



State of North Carolina Office of the State Controller

Michael F. Easley, Governor

David McCoy, State Controller

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

It is our pleasure to furnish you with the 2008 Comprehensive Annual Financial Report (CAFR) of the State of North Carolina in compliance with G.S. 143B-426.40H. This report has been prepared by the Office of the State Controller. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the state government and this office. To the best of our knowledge and belief, this financial report is complete and reliable in all material respects. We believe all disclosures necessary to enable you to gain an understanding of the State's financial activities have been included.

Although the State budgets and manages its financial affairs on the cash basis of accounting, G.S. 143B-426.40H requires the Office of the State Controller to prepare a Comprehensive Annual Financial Report (CAFR) in accordance with generally accepted accounting principles (GAAP) in the United States of America. Except for schedules clearly labeled otherwise, this CAFR has been prepared in accordance with GAAP.

For the convenience of users we have divided the CAFR into three major sections, described as follows:

- The **introductory section** includes this transmittal letter and the State's organization chart, including a listing of principal State officials.
- The **financial section** includes management discussion and analysis (MD&A), the basic financial statements (government-wide financial statements, fund financial statements, and notes), other required supplementary information, the combining and individual fund financial statements, and schedules.
- The **statistical section** includes selected financial, non-financial and demographic information, much of which is presented on a ten-year basis, as well as required supplementary information.

Management of the government is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

In compliance with State statute, an annual financial audit of the State financial reporting entity is completed each year by the North Carolina Office of the State Auditor. The Auditor's examination was conducted 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, and the Auditor's opinion has been included in this report. In addition, the State coordinates the *Single Audit* effort of all federal funds through the State Auditor.

This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A provides an overview of the State's financial activities addressing both governmental and business-type activities reported in the government-wide financial statements. In addition, MD&A focuses on the State's major funds: the General Fund, the Highway Fund, the Highway Trust Fund, the Unemployment Compensation Fund, the EPA Revolving Loan Fund and the N.C. State Lottery Fund. The MD&A can be found immediately following the Independent Auditor's Report.

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Profile of the State of North Carolina

The Old North State, The Tar Heel State

North Carolina became the 12th state of the union in 1789. North Carolina is located on the Atlantic coast and is bordered by Georgia, South Carolina, Tennessee and Virginia. The State has a land area of approximately 50,000 square miles. The State's estimated population is 9 million, making it the 10th most populated state in the nation. Sixty percent of the population is found in urban areas, while forty percent is found in rural areas. The North Carolina coastline is 301 miles, the greatest distance east to west is 543 miles, and the greatest distance north to south is 188 miles. The State's elevation rises from sea level on the eastern coastline to 6,684 feet at Mount Mitchell in the Appalachian mountain range on our western border. There are 79,261 miles of roads, with Interstate 40 crossing North Carolina east to west, and Interstates 85 and 95 crossing the State north to south. North Carolina's capital and central state government administration is located in Raleigh, in the central piedmont. Charlotte, Raleigh, Greensboro, Durham, and Winston-Salem are North Carolina's largest cities and there are 100 counties.

Government

North Carolina's state government consists of an executive branch, a legislative branch, and a judicial branch. The executive branch is headed by the Governor. The Governor, Lieutenant Governor, and eight other statewide elected officers form the Council of State. The State Constitution provides that, "A Secretary of State, an Auditor, a Treasurer, a Superintendent of Public Instruction, an Attorney General, a Commissioner of Agriculture, a Commissioner of Labor, and a Commissioner of Insurance shall be elected by the qualified voters of the State...."

The legislative power of the State is vested in the General Assembly, which consists of a Senate and a House of Representatives. The Senate is composed of 50 Senators, elected on a biennial basis. The House of Representatives is composed of 120 Representatives, elected on a biennial basis.

The Courts of the Judicial Branch are split into three divisions, the Appellate Division, the Superior Court Division, and the District Court Division. Judges are elected on a non-partisan basis.

