



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

INDEPENDENT AUDITOR'S REPORT

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of North Carolina, as of and for the year ended June 30, 2006, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of North Carolina's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the North Carolina State Lottery Fund, which is both a major fund and 3 percent, 0 percent, and 15 percent, respectively, of the assets, net assets, and revenues of the business-type activities; the financial statements of the 401(K) Supplemental Retirement Income Plan, which represent 4 percent, 5 percent, and 4 percent, respectively, of the assets, net assets, and revenues of the aggregate remaining fund information; the North Carolina Housing Finance Agency, which represent 9 percent, 3 percent, and 3 percent, respectively, of the assets, net assets, and revenues of the aggregate discretely presented component units; the financial statements of the State Education Assistance Authority, which represent 15 percent, 4 percent, and 3 percent, respectively, of the assets, net assets, and revenues of the aggregate discretely presented component units; nor the financial statements of the University of North Carolina System – University of North Carolina Health Care System – Rex Healthcare, which represent 2 percent, 2 percent, and 4 percent, respectively, of the assets, net assets, and revenues of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the 401(K) Supplemental Retirement Income Plan, the State Education Assistance Authority, and the University of North Carolina System – University of North Carolina Health Care System – Rex Healthcare were not audited in accordance with *Governmental Audit Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of

North Carolina, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 21 to the financial statements, the State changed its method of recognizing individual income taxes and implemented Governmental Accounting Standards Board Statement No. 46, *Net Assets Restricted by Enabling Legislation*, during the year ended June 30, 2006.

In accordance with *Government Auditing Standards*, we will also issue our report dated December 11, 2006 on our consideration of the State of North Carolina'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 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 report on internal control and on compliance and other matters will be published at a later date in the State of North Carolina's *Single Audit Report*.

The Management's Discussion and Analysis; Schedules of Funding Progress – All Defined Benefit Pension Trust Funds; Schedule of Contributions from the Employers and Other Contributing Entities – All Defined Benefit Pension Trust Funds; Schedule of Revenues, Expenditures and Changes in Unreserved Fund Balances – Budget and Actual – General Fund; and the Notes to Required Supplementary Information – Budgetary Reporting, as listed in the table of contents, are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of North Carolina's basic financial statements. The introductory section, the combining fund financial statements and schedules, and the statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.



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December 11, 2006