AUDITED FINANCIAL STATEMENTS
AND
REQUIRED SUPPLEMENTAL INFORMATION

SOUTH CAROLINA MEDICAL MALPRACTICE
PATIENTS' COMPENSATION FUND

JUNE 30, 2006

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State of South Carolina

Office of the State Auditor

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October 3, 2006

The Honorable Mark Sanford, Governor
and
Members of the Board of Governors
South Carolina Medical Malpractice Patients' Compensation Fund
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Medical Malpractice Patients' Compensation Fund for the fiscal year ended June 30, 2006, was issued by The Hobbs Group, P.A., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

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

RHGjr/trb

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June *30,2006*

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying basic financial statements of the business-type activities of the South Carolina Medical Malpractice Patients' Compensation Fund *("the Fund")* a non-major enterprise fund of the State of South Carolina, as of and for the years June 30, 2006 and 2005 as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 audits provides a reasonable basis for our opinion.

As described in Note A, the financial statements of the Fund are intended to present the financial position and the changes in financial position and cash flows of the business-type activities of the State of South Carolina that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of South Carolina primary government as of June 30, 2006 and 2005, and the changes in its financial positions or where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Fund as of June 30,2006 and 2005, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with Government Auditing Standards, we have also issued our report dated September 7, 2006, 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 the 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 assessing the results of our audit.

The management's discussion and analysis on pages 3 through 6 are not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The Hobbs Group, P.A.

Columbia, South Carolina
September 7, 2006

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REQUIRED SUPPLEMENTAL INFORMATION

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Management's Discussion and Analysis

Overview of the Financial Statement and Financial Analysis

This report is prepared in accordance with Governmental Accounting Standards Board Statement 34, *Basic Financial Statements and Management's Discussions and Analysis for State and Local Governments.* This financial statement is presented in three parts: Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows. This discussion and analysis of the South Carolina Patients' Compensation Fund's (PCF) financial statements provide an overview of its financial activities for the year.

Statement of Net Assets

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

Condensed Statement of Net Assets

	FY 2006	FY 2005	Variance
Assets:			
Total Cash:	$ 9,756,656	$ 8,220,433	$1,536,223
Interest Receivable and prepaid expenses	108,742	86,742	21,775
Total Assets	$ 9,865,173	$ 8,307,175	$1,557,998
Liabilities			
Current Liabilities	$ 47,489,286	$ 50,841,001	$(3,351,715)
Non-current liabilities	185,409,261	171,878,593	13,530,668
Total Liabilities	$ 232,898,547	$ 222,719,594	$10,178,953
Net Assets (Deficit):			
Deficit	$(223,033,374)	$(214,412,419)	$(8,620,955)
Total Liabilities & Net Assets	$ 9,865,173	$ 8,307,175	$ 1,557,998

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

Changes in total net assets as presented in the statement activities are based on the activity presented in the Statement of Revenues, Expenses and Changes in Net Assets. The purpose of the statement is to present the revenues earned by the PCF, operating and non-operating and the expenses incurred by the PCF. Non-operating revenues are those for which goods or services are not provided.

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

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	FY 2006	FY 2005	Variance
Operating revenues	$ 42,176,603	$ 41,638,355	$ 538,248
Operating expenses	52,575,127	47,432,217	5,142,910
Operating income or loss	(10,398,524)	(5,793,862)	(4,604,662)
Non-operating revenues	1,777,569	286,162	1,491,407
Decrease in Net Assets	(8,620,955)	(5,507,700)	(3,113,255)
Net Deficit - Beginning of year	(214,412,419)	(208,904,719)	(5,507,700)
Net Deficit – End of Year	$(223.033.374)	$(214.412.419)	$(8.620.955)

Statement of Cash Flows

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

Condensed Statement of Cash Flows for the Year Ended June 30,2005 & June 30,2006

	FY 2006	FY *2005*	Variance
Cash provided (used) by:			
Operating activities	$ (664,913)	$ 935,364	$(1,600,277)
Non-Capital Financing Activities	2,000,000	0	2,000,000
Investing activities	(6,403,150)	309,342	(6,712,492)
Net change in cash	(5,068,063)	1,244,706	(6,312,769)
Cash and cash equivalents – beginning of year	8,220,433	6,975,727	1,244,706
Cash and cash equivalents – end of year	$3.152.370	$8.220.433	$(5.068.063)

Assessment and Rate Increases

The PCF Board of Governors determined that a deficit assessment was not necessary during this fiscal year. The last deficit assessment was in June 2000. The statute grants the Board the authority to make assessments under Section 38-79-450 of the Code of Laws of South Carolina, 1976.