State Reporting Entity and Its Services

The State of North Carolina entity as reported in the CAFR includes all fund types of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches. In addition, the reporting entity includes legally separate component units for which the State is financially accountable. The component units are discretely presented in the government-wide financial statements. The State's discretely presented major component units are the University of North Carolina System; the State's community colleges; Golden LEAF, Inc., North Carolina Housing Finance Agency, and North Carolina State Education Assistance Authority. The criteria for inclusion in the reporting entity and its presentation are defined by the Governmental Accounting Standards Board (GASB) in its GASB Codification Section 2100. These criteria are described in Note 1 of the accompanying financial statements.

The State and its component units provide a broad range of services to its citizens, including k-12 public education; higher education; health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; transportation; agriculture; and general government services. The costs of these services are reflected in detail and in summary in this report.

Budgetary Control

In addition to internal controls discussed previously, the State maintains budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the General Assembly. Activities of the General Fund, departmental special revenue funds, and permanent funds are included in the annual appropriated budget. The State Highway Fund and the Highway Trust Fund, the State's major special revenue funds, are primarily budgeted on a multi-year basis. Capital projects are funded and planned in accordance with the time it will take to complete the project. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is exercised at both the departmental and university level, with allotment control exercised by the State Controller, and on the program line-item levels requiring certain approvals by the Director of the Budget. Legislative authorization of departmental expenditures appears in the State Appropriation Bill. The certified budget is the legal expenditure authority; however, the Office of State Budget and Management (OSBM) may approve executive changes to the legal budget as allowed by law. These changes result in the *final budget* presented in the required supplementary information.

Economic Condition

Overview

The economy over the last twelve months has been battling significant headwinds caused by the slow unwinding of the housing market recession and the subsequent turmoil in the financial markets. The result is that both businesses and consumers will struggle until the financial markets stabilize and the housing market begins to recover.

Problems in the economy began to surface from significant losses in household wealth caused by the housing market recession. As early as 2006, troubles in the housing sector started to appear. At first, the housing slump seemed isolated to a few regions in the nation, but by the start of 2007 most of the nation was feeling the impact from a significant slowdown in housing. The drop in home purchases began to affect industries tied to home sales and construction. For example, retail sales items such as furniture and appliance purchases declined. The fallout from the housing recession began to impact financial markets as well, where loans and investments tied to real estate began to falter.

In the second quarter of 2007, the housing slowdown and financial market troubles deepened and began to show significant signs of affecting the overall economy. While some slowdown is expected in the middle of a business cycle, the impact of the financial market upheaval, exacerbated by the prolonged housing recession, put the economy perilously close to a recession and by the end of the second quarter of 2008 many economist were expecting a recession to occur.

Consumers were starting to feel the strain caused by a slowing economy. In addition to troubles in the housing and financial market, they faced higher commodity prices. Most noticeably they were paying higher prices at the gas pump and in grocery stores. Consumers were being hit hard by these economic conditions. Employment opportunities began to decline, real wages (adjusted for inflation) were falling, credit markets made it difficult to borrow money, and household debt was at an all time high. By the end of the summer of 2008, consumer confidence, as measured by the Consumer Confidence Index survey, dropped to recession-like levels.

One bright spot in the economy has been the global demand for U.S. products. In fact, one of the stronger facets of the nation's economy during 2007, were exports. Strong growth of global economies coupled with falling exchange rates for the dollar fueled demand for U.S. products. Exports helped bolster the national economy and soften the blow caused by problems in the housing and financial sectors.

For North Carolina, economic conditions did not begin to weaken until early in 2008. Through 2007, the State seemed less vulnerable to the nation's economic downturn, which was already well underway. By mid-summer 2008 however, many industry sectors in the State were beginning to feel the strain as financial market conditions deteriorated and consumer spending weakened further. Recent economic developments nationally, globally, and in the State indicate most of 2008, and all

of 2009, will be characterized by stagnant employment growth, lower real wages and reduced consumer spending.

