,622
Office of State Infrastructure Bank	9,432
Orangeburg-Calhoun Technical College	1,335,087
Patients' Compensation Fund	47,433
Patriot's Point Development Authority	510,605
Piedmont Technical College	2,112,018
Procurement Review Panel	5,228
Public Service Commission	327,083
Retirement System Investment Commission	284,507
Arts Commission	133,647
Department of Consumer Affairs	210,059
Department of Insurance	560,494
Department of Motor Vehicles	7,858,186
Department of Natural Resources	5,411,178
Department of Probation, Parole and Pardon Services	4,207,834
Education Oversight Committee	43,192
Educational Television Commission	1,033,580
Human Affairs Commission	109,154
Jobs Economic Development Authority	12,667
School for the Deaf and Blind	2,493,259
State Library	226,720
State Senate	1,206,998
South Carolina State University	4,770,157
Workers' Compensation Commission	386,478
Department of Public Safety	10,133,477
Administrative Law Court	246,475
Commission for the Blind	670,149
Commission for Indigent Defense	468,530
Commission on Prosecution Coordination	317,281
Department of Commerce	490,781
Department of Juvenile Justice	8,900,307
Department of Alcohol and Other Drug Abuse Services	288,722
Department of Disabilities and Special Needs	11,403,042
Rural Infrastructure Authority	7,693
State Housing Finance and Development Authority	937,335
Sea Grant Consortium	102,444
Second Injury Fund	154,985

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Transactions with State Entities (Continued)

Secretary of State's Office	207,946
Aeronautics Commission	76,603
Budget and Control Board	6,130,806
Conservation Bank	7,364
Criminal Justice Academy	847,740
Department of Corrections	36,286,688
First Steps to School Readiness	206,208
Judicial Department	4,151,782
State Museum Commission	205,531
Public Employee Benefit Authority	1,090,346
Spartanburg Community College	2,315,041
State Accident Fund	469,311
Technical and Comprehensive Education	491,939
State Board of Financial Institutions	295,355
State Commission for Minority Affairs	51,576
State Election Commission	110,616
State Ethics Commission	45,405
State Law Enforcement Division	3,274,648
State Treasurer's Office	480,195
Technical College of Lowcountry	1,081,227
The Citadel	4,730,648
Tri County Technical College	2,510,899
Trident Technical College	5,305,720
University of South Carolina	51,147,332
Department of Vocational Rehabilitation	7,661,210
Wil Lou Gray Opportunity School	411,045
Williamsburg Technical College	459,261
Winthrop University	6,455,306
York Technical College	2,166,632
	<u>\$ 505,072,021</u>

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

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 Fund administers the Trust and the PEBA 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 Fund 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 \$64,626,715 in 2013.

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 Fund administers the Trust and the PEBA 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.

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 2013 expenses applicable to related party transactions are as follows:

South Carolina Retirement Division	\$ 624,065
South Carolina State Accident Fund	5,383
South Carolina Department of Employment and Workforce	8,134
	<hr/>
	\$ 637,582

In addition, transfers include the following:

Transfers of funds to the South Carolina Retiree Health Insurance Trust Fund	\$ 64,626,715
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**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

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 PEBA. Premiums owed from these entities at June 30, 2013 were:

Adjutant General's Office	\$ 7,635
Aid to Subdivisions	20
Attorney General's Office	3,874
Commission on Higher Education	1,607
Department of Agriculture	6
Department of Archives and History	60
Department of Education	1,136
Department of Health and Environmental Control	2,005
Department of Labor, Licensing and Regulations	390
Department of Mental Health	57,323
Department of Parks, Recreation and Tourism	149,018
Department of Revenue	215,982
Department of Social Services	13,709
Department of Transportation	15,983
Department of Employment and Workforce	12,921
Forestry Commission	1,535
Governor's Office	31,265
Health and Human Services	4,941
Higher Education Tuition Grants Commission	40
John de la Howe School	124
Lieutenant Governor's Office	1,688
Office of State Infrastructure Bank	266
Patients' Compensation Fund	62
Patriot's Point Development Authority	29,142
Public Service Commission	23
Retirement System Investment Commission	5,132
Arts Commission	200
Department of Consumer Affairs	8,870
Department of Insurance	6,601
Department of Motor Vehicles	35,959
Department of Natural Resources	11,010
Department of Probation, Parole and Pardon Services	709
Educational Television Commission	10,616
Human Affairs Commission	109
Jobs Economic Development Authority	25
School for the Deaf and Blind	675
State Library	27