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

Unlimited:	9.2%
10 million per claim/12 million per annual aggregate:	2.5%
5 million per claim/7 million per annual aggregate:	2.5%
3 million per claim/6 million per annual aggregate:	2.5%
1 million per claim/3 million per annual aggregate:	2.5%

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

Business Overview

The Patients' Compensation Fund now functions with a staff of five full-time equivalent employees. The PCF had one FTE to retire after 20 years of service to the state. Mary Ann West, the PCF Program Manager retired effective June 30, 2006. Leigh Brazell, formerly of the South Carolina Medical Association was hired to fill this position.

At the close of the fiscal year, the PCF had a membership total of 7,050. This includes one nursing home, 35 clinics, 6 hospitals, 902 professional associations, 4273 physicians, 1,191 dentists and oral surgeons, 486 nurses and techs, 206 pharmacists and other healthcare providers. The PCF paid a total of $44,585,378 for claims, settlements and judgments during the fiscal year. The PCF collected $41,575,848 net of refunds of $999,906 in membership fees.

Leadership

The Board of Governors is composed of three physicians, two dentist, two hospital representatives, two insurance representatives, two attorneys and two representatives of the general public, all appointed by the Governor. The appointed members serve a term of six years. The Board develops a Plan of Operations for efficient administration of the Fund, consistent with the provisions of the plan of operations and Article 5 of the enabling legislation.

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

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Management's Discussion and Analysis - Continued

The Fund provides customer services to its members through enrollment of new members, renewal of current members, collection of fees and assessments and payment of claims. It provides credentialing information to hospitals and managed care organizations.

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

Physicians and dentists that attend the South Carolina Medical Association and the South Carolina Dental Association Risk Management Seminar, which is sponsored by the South Carolina Medical Malpractice Liability Insurance Joint Underwriting Association (JUA), receive a discount in their annual membership fee. The discount is equivalent to a maximum of 25% or the base premium, up to a maximum of $2,000. It is a one-time discount fee. The discount does not apply to a physician's professional association.

As previously stated, the PCF consists of five full-time employees. The Executive Director, along with the Board of Governors, is closely monitoring the employee's ability to meet the demands and needs of its members, which continue to increase. The PCF is a highly complex organization that works extensively with legal counsel for claims defense, expert witnesses and claims investigations, all in conjunction with the primary carrier. The effective selection, coordination and management of these professionals are critical to the success of the PCF. It requires employees with special skills and a high work ethic.

The Agency continues to make improvements in computer software to ensure that its members are receiving efficient and accurate information. There is a tremendous need to continue to explore and expand technological capabilities that will allow the agency to meet future needs of its members.

The principal challenge of the PCF is to retain current members and at the same time, increase premiums to reduce the loss reserve liability. Revenue is needed to maintain agency solvency, but it is a delicate balance, as a significant loss in members would result in a dramatic increase in premiums for those members who remain in the Fund. The other significant challenge is to manage the claims process effectively and coordinate with the primary carriers for satisfactory resolution of all claims. The PCF's ultimate goal is to provide medical professionals with effective medical malpractice liability coverage, while ensuring that the PCF is in a financial sound position to pay all of its liabilities.

Economic Outlook

The South Carolina Patients' Compensation Fund shows an overall deficit due to the fact that it records the actuarial liability for unpaid claims as well claims that are "incurred but not reported." The PCF continues to meet its obligations in a timely manner. There is only one pending judgment on appeal all other judgments have been satisfied.

We feel the South Carolina Patient's Compensation Fund's overall financial positions are sound. The Fund is not aware of any facts, decisions, or conditions that can reasonably be expected to have a material impact on the Fund's economic outlook during the fiscal year beginning July 1, 2006.