National Economic Outlook

United States Economic Indicators

	FY2006-07 Actual	FY 2007-08 Actual	FY2008-09 Projected	FY2009-10 Projected
Economic Growth (GDP)*	2.9%	2.4%	0.6%	2.4%
Personal Income	6.5%	5.3%	2.7%	4.1%
Corporate Pre-Tax Profits	7.9%	-3.2%	-5.4%	-2.1%
Retail Sales and Food Services	4.2%	3.6%	0.3%	3.3%
CPI	2.6%	3.7%	3.8%	1.7%
30-yr Fixed Mortgage Interest Rate	6.2%	6.1%	6.1%	7.3%

*adjusted for inflation

The nation's economic indicators point to the onset of a slowdown in FY2007-08 and the projected continued downturn in the economy for FY2008-09. Through calendar year 2009, economic growth is expected to be well below the long-term, average growth of 3.1 percent. With this economic slowdown, total personal income growth will slow to 2.7 percent in FY2008-09 and only rise modestly to 4.1 percent the following fiscal year.

Businesses coming out of the last recession experienced a boost in profits from robust growth in sales and cost-cutting efficiencies undertaken during the recession. The current downturn will make it difficult for businesses to maintain current profit levels. The impact of falling consumer demand, the global downturn, plus upward cost pressures (inputs, interest rates, energy) will reduce corporate profits and negative yearly growth is projected for 2008 and 2009. A slight increase in profitability is anticipated for 2010 as both the nation and global economies begin a modest economic recovery.

One indication of how well the economy is performing is retail sales. Projections anticipate this key indicator will experience zero to slightly negative growth the last quarter of 2008 and the first two quarters of 2009. Retail is not expected to fully rebound until 2010. The key to a rebound in retail sales will be a recovery in the real estate market and a stable financial market offering low, attractive interest rates to consumers.

If inflation can be held in check, then the Federal Reserve Board will have more flexibility to continue fighting the economic recession, but there is little more they can do to lower interest rates in response to the housing slump. In fact, forecasted 30-year mortgage rates are expected to fall slightly in 2009 and then increase going into the 2010 fiscal year.

To summarize, a housing recession that began in 2006 grew much worse in 2007. The housing recession led to a financial market crisis that will send the nation into a period of recession-like economic conditions. Conditions marked by higher unemployment, reduced income, and a drop in consumer spending. The earliest an economic recovery is anticipated to occur will be the last half of 2009.

**North
Carolina
Economic
Outlook**

North Carolina Economic Indicators

	FY2006-07	FY2007-08	FY2008-09	FY2009-10
	Actual	Actual	Projected	Projected
Personal Income	6.9%	5.4%	4.1%	3.4%
Wages & Salaries	7.3%	4.4%	2.5%	3.3%
Retail Sales	7.0%	4.9%	0.6%	2.7%
Unemployment Rate	4.7%	5.0%	7.1%	7.5%
Employment (Nonagricultural)	3.4%	1.7%	-0.8%	0.4%
Existing Single-family Home Sales	-0.1%	-21.3%	2.7%	9.8%
Average Hourly Earnings: Manufacturing	2.9%	3.2%	3.9%	3.0%

For North Carolina, the economic slowdown began in earnest the second quarter of 2008. Prior to then, it appeared the State might weather the economic turmoil experienced by some states and avoid recession-like conditions. The initially mild slowdown experienced by the State may be due in part to North Carolina's relatively mild housing problems. The State's housing bubble was limited to a few resort areas, therefore the statewide impact from the initial housing slowdown was far less severe than in many states. Through the first half of 2007, the State continued to experience strong population and employment growth. This growth helped dampen the impact from the housing slump. Even towards the end of 2007, the State's economy remained one of the few state economies still experiencing near-normal employment and income growth. However, by the spring of 2008, the national economic slowdown had spread to North Carolina and employment and income growth began to stall.