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

9. Transactions with State Entities (Continued)

Technical and Comprehensive Education	83
Worker's Compensation Commission	778
Department of Public Safety	982
Administrative Law Court	3,378
Commission of the Blind	244
Commission on Indigent Defense	215
Commission on Prosecution Coordination	5,426
Department of Commerce	11
Department of Juvenile Justice	1,143
Department of Alcohol and Other Drug Abuse Services	1,631
Department of Disabilities and Special Needs	163,614
Rural Infrastructure Authority	18
State Housing Finance and Development Authority	663
Sea Grant Consortium	30,017
Second Injury Fund	2,155
Secretary of State's Office	3,350
Aeronautics Commission	228
Budget and Control Board	415
Criminal Justice Academy	650
Department of Corrections	7,071
Judicial Department	462
State Museum Commission	1
Public Employee Benefit Authority	1,910
State Accident Fund	130
State Treasurer's Office	1,225
Department of Vocational Rehabilitation	3,844
Wil Lou Gray Opportunity School	15,886
	<hr/> <u>\$ 876,218</u>

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, 2013, \$6,763,897 was collected from state agencies and disbursed to the State Life and Long-Term Disability carrier.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

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.

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 (PEBA – Insurance Services); and
4. Claims of covered public employees for long-term disability and group life insurance (PEBA – Insurance Services).
5. Claims of covered property damage, theft, collision (automobile), liability, and general tort (Insurance Reserve Fund).

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

11. Risk Management/Reinsurance (Continued)

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.

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, 2013 because information at June 30 did not indicate that an asset had been impaired or a liability had been incurred. 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. As of January 1, 2013 BlueChoice HMO became fully 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 PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

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)	
	2013	2012
Unpaid claims and claim adjustment expenses at beginning of the fiscal year	\$ 176,801	\$ 144,880
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current fiscal year	1,128,404	1,139,562
Increases in provision for insured events of prior fiscal years	689,183	631,981
Total incurred claims and claim adjustment expenses	1,817,587	1,771,543
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current fiscal year	1,022,622	1,037,653
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	757,270	701,969
Total payments	1,779,892	1,739,622
Total unpaid claims and claim adjustment expenses at end of the fiscal year	\$ 214,496	\$ 176,801
The above totals are comprised of the following:		
Claims payable	\$ 70,963	\$ 41,856
Claims incurred but not reported	143,533	134,945
Total	\$ 214,496	\$ 176,801

The HMO self-insured managed care plan liability at June 30, 2013 and 2012 was \$29,707 and \$6,031,088, respectively, and is included in the claims liability listed above.

SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS

NOTES TO FINANCIAL STATEMENTS

(CONTINUED)

13. Changes in Long-Term Liabilities

Changes in long-term obligations for the year ended June 30, 2013, were as follows:

	Beginning Balance July 1, 2012	Increases	Decreases	Ending Balance June 30, 2013	Due Within One Year
Compensated absences payable	\$ 422,917	\$ 301,066	\$ (176,157)	\$ 547,826	\$ 197,893

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 \$44,429,193 in RDS funding for the year ended June 30, 2013. As of June 30, 2013, the Plan had a receivable of \$7,370,529.

**SOUTH CAROLINA PUBLIC EMPLOYEE BENEFIT AUTHORITY
INSURANCE BENEFITS**

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		Total Premium Revenue	Claims Expenses	Expenses		Third Party Administrative Expenses
	Active Employees	Retirees			Premium Expenses	Premium Expenses	
Medical-PPO	\$ 1,196,843,467	\$ 499,993,908	\$ 1,696,837,375	\$ 1,114,792,160	\$ -	\$ 46,923,528	
Medical-HMO	100,139,439	12,749,709	112,889,148	71,931,484	50,608,064	3,251,503	
Dental	77,184,527	26,508,431	103,692,958	52,280,151	48,636,367	2,212,987	
Prescription drug (1)	-	-	-	578,583,730	-	2,081,051	
Life and optional dependent life	44,081,463	-	44,081,463	-	44,064,888	-	
Vision	13,329,838	2,619,705	15,949,543	-	15,951,056	-	
Long-term disability	6,650,445	-	6,650,445	-	6,651,315	-	
	\$ 1,438,229,179	\$ 541,871,753	\$ 1,980,100,932	\$ 1,817,587,525	\$ 165,911,690	\$ 54,469,069	

(1) 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 Fund stated that a portion of these funds would be used to reduce premiums charged to plan participants in the 2013 calendar year. During the year ended June 30, 2013, the Fund utilized the remaining amount of \$13,571,251 for current operations.

17. Subsequent events

Subsequent events were evaluated through October 1, 2013, 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.

DELOACH & **W**ILLIAMSON, L.L.P.
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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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of the South Carolina Public Employee Benefit Authority, Insurance Benefits (the “Fund”), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Fund’s basic financial statements, and have issued our report thereon dated October 1, 2013.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

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

A handwritten signature in black ink that reads "DeLoach & Williamson, C.C.P." The signature is fluid and cursive, with "DeLoach" and "Williamson" connected by a horizontal stroke.

Columbia, South Carolina

October 1, 2013