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BASIC FINANCIAL STATEMENTS

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

	June 30, 2006	June 30, 2005
Current Assets		
Cash and Cash Equivalents	$ 3,152,370	$ 8,220,433
Investments	6,604,286	0
Refund Receivables	750	0
Prepaid Expenses	24,481	80,330
Interest Receivable	83,286	6,412
Total Current Assets	9,865,173	8,307,175
TOTALASSETS	$ 9,865,173	$ 8,307,175
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts Payable	$ 177,379	$ 12,879
Accrued Salaries and Benefits	26,777	23,533
Accrued Compensated Absences	14,502	1,500
Unearned Fees	13,270,628	12,303,089
Note Payable	2,000,000	0
Current Portion of Claims Payable	32,000,000	38,500,000
Total Current Liabilities	47,489,286	50,841,001
Accrued Compensated Absences	2,560	11,593
Claims:		
Claims Payable	213,711,701	203,385,000
Claims Discount	(28,305,000)	(31,518,000)
Total Liabilities	232,898,547	222,719,594
Net Assets (Deficit)	(223,033,374)	(214,412,419)
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	$ 9,865,173	$ 8,307,175

See independent auditor's report and accompanying notes

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

	For the Years Ended June 30, 2006	2005
Operating Revenues		
MembershipFees, net of refunds ($999,906 and $1,083,948)	$ 41,575,848	$ 41,064,253
Administrative Fees	597,609	572,086
Deficit Assessment	1,321	2,016
Miscellaneous Income	1,825	0
Total Operating Revenues	42,176,603	41,638,355
Operating Expenses		
Claims, net of discounts	51,625,079	46,576,709
Personnel Services	335,313	295,306
Operating and Contractual Services	572,959	523,816
Supplies and Materials	41,776	36,386
Total Operating Expenses	52,575,127	47,432,217
OPERATING INCOME (LOSS)	(10,398,524)	(5,793,862)
Nonoperating Revenues (Expenses)		
Transfer in from State General Fund	1,499,559	0
Interest Income	349,017	286,162
Investment Account Fees	(22,595)	0
Unrealized Gain (Loss) on Investment	(48,412)	0
Total Nonoperating Revenues (Expenses)	1,777,569	286,162
Change in Net Assets	(8,620,955)	(5,507,700)
Net Assets (Deficit) at beginning of year	(214,412,419)	(208,904,719)
NET ASSETS (DEFICIT) AT END OF YEAR	$ (223,033,374)	$ (214,412,419)

See independent auditor's report and accompanying notes

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

	For the Years Ended June 30, 2006	2005
Cash Flows From Operating Activities		
Cash Received from Members	$ 43,140,996	$ 41,614,428
Cash Received from Assessment	1,321	2,016
Cash Payments for Claims	(44,585,378)	(39,809,709)
Cash Payments for Personnel Services	(327,855)	(293,907)
Cash Payments for Operating and Contractual Services	(351,333)	(536,230)
Cash Payments for Suppliers	(42,223)	(41,234)
Net Cash Provided (Used)By Operating Activities	(2,164,472)	935,364
Cash Flows From Non-Capital Financing Activities		
Proceeds from Note Payable	3,000,000	0
Principal Payment on Note Payable	(1,000,000)	0
Transfer in from State General Fund	1,499,559	0
Net Cash Provided By Non-Capital Financing Activities	3,499,559	0
Cash Flows From Investing Activities		
Purchase of Investments	(13,863,876)	0
Proceeds from Sale of Investments	7,211,178	0
Investment Income	78,877	0
Interest Income	170.671	309.342
Net Cash Provided (Used)By Investing Activities	(6,403,150)	309,342
Net Increase (Decrease)In Cash And Cash Equivalents	(5,068,063)	1,244,706
Cash and Cash Equivalents at beginning of year	8,220,433	6,975,727
Cash and Cash Equivalent At End of Year	$ 3,152,370	$ 8,220,433
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating Loss	$ (10,398,524)	$ (5,793,862)
Change in Assets and Liabilities		
Decrease (Increase) in Receivables	(750)	0
Decrease (Increase) in Prepaid Expenses	55,849	(8,838)
Increase (Decrease) in Accounts Payable	164,500	(8,389)
Increase (Decrease) in Accrued Salaries and Benefits	3,244	2,468
Increase (Decrease) in Accrued Compensated Absences	3,969	(1,104)
Increase (Decrease) in Unearned Fees	967,539	(21,911)
Increase (Decrease) in Claims Payable, net of discounts	7,039,701	6,767,000
Net Cash Provided (Used)By Operating Activities	$ (2,164,472)	$ 935,364
Non-cash Investing Activities:		
Net Increase (Decrease) in Fair Value of Investments	$ (48,412)	$ 0

See independent auditor's report and accompanying notes.