Thus, for FY2007-08, State economic indicators such as employment and income growth had noticeably slowed compared to the previous fiscal year. Going forward income growth is projected to continue to slow for the next two fiscal years with a modest rebound in wage and salary growth forecast for 2010. As with the nation, the majority of the housing slump's effects will have worked themselves out by 2009, but residual effects will continue to be a drain on the State's economy. For FY2008-09, the economic downturn and the strain on consumers will result in almost no growth in retail sales (0.6 percent) and falling employment (-0.8 percent).

As the State's economy suffers through the downturn, unemployment will increase and is projected to remain at, or above, 7 percent through 2009 and into 2010. This past year a drop in employment in the housing related industries including financial services, residential construction, and transportation occurred. Long-term negative growth trends in manufacturing continued as the State transitions away from traditional manufacturing jobs. In the last recession, manufacturing, particularly in the furniture and textile industries, shed jobs at a rate of 10 percent per quarter. The State's manufacturing sector will not be as vulnerable during this recession and job losses in this industry sector will continue, but are not projected to fall at the accelerated pace experienced during the last recession.

Additionally, the recent financial market upheaval has had a detrimental impact on the financial service sector's employment. Current estimates indicate job losses in this sector will continue into 2010. Compounding problems in the job market will be employment cutbacks in the service and retail sectors due to falling consumer spending. Thus, the number of people employed in non-agricultural industries in the State are expected to decline in FY2008-09, and the following fiscal year only grow at a rate of 0.4 percent.

An indication of the magnitude of the recession in the housing market can be represented by the 21.3 percent decline of existing-home sales in FY2007-08. This pullback in the sale of real estate can take a long time to recover from and for stability to return to the real estate market. Once the housing market stabilizes and an economic recovery is underway, North Carolina's economy is expected to expand at a faster pace than the nation. This should bode well for overall employment in the State and help bolster income growth going into 2010. Employment losses in the manufacturing industries will continue, but growth in the service and tech industries should rebound and continue to be a major stimulus to economic growth.

There is little doubt that the State will experience an economic slowdown with recession-like conditions possible over the next couple of years, but it is in a position to perform better than the nation as a whole during this period and is expected to bounce back faster than many other regions of the country.

— *Economic analysis prepared by Barry Boardman, Ph.D., Staff Economist
North Carolina General Assembly, Fiscal Research Division
October 31, 2008*

Issues and Observations

BEACON

BEACON (Building Enterprise Access for NC's Core Operational Needs) is a statewide collaborative effort aimed at transforming the way we do business in North Carolina by modernizing and standardizing key business processes in human resources, payroll, budget management, taxation, data storage and accounting. In December 2007, after five years in the planning and development phases, the State completed a historic upgrade of its antiquated business systems by replacing them with SAP's Enterprise Resource Planning (ERP) software solution.

The HR/Payroll system uses a technology framework from SAP that ties agency information together in a single network. The SAP software also allows for future business operations to be added to the central system. The North Carolina State Legislature already has approved funding to add electronic recruiting, which will keep track of state job applicants; and electronic training, which will handle a number of training-related functions, to the new system. Once full stabilization of the HR/Payroll system is achieved, projects like electronic recruitment and others will be prioritized and resources will be directed to those projects.

Planning has started on the next phase of the project, which will potentially add budgeting, accounting and cash management functions. When completed, the BEACON system will provide centralized, coordinated business operations that can improve efficiency and provide timely, accurate information for decision-makers and the public.

Since 2004 the General Assembly has appropriated \$76.831 million in non-recurring funding and approximately \$10 million in recurring dollars to support this initiative. Session Law 2007-323 directed the Office of the State Controller, in cooperation with the State Chief Information Officer, to develop a Strategic Implementation Plan for the integration of data bases and the sharing of information among state agencies and programs. It further directed that the plan be developed under the governance of the BEACON Project Steering Committee, in conjunction with the leadership in the state agencies and with the support of the Office of State Budget and Management.

Subsequent to the initial data integration legislation, SL 2008-107 was passed in response to the unfortunate death of two university students. The legislation directed that the Office of the State Controller, in cooperation with the State Chief Information Officer and under the governance of the BEACON Program Steering Committee, to develop and implement a Criminal Justice Data Integration Pilot Program in Wake County. The objective of the pilot program is to provide law enforcement professionals with enhanced decision making ability through access to a secure network that offers timely, complete and accurate criminal information.

**State Budget
Act**

On July 20, 2006, the General Assembly passed House Bill 914 State Budget Act to replace the Executive Budget Act. This new legislation was effective July 1, 2007 and affects budget development and management by simplifying, reorganizing, updating the current budget statutes, and making changes to conform the statutes to the state constitutional provisions governing appropriations. The State Budget Act defines key budget aspects and increases the targeted balance of the General Fund savings reserve from 5 percent to 8 percent of prior year operating appropriations expenditures. The new legislation provides that agency budgets be classified in accordance with generally accepted accounting principles as interpreted by the State Controller.

As part of the implementation of the State Budget Act, budgetary processes, budget code structures, and budgetary reports have been reviewed and revised as appropriate. Some revisions have required adjustment to the State's budgetary and accounting systems. The State Budget Manual has been updated to reflect changes required by House Bill 914.

**Other Post-
Employment
Benefits:
Retiree
Healthcare**

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (effective for fiscal year 2006-07), and in June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (effective for fiscal year 2007-08).

The actuarial data for the retiree healthcare benefit plan is disclosed in Note 13, Other Postemployment Benefits, based on the disclosure requirements for a cost-sharing, multiple-employer plan, and is also presented as required supplementary information (RSI). Based on the disclosure requirements of a cost-sharing, multiple-employer plan, the unfunded actuarial liability is not recorded as an accounting liability.

The State retiree healthcare benefit is currently funded on a pay-as-you-go basis, with minimal additional accumulation of funds to pay the retiree health benefit. Based on the current funding method with limited accumulation of funds, the actuarial assumptions reflect a short-term discount rate of 4.25%. The December 31, 2007 actuarial valuation using the projected unit credit cost method indicated an accrued liability of \$28.89 billion for the retiree healthcare plan (\$28.594 billion unfunded), with an annual required contribution (ARC) of \$2.714 billion.

Participating employers in the retiree health care benefit plan include the primary government state employees, local education agencies (LEAs), the University of North Carolina, community colleges, and several local governments. For the fiscal year ended June 30, 2008, retiree healthcare employer contributions were \$601.032 million, representing an annual increase of 13.75%. Retiree healthcare premium costs paid to the State Health Plan were \$523.267 million, representing an annual increase of 19.8%. Plan net assets of \$361.524 million represent an increase of \$90.885 million, or 33.6% from the prior year.

State Governmental Accountability and Internal Control Act

The purpose of the *State Governmental Accountability and Internal Control Act* is to establish internal control standards for State government and to increase fiscal accountability. Recognizing the public interest and the importance of oversight over public institutions, the Governor and General Assembly enacted new legislation that provides for the implementation of an effective and efficient system of internal control providing reasonable assurance that the public's objectives are met. Moving forward, the *State Governmental Accountability and Internal Control Act* will ensure that our State system of internal control incorporates applicable statewide standards and clearly defines and assigns specific internal control related responsibilities.

On February 26, 2008, the Office of the State Controller launched an exciting new initiative for state government. This initiative, referred to as EAGLE, resulted from the passage of the State Governmental Accountability and Internal Control Act (North Carolina General Statutes, Chapter 143D) during the 2007 session of the General Assembly. EAGLE, which stands for *Enhancing Accountability in Government through Leadership and Education*, is intended to meet the public's increasing expectations for effective operations and accountability within state government and provides an opportunity for North Carolina to leverage on the best practices that have recently been implemented in the private sector.

The legislation passed in 2007 defines internal control as: "an integral process, effected by an entity's governing body, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives related to the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations."