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NOTES TO THE BASIC FINANCIAL STATEMENTS
SOUTH CAROLINA MEDICAL MALPRACTICE PATIENTS' COMPENSATION FUND
June *30,2006*

NOTE A -- SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Entity: The South Carolina Medical Malpractice Patients' Compensation Fund was established by Section 38-79-420 of the Code of Laws of South Carolina on July 1, 1976. The Fund is part of the primary government of the State of South Carolina and is included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Board of Governors, whose members are appointed by the Governor, is the governing body of the Fund. The Board was created to manage and operate the Fund. The Board has the authority to set annual membership fees and to make deficit assessments when insufficient money is available to pay the Fund's liabilities. The Board also has the authority to approve and pay claims liabilities and to actively defend the Fund against claims.

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

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

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

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NOTE **A** -- SIGNIFICANT ACCOUNTING POLICIES - Continued

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

The Fund was created by act of the General Assembly for the purpose of providing funds for payment of that portion of any medical malpractice claim, settlement or judgment against a health care provider which until November 26, 2000, was in excess of $100,000 per incident, and $300,000 in the aggregate, and which thereafter is in excess of $200,000 per incident or in excess of $600,000 in the aggregate for one year. The Fund is liable only for payment of claims against 'licensed health care providers", which includes physicians and surgeons, directors, officers, and trustees of hospitals; nurses; oral surgeons; dentists; pharmacists; chiropractors; hospitals; nursing homes; or any similar category of licensed health care providers. All providers licensed in South Carolina are eligible to participate in the Fund upon remitting the annual assessment fees in amounts as determined by the governing board of the Fund.

Budget Policy: The Fund is granted an annual appropriation for administrative operating purposes by the General Assembly. The appropriation as enacted becomes the legal operating budget for the Fund for its budgeted activities. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and expenditures of total funds. None of the funding of the Fund is provided from State General Fund appropriations. The General Assembly enacts the budget through passage of line-item appropriations by program within budgetary unit. Budgetary control is maintained at the line-item level of the budgetary entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist.

Transfers of funds may be approved by the State Budget and Control Board under its authority or by the agency as set forth in the Appropriation Act for fiscal year 2005-2006 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

During the fiscal year-end closeout period in July, agencies may continue to charge vendor, interagency, and interfund payments for the fiscal year to that fiscal year's appropriation. For the Fund, any unexpended funds as of June 30, automatically carry over to the ensuing

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NOTE A -- SIGNIFICANT ACCOUNTING POLICIES - Continued

fiscal year. State law does not require the use of encumbrance accounting.

State law does not precisely define the budgetary basis of accounting. The current Appropriation Act states that the General Assembly intends to appropriate all State funds and to authorize and/or appropriate the use of all other monies to operate State government for the current fiscal year. The State's annual budget is prepared primarily on the modified accrual basis of accounting with several exceptions, principally the cash disbursements basis for payroll expenditures.

Cash and Cash Equivalents: The amounts shown in the financial statements as *"cash and cash equivalents"* represent cash on hand, cash on deposit with the State Treasurer and local financial institutions, and cash invested in various investments by the State Treasurer as part of the State's internal cash management pool.

Because the State's internal cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Most State agencies participate in the State's internal cash management pool; however, some agency accounts are not included in the pool because of restrictions on the use of funds. For those accounts, cash equivalents included investments in short-term, highly liquid securities having a maturity at the time of purchase of three months or less.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each agency's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Agencies record and report their deposits in the general deposit account at cost. However, agencies report their deposits in the special deposit accounts at fair value. Investments in the pool are recorded at fair value. Interest earned by the agency's special deposit accounts is posted to the agency's account at the end of each month and is retained by the agency. Interest earnings are allocated based on the percentage of an agency's accumulated daily interest receivable to the total undistributed interest received by the pool. Reported interest income includes interest earnings, realized gains/losses and unrealized gains/losses on investments in the pool arising from changes in fair value. The Fund only has special deposit accounts. Realized gains and losses are allocated daily and are included in the accumulated income receivable. Unrealized gains and losses are allocated at year-end based on the agency's percentage of ownership in the pool.

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NOTE A -- SIGNIFICANT ACCOUNTING POLICIES - Continued

Although the State's internal cash management pool includes some long-term investments, it operates as a demand deposit account; therefore, for credit risk information pertaining to the internal cash management pool see the deposits disclosures in Note B.

Prepaid Expenses: Prepaid expenses consist of normal operating expenses for which payment is due in advance such as insurance premiums and consulting contracts and are expensed when the benefit is received

Capital Assets: Equipment acquisitions require the use of fund financial resources and are for amounts in excess of $5,000 capitalized at cost in the Fund upon acquisition. Depreciation of equipment is charged as an expense against operations, and accumulated depreciation is reported on the Fund's statement of net assets. There are no capital assets or depreciation recorded as of June 30, 2006 and 2005.