During 2008, OSC began a phased-in implementation of the EAGLE Program. In Phase I of the implementation, each agency is required to perform an annual assessment of internal control over financial reporting. By performing these assessments, agencies are able to identify risks and compensating controls that reduce the possibility of material misstatements and misappropriation of assets. Opportunities to increase efficiency and control effectiveness in business processes and operations also result from these assessments.

To assist the agencies in their efforts to comply with the requirements of the Statewide Governmental Accountability and Internal Control Act, the Office of the State Controller conducted statewide training sessions to educate the participants on the EAGLE Program requirements, in addition to providing general guidance on understanding basic internal control concepts/principles. Approximately 300 participants attended the March 31, 2008 training session and another 225 attended the one on October 22, 2008. In addition, our staff has conducted one-on-one agency training sessions. Keeping with our goal of educating agency personnel on internal control concepts/principles, the Office of the State Controller plans to offer additional training opportunities in the future.

The first group of state entities implementing Phase I of the EAGLE Program is nearing completion of their Year 1 efforts. The Office of the State Controller recently solicited comments from the initial participants regarding their implementation experiences. We believe this feedback is imperative for the success of the EAGLE Program. The Office of the State Controller will evaluate the comments received and, where feasible, incorporate necessary changes to the Program.

The EAGLE Program has begun to generate national interest and should further solidify North Carolina's status as a proven national leader in governmental accountability and fiscal management.

North Carolina Internal Audit Act

The North Carolina General Assembly enacted the Internal Audit Act in Chapter 143 of the North Carolina General Statutes. The purpose of the Act is to promote effective use of internal audit efforts throughout the State. The Act requires State agencies and universities to establish a program of internal auditing; establishes the Council of Internal Auditing; and directs the Office of State Budget and Management (OSBM) to serve as staff and support to the Council. The Act applies to State agencies and universities that have an annual operating budget exceeding \$10 million; more than 100 full time equivalent employees; or receive and process more than \$10 million in cash in a fiscal year.

State agencies and universities meeting the Internal Audit Act participation requirements are directed to establish a program of internal auditing that promotes an effective system of internal controls, safeguards public funds and assets, and minimizes incidences of fraud, waste, and abuse. Internal auditing programs review the effectiveness and efficiency of agency and program operations and service delivery. Specifically, state agencies and universities internal audit activities include:

- Appointing an Internal Audit Director
- Establishing an internal audit program
- Complying with auditing standards
- Submitting an audit charter and organizational chart to the Office of Internal Audit (OIA) as they are updated
- Following the North Carolina Internal Audit Manual
- Submitting internal audit plans on a yearly basis
- Submitting internal audit reports regularly
- Submitting reports or information to the OIA as requested by the Council

The Council of Internal Auditing plays a significant role in the implementation of the North Carolina Internal Audit Act. The Council consists of the State Controller, who serves as Chair, the State Budget Officer, the Secretary of Administration, the Attorney General, the Secretary of Revenue, and the State Auditor who serves as a nonvoting member. The Council of Internal Auditing meets every other month and works to:

- Develop guidelines for the uniformity and quality of state agency internal audit activities
- Administer an independent peer review system
- Recommend the number of internal audit employees required by each state agency
- Provide central training sessions, professional development opportunities, and recognition programs for internal auditors
- Administer a program for sharing internal auditors
- Maintain a central database of all internal audit plans and reports
- Issue an annual report including, but not limited to, service efforts and accomplishments of State agency internal auditors
- Propose legislation for consideration by the Governor and General Assembly

To support the Council, OSBM established the Office of Internal Audit (OIA) to assist in carrying out Council's responsibilities. The staff develops yearly objectives based on the legislative mandates and reports the progress of the objectives at each Council meeting. In addition, staff members are working to develop the following programs:

- **Interagency Internal Audit Program:** The Interagency Internal Audit Program provides technical expertise to internal audit functions and assists state agencies with internal audit activities whose budgets are between \$10 and \$70 million. The Program helps agencies develop and implement audit plans to add value and improve a state agency's operations.
- **OIA Peer Review Program:** The OIA Peer Review Program will help state agencies and universities comply with The Institute of Internal Auditors (IIA) Standards for the Professional Practice of Internal Auditing (Standards). In order to comply with the Standards, internal auditing offices are required to have an external assessment at least once every five years. The purpose of an external review is to evaluate and express an opinion on an Internal

Audit function's compliance with the Standards. The Peer Review Program will enable state agencies and universities to obtain their external assessment in a method that is cost-effective and educational.

- On-going Training Opportunities: The OIA provides centralized training for State internal auditors on a yearly basis. Staff members conduct an annual training survey to understand internal auditor needs and interests. One to two trainings are planned per year depending upon fund availability. In addition, staff members provide information on external professional development opportunities on a regular basis.

Additional information on the Council of Internal Auditing and the Office of Internal Audit can be found on the Office of State Budget and Management website.

Economic Development

North Carolina has again been recognized for its economic development efforts. North Carolina, for the fourth year in a row and seven of the last eight years, is the state with the *Top Business Climate* according to *Site Selection* magazine. *Site Selection* is one of the nation's premier magazines for economic development.

"Corporate executives know North Carolina is listening to them and we understand what they need to succeed," Easley said. "We are investing in education to provide a skilled workforce and offering an unmatched quality of life so people want to live and work here. All these make our state the top choice for companies looking to grow."

Site Selection magazine's annual *Top Business Climate* rankings are based on quantitative and qualitative factors that corporate site-seekers, those who help companies expand or relocate, say they consider most important. Fifty percent of the ranking comes from a survey of corporate site selection executives who were asked to rank their top 10 states and 50 percent is based on four measures of new plant activity as tracked by *Site Selection*. The magazine describes the ranking process as "a blend of objective, actual new or expansion project announcements, and subjective input from corporate site seekers." According to the magazine, corporate executives identified incentives, low taxes and an effective economic development team as well as the Governor's commitment to retooling the state's workforce as the factors behind North Carolina's winning business climate.

The article about North Carolina's No. 1 ranking can be found at: www.siteselection.com.

Debt Affordability

The 2004 General Assembly passed legislation creating the Debt Affordability Advisory Committee. The Committee is charged, on an annual basis, with advising the Governor and the General Assembly of the estimated debt capacity of the State for the upcoming 10 fiscal years.

The Committee produces the *Debt Affordability Study* on an annual basis. The report was created to serve as a tool for sound debt management practices by the State of North Carolina. The report provides the Governor and the General Assembly with a basis for assessing the impact of future debt issuance on the State's fiscal position and enables informed decision-making regarding both financing proposals and capital spending priorities. The report also provides a methodology for measuring, monitoring and managing the State's debt levels. The concept of debt affordability is widely regarded as an essential management tool. The methodology used in the study to analyze the State's debt position incorporates historical and future trends in debt levels, peer group comparisons and provides recommendations within adopted guidelines. The study also provides recommendations regarding other debt management related policies considered desirable and consistent with the sound management of the State's debt. Such recommendations were developed by incorporating management practices consistent with those utilized by the most highly rated states.

Awards and Acknowledgements

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of North Carolina for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007. This was the 14th consecutive year (1994 to 2007) the State has received the prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA.

Acknowledgments

In conclusion, we believe this report provides useful data to all parties using it in evaluating the financial activity of the State of North Carolina. We in the Office of the State Controller express our appreciation to the financial officers throughout the State and to the Office of the State Auditor for their dedicated efforts in assisting us in the preparation of this report. Any questions concerning the information contained in this Comprehensive Annual Financial Report should be directed to the Office of the State Controller at (919) 981-5454.

Respectfully submitted,



David McCoy
State Controller

December 8, 2008

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CERTIFICATE OF ACHIEVEMENT

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2007

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Oliver S. Cox

President

Jeffrey R. Emer

Executive Director