Accrued Compensated Absences: Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's workweek are entitled to accrue and carry forward at calendar year-end a maximum of 180 days sick leave and 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum of 45 days, but are not entitled to any payment for unused sick leave. The Fund calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments is recorded as a current liability. The net change in the liability is recorded in the current year in the applicable administrative expense categories.

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

The Fund actuarially establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. The Fund, because it carries only excess liability coverage, does not incur claim adjustment expenses. The length of time for which claims costs must be

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NOTE A -- SIGNIFICANT ACCOUNTING POLICIES - Continued

estimated varies depending on the coverage involved. Because actual claims costs depend on such complex factors as medical technology, changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed annually using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. **An** independent actuary performs an actuarial study annually with the latest done in September 2006 for the current year. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made. Claims liabilities are discounted based upon the Fund's payment experience and interest rates on cash equivalents held. The discounted liabilities provide the amount needed, at the date of computation, to fund liabilities that are expected to be paid in future years.

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

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

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

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

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

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NOTE B -- DEPOSITS AND INVESTMENTS

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

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

The carrying amounts of the deposits for the Fund at June 30, 2006 at local financial institutions were $2,359,621 and $7,293,532 at June 30, 2005. Bank balances were $4,233,909 and $1,760,352 at June 30, 2006 and 2005, respectively, and are insured as follows:

	2006	2005
Amount insured by FDIC	$ 100,000	$ 100,000
Amount collateralized by US Government or Agency Securities	4,133,909	0
Amount uninsured and uncollateralized	0	1,660,352
	$ 4,233,909	$ 1,760,352

The remaining deposits of the Fund in the amounts of $792,749 and $926,901 at June 30, 2006 and 2005, respectively, are deposits held by the State Treasurer. Please refer to the Comprehensive Annual Financial Report of the State of South Carolina.

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

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

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NOTE B -- DEPOSITS AND INVESTMENTS - Continued

The Fund's investments at local financial institutions are in US Government Agency Securities. As of June 30, 2006 the Fund had the following investments and maturities:

		Investment Maturities (in Years)			
Investment	**Fair Value**	**Less Than 1**	**1-5**	**6-10**	**10+**
Federal Home Loan Mortgage Corp.	**$ 897,836**	**$ 897,836**	**$ 0**	**$ 0**	**$ 0**
Federal Home Loan Bank	**5,217,310**	**3,737,465**	**1,479,845**	**0**	**0**
Federal National Mort Assn	**489,140**	**0**	**489,140**	**0**	**0**
	$6,604,286	**$4,635,301**	**$1.968.985**	**$ 0**	**$ 0**

The Fund had no investments at local financial institutions at June 30, 2005.

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

	2006	2005
Statement of Net Assets:		
Cash and Cash Equivalents	$ 3,152,370	$ 8,220,433
Investments	6,604,286	0
	$ 9,756,656	$ 8,220,433
Disclosure, Deposits and Investments Plus Reconciling Items:		
Carrying value of deposits:		
Held by State Treasurer	$ 792,749	$ 926,901
Other	2,359,621	7,293,532
Carrying value of investments:		
Federal Home Loan Mortgage Corp.	897,836	0
Federal Home Loan Bank	5,217,310	0
Federal National Mortgage Assn	489,140	0
Total Disclosure, Deposits and Investments Plus Reconciling Items	$ 9,756,656	$ 8,220,433

NOTE C -- CLAIMS LIABILITIES

Because medical malpractice liability insurance covers claims occurring during the coverage period and claims emerging over a long period of time and because the Fund has limited claims experience history, provisions for estimated losses incurred but not reported and claims reported but not settled are based on an actuarial formula which is used to estimate the ultimate incurred losses. An independent actuary does an actuarial study each year to determine these liabilities. As a result of the actuarial study as of June 30, 2006 net discounted liabilities for claims were $7,039,701 more than those at June 30, 2005.

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NOTE C -- CLAIMS LIABILITIES - Continued

The actuarial study establishes a low, medium and high range for the estimated net claims liability. Management's best judgment is that the low range is the best representation of the Fund's net claims liability. The high and medium ranges are $280,379,701 and $248,894,201, respectively as opposed to the low of $217,406,701.

As discussed in Note A, the Fund establishes a liability for both reported and unreported insured events, which includes estimates of future payment of losses. The following represents changes in those aggregate liabilities for the last two years.

Reconciliation of Claims Liabilities

	2006	2005
Unpaid claims at beginning of the fiscal year	$241,885,000	$234,005,000
Incurred Claims:		
Provision for insured events of the current fiscal year	40,185,000	44,400,000
Increases (decreases) in provisions for insured events of prior fiscal years	9,203,079	3,265,424
Total Incurred Claims	49,388,079	47,665,424
Payments of claims:		
Attributable to events of prior fiscal years	(45,561,378)	(39,785,424)
Unpaid claims at end of the fiscal year	$245,711,701	$241,885,000

The schedule above is the undiscounted liabilities for both years. The total discount in 2006 was $28,305,000 and was $31,518,000 in 2005. The claims liabilities were discounted at a 4% rate for 2006 and 2005.

NOTE D -- LONG TERM LIABILITIES

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

	July 1, 2005	Increase	Decrease	June 30, 2006	Due Within One Year
Claims, net	$ 210,367,000	$ 52,601,079	$ 45,561,378	$ 217,406,701	$ 32,000,000
Compensated Absences	13,093	19,293	15,324	17,062	14,502
	$ 210,380,093	$ 52,620,372	$ 45,576,702	$ 217,423,763	$ 32,014,502

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

NOTE E -- PENSION PLAN **OTHER EMPLOYEE** BENEFITS

Pension Plan: The Retirement Division of the State Budget and Control Board maintains four independent defined benefit plans and issues its own publicly available comprehensive Annual Financial Report ("CAFR") which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the Retirement Division, 202 Arbor Lake Drive, Columbia, South Carolina 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

Substantially all employees of the Fund are covered by a pension plan through the South Carolina Retirement System ("SCRS"), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees.

Under 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 15 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 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. Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits. Beginning July 1, 2005, TERI participants are required by state law to make SCRS contributions. Due to the South Carolina Supreme Court decision in Layman et a1 v. South Carolina Retirement System and the State of South

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NOTE E -- PENSION PLAN OTHER EMPLOYEE BENEFITS - Continued

Carolina, employees who chose to participate in the TERI Program prior to July 1, 2005 will not be required to make SCRS contributions.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6.0 percent of all compensation. This percentage increased to 6.25%, effective July 1, 2005 and will increase by -5% to 6.5% beginning July 1, 2006. As of July 1, 2004, the employer contribution rate was 10.85 percent, which included a 3.30 percent surcharge to fund retiree health and dental insurance coverage. This rate will increase by 1% over the next two years (11.35% effective July 1, 2006 and 11.85% effective July 1, 2007). The Fund's actual contributions to the SCRS for the fiscal year ended June 30, 2006 were $15,951. Employer contributions for fiscal years 2005 were $15,183 and 2004 were $12,819. Also, the Fund paid employer group-life insurance contributions of $385 in the current fiscal year at the rate of .15 percent of compensation.

Article *X*, Section 16, of the South Carolina Constitution required 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, benefits, and employee/employer contributions for each pension plan. 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 System does not make separate measurements of assets and pension liabilities for individual employers. Under Title 9 of the South Carolina Code of Laws, the Fund's liability under the plan is limited to the amounts 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 plan is limited to the contribution requirements for the applicable year from amounts appropriated 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 plan.

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

Post-Employment and Other Employee Benefits: In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to active and certain retired State employees and certain surviving dependents of retirees. All permanent full-time employees of the Fund are eligible to receive these benefits. The

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NOTE E -- PENSION PLAN OTHER EMPLOYEE BENEFITS - Continued

State provides post employment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits. These benefits are provided through the Fund's applicable revenue sources for active employees and the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable revenue sources of the Fund for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Currently, approximately 24,000 State retirees meet these eligibility requirements.

The Fund recorded employer contribution expenses for these insurance benefits for active employees in the amount of $15,209 for the year ended June 30, 2006. As discussed above, the Fund paid $6,860 applicable to the retiree health/dental benefits surcharge described above, which is included with the employer contributions for South Carolina Retirement Systems benefits. These amounts were remitted to the SCRS for distribution to the Office of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to the Fund retirees is not available. By State law, the Fund has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

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 System's earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS benefits.

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

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NOTE F -- RELATED PARTY

The South Carolina Medical Malpractice Patients' Compensation Fund has significant transactions with the State of South Carolina and various other State agencies.

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

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

The Fund also had financial transactions with various State agencies during the fiscal year. Significant payments were made to divisions of the State Budget and Control Board for office supplies, telephone, interagency mail, and data processing services. The amounts of 2005 expenses applicable to related party transactions were $15,958.

The Fund provided no services free of charge to other State agencies during the fiscal year.

The Fund is related to the South Carolina Medical Malpractice Liability Joint Underwriting Association ("the *JUA")* as both were created by South Carolina Statute and substantially all members of the JUA are also Fund members. The **JUA** is responsible for payment of that portion of any covered medical malpractice claim, settlement, or judgment up to $100,000 per incident or in excess of $300,000 in the aggregate for one year. Effective November 26, 2001 coverage thresholds were increased to $200,000 and $600,000. The Fund is responsible for payments exceeding those thresholds. JUA by state law is responsible for defense costs of all claims, however the Fund has the right to review and approve all awards that are ultimately made on cases. The Fund reimburses JUA for management oversight per an annual agreement. The current year fee for this service was $200,000, which may be adjusted annually for increases in the consumer price index. The JUA is considered a discrete component unit of the State of South Carolina and is included in the State's CAFR.

NOTE G -- RESTRICTION ON PAYMENT OF CLAIMS

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

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NOTE H -- LEASES

The Fund leases its office space under an operating lease. In July 2004 a lease was extended obligating the Fund to a three year rental for commercial office space. The monthly payments required under the lease were $2,927 per month for fiscal year 2006. The obligations under this lease as of June 30, 2006 are as follows:

For the Year Ending June 30	
2007	$ 36,176

The Fund recorded payments under these operating leases of $ 37,555 and $34,092 for fiscal years 2006 and 2005, respectively.

NOTE I -- UNEARNED MEMBERS FEES

Unearned fees liability at June 30, 2006 and 2005 were $13,270,628 and $12,303,089 respectively, on advance payment of membership fees. Effective June 1, 2001, the Fund began allowing members to pay their fees quarterly. Effective June 1, 2002 the Fund began charging a 1 percent per month administrative charge for those members who elect to pay quarterly. Effective June 1, 2003, this was changed to a minimum of $30 or ½ percent per month on the unpaid balance. Beginning, June 1, 2005 the administrative fee is due up front and is non-refundable.

NOTE J -- RISK MANAGEMENT

The Fund is exposed to various risks of loss and maintains State or commercial insurance coverage for certain risks. Management believes such coverage is sufficient to preclude any significant uninsured losses to the Fund. The Fund has not had any claims in the past three years. There were no significant reductions in insurance coverage from coverage in the prior year. The Fund pays insurance premiums to certain other State agencies and commercial insurers to cover risk that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered premium losses sustained during the policy period in accord with the insurance policy and benefit program limits. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of covered employees for health and dental insurance benefits (Office of Insurance Services).

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

3. Claims of covered public employees for workers' compensation insurance benefits (State Accident Fund).

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NOTE J -- RISK MANAGEMENT – Continued

4. Claims of covered public employees for unemployment compensation insurance benefits (Employment Security Commission).

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

1. Personal property and equipment – Eighty percent of each loss is covered by the IRF. Losses are subject to a $250 deductible.

2. Data processing equipment – Coverage is up to $100,000 per loss with a $250 deductible

3. Torts

The IRF is a self-insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of property, boiler and machinery, and automobile liability. The IRF's rates are determined actuarially.

State agencies are the primary participants in the State's Health and Disability Insurance Fund and in the IRF.

The Fund does not purchase insurance coverage for employee fidelity bond insurance coverage arising from theft or misappropriations. Management believes based on exposure and likelihood of loss that this coverage is not necessary. The Fund has not incurred any expenditures for the past three years for losses from employee theft or misappropriations.

The Fund has not recorded any estimated losses or expenses related to the deductible or policy limits because there is no evidence of asset impairment or other information to indicate a loss should be recorded.

NOTE K -- RETAINED EARNINGS DEFICIT

The Fund has experienced large operating losses in prior years, which has resulted in a net deficit. The operating losses have been attributable to large increases in paid and reported claims, which have substantially effected the actuarial determination of claims liabilities. Contributing factors are that the Funds coverage was unlimited and the Fund does not purchase reinsurance to help defray the effect of large individual claims. As a result, the Fund has substantially increased fees over the last five years. Also, the Fund if needed can assess members' additional fees. This authority was exercised in April, 1998. The April 1998 special assessment approximated $7,450,000. Also in September 2000, the Fund did another

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NOTE K -- RETAINED EARNINGS DEFICIT - Continued

special assessment, which amounted to approximately $16,000,000. To conserve cash, if necessary, the Fund can restrict payment of claims as discussed in Note G. Also as noted in Note A, the threshold for covered losses has increased to $200,000 and $600,000. In 2003 the fund began allowing members to purchase, at lower rates, policies with reduced coverage limits of up to $10,000,000 instead of unlimited coverage. Fees were also increased in the current year. An additional rate increase will be in effect for fiscal year ending June 30, 2007.

NOTE L -- ENTERPRISE FUND INFORMATION

	2006	2005
Charges for services	$ 42,176,603	$ 41,638,355
Operating contributions	1,777,569	286,162
Less: expenses	(52,575,127)	(47,432,217)
Change in net assets	(8,620,955)	(5,507,700)
Net deficit – beginning	(214,412,419)	(208,904,719)
Net deficit – ending	$ (223,033,374)	$ (214,412,419)

This information is included only for the State of South Carolina GAAP reporting purposes and includes terminology and classifications which are not consistent with the financial statements.

NOTE M -- NOTE PAYABLE

The Fund has a short-term note payable of $2,000,000 with Carolina First. The note is due in a lump sum payment, plus accrued interest of 8%, on October 18, 2006.

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COMPLIANCE AND INTERNAL CONTROL

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Mark T. Hobbs, CPA
Eldora T. Whitcomb, CPA
Malynda M. Grimsley, CPA
Christina R. Kelly, CPA

The Hobbs Group, P.A.
Certified Public Accountants
and Consultants

Jeff Nates, CPA, CISA
Stacy F. Smith, CPA
Christie B. Gilbert, CPA

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
South Carolina Office of the State Auditor
Columbia, South Carolina

We have audited the accompanying financial statements of the business-type activities of the South Carolina Medical Malpractice Patients' Compensation Fund ("the *Fund*") as of and for the years ended June 30, 2006 and 2005 as listed in the table of contents and have issued our report thereon dated September 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

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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*.

We noted a certain matter that we reported to management of the Fund, in a separate letter dated September 7, 2006.

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

The Hobbs Group, P.A

Columbia, South Carolina
September 7, 2006

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MANAGEMENT LETTER

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

In planning and performing our audit of the financial statements of South Carolina Medical Malpractice Patients' Compensation Fund ("the ***Fund")*** for the year ended June 30, 2006, we considered the Fund's internal control to plan our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control.

However, during our audit we noted a certain matter involving the internal control and other operational matters that is presented for your consideration. This letter does not affect our report dated September 7, 2006 on the financial statements of the Fund. We will review the status of this comment during our next audit engagement. Our comment and recommendation, which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss this comment in further detail at your convenience, perform any additional study of this matter, or assist you in implementing the recommendation. Our comment is summarized following this letter.

The Hobbs Group, P.A.

Columbia, South Carolina
September 7, 2006

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Revenue to Membership Reconciliations

During our audit, we discovered a difference between the calculated membership and administrative fees in the accounting records and the Fund's membership database. Although the difference was small, we suggest that a system be implemented to reconcile the separately maintained membership data to the membership and administrative fees recorded in the accounting system. This reconciliation process would help to ensure that all membership receipts are accounted for and appropriately classified as well as establish an additional internal control over cash receipts and revenue recognition.

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Edward W. Catalano, Jr., M.D.
Chairman of the Board

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South Carolina Medical Malpractice Patients' Compensation Fund

September 07, 2006

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

Re: PCF Response to Management letter

Mr. Gilbert:

Please allow this letter to serve as the response of the PCF to the Management Letter completed by the Hobbs Group, PA.

Revenue to Membership Reconciliations

The PCF began charging administrative fees (''admin fees'') associated with the allowance of quarterly payments by our members. Historically, we were spreading out this fee over the last three quarters of the membership year. Last year our Board granted authority to charge the admin fee at the beginning of the membership year with the fist quarterly payment in one lump sum amount. We feel this was a big step in the right direction in keeping a more accurate accounting of these fees. I believe this year, while we did have some programming issues with some of the memberships, we do have a more accurate number. I do agree, however, with our auditor that our system should reconcile separately the membership fee data fiom the admin fees. We have already begun implementing a change to our system that will allow us to book the admin fees daily segregating them fiom the actual membership fees. It is our intention that this change should be implemented within the next thirty (30) days.

Otherwise, I believe this year's audit went really well and I would like to thank our auditors for helping not only expedite our audit, but also their assistance with finalizing our audit and in meeting with the PCF Finance and Audit committee.

Very truly yours,

Terry A. Coston, SCLA
Executive Director

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