



State of North Carolina

Office of the State Controller

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STATE CONTROLLER RELEASES 2012 COMPREHENSIVE ANNUAL FINANCIAL REPORT

RALEIGH – The Office of State Controller today released North Carolina’s 2012 Comprehensive Annual Financial Report (CAFR). The CAFR is prepared in accordance with generally accepted accounting principles. (*Key 2012 financial results are summarized on pages two through four below.*)

North Carolina is one of the first states to complete and submit its CAFR. In fiscal year 2011, only three states (New York, Utah, and Washington) and the District of Columbia submitted their CAFR prior to North Carolina’s submission. In addition, OSC recently received the Certificate of Achievement for Excellence in Financial Reporting by the Government Finance Officers Association of the United States and Canada (GFOA) for its 2011 Comprehensive Annual Financial Report. The award is the highest form of recognition in the area of governmental accounting and financial reporting. The 2011 award marked the 18th consecutive year that OSC’s CAFR received this noteworthy recognition. The OSC believes the 2012 CAFR will meet or exceed the Certificate of Achievement Program requirements and have submitted it to the GFOA for review.

The CAFR is used by bond agencies and other financial organizations to assess the State’s fiscal health and economic outlook. North Carolina remains one of only eight states to enjoy top-tier rankings (i.e., AAA) from all three credit rating agencies.

The CAFR is prepared each year by the Office of the State Controller and audited by the Office of the State Auditor. The report, which outlines North Carolina’s financial condition, has received a “clean” opinion from auditors, indicating that it fairly represents the financial position of the State.

The full 2012 CAFR is available on the Office of the State Controller (OSC) website at:
<http://www.osc.nc.gov/financial/12CAFR/index.html>.

A summary level Financial Highlights report based on the 2012 CAFR is also available on the OSC website at:
http://www.osc.nc.gov/financial/12cafr/2012_Popular_Report.pdf.

Each year, OSC uses the cover of the CAFR to highlight the people, events and history of North Carolina. Featured on the cover of the 2012 CAFR is a scene from the grand opening of the Nature Research Center (NRC) – the new wing of the North Carolina Museum of Natural Sciences. The NRC, with its iconic Daily Planet (the large globe pictured on the CAFR cover), brings research scientists and their work into the public eye, helps demystify an often intimidating field of study, better prepares science educators and students and inspires a new generation of young scientists. The new wing opened after a successful public/private capital campaign.

**STATE OF NORTH CAROLINA
KEY FINANCIAL RESULTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

General Fund

The General Fund is the chief operating fund of the State. The fund balance of the General Fund declined 13.58% to \$1.022 billion at June 30, 2012. The decrease is due to the expiration of temporary taxes and significant growth in Medicaid expenditures. At the end of the current fiscal year, the unassigned fund balance of the General Fund was negative \$62.303 million. The negative unassigned fund balance is due to nonspendable, restricted, and committed fund balances exceeding total fund balance.

Individual income tax and corporate income tax revenues increased by 4.38% and 4.85% respectively, while sales and use tax revenues decreased by 10.07%. All individual income tax payment types (i.e., final payments by individuals, withholdings by employers, and estimated payments by individuals) increased during the current fiscal year. This trend shows that the economy is slowly turning in a positive direction. The largest tax change for fiscal year 2011-12 was the expiration of the temporary tax package passed as part of the 2009-2011 biennium budget. This package included a 1% increase in the state sales tax (expired on July 1, 2011), a 2% or 3% income tax surcharge on highest-income households (expired for taxable years on or after January 1, 2011), and a 3% surcharge on corporate income taxes (expired for taxable years or after January 1, 2011). Allowing the package to expire decreased annual State revenue by an estimated \$1.3 billion.

During the current and previous fiscal years, the General Fund recognized federal recovery funds provided under the American Recovery and Reinvestment Act of 2009 (ARRA) of \$421.815 million and \$1.791 billion, respectively. ARRA includes two key funding streams for states, the State Fiscal Stabilization Fund (SFSF) and increased federal participation in Medicaid (FMAP). The federal recovery funds were used to avoid deeper reductions in spending. The ARRA funding streams for the SFSF and FMAP ended in fiscal year 2010-11.

One of the major budget drivers for the General Fund is the Medicaid Program. On the budget basis, expenditures for Medicaid increased 22.76% in fiscal year 2011-12 to \$3.03 billion. The significant increase is due to the reduced federal participation in Medicaid and a Medicaid budget shortfall. The fiscal year 2011-12 certified budget fell short by \$375 million of the amount needed to provide Medicaid services for the entire fiscal year. This increase is explained by unbudgeted liabilities (i.e., over-collection of federal funding in fiscal year 2008-09), unachievable budget reductions, and an increase in Medicaid enrollment. To assist with the Medicaid shortfall, the N.C. General Assembly enacted legislation that transferred funds to the Medicaid Program from sources such as the Repairs and Renovations Reserve and agency reversions.

Highway and Highway Trust Funds

The fund balance of the Highway Fund increased from \$572.667 million at June 30, 2011 (as restated) to \$629.073 million at June 30, 2012, an increase of 9.85%. The fund balance increase is attributable, in part, to the issuance of \$179.54 million in grant anticipation revenue vehicle bonds (GARVEE's) in January 2012. This innovative financing tool was used to accelerate the funding of transportation improvement projects across the State by leveraging future federal transportation revenues. At June 30, 2012, \$88.41 million of the GARVEE proceeds were unspent.

The fund balance of the Highway Trust Fund increased from \$262.161 million at June 30, 2011 (as restated) to \$381.729 million at June 30, 2012, an increase of 45.61%. The enabling legislation also specifies that a designated amount will be transferred each year to the General Fund. The amounts transferred to the General Fund for fiscal years 2012 and 2011 were \$76.721 million and \$72.895 million, respectively. The enabling legislation was amended in 2008 to also require annual transfers to the N.C. Turnpike Authority to pay debt service or financing expenses for specified toll road construction projects.

Unemployment Compensation Fund

The Unemployment Compensation Fund (Trust Fund) reported net assets of negative \$1.969 billion at June 30, 2011 compared to negative \$1.909 billion at June 30, 2012. The improvement in net assets is explained primarily by the drop in the State's unemployment rate from 10.6% in June 2011 to 9.4% in June 2012. The Trust Fund's operating margin (operating revenues less operating expenses) was negative \$1.719 billion this year compared to negative \$3.074 billion in 2011. Unemployment benefit expenses (both State and Federal) decreased 26.92% in fiscal year 2011-12 to \$3.192 billion, primarily due to claimants exhausting their maximum allowable benefits and a reduction in the number of new initial claims.

In February 2009, because of depleted cash balances, the State began borrowing from the U.S. Treasury to ensure the uninterrupted payment of State unemployment benefits. At June 30, 2012, the repayable advances from the State's Federal Unemployment Account totaled \$2.566 billion compared to \$2.536 billion at the previous fiscal year-end. Interest began accruing January 1, 2012 at an interest rate of 2.94%. Interest is due and payable on September 30 for each year that the loan has an outstanding balance. The required interest payment of \$84 million was made on September 30, 2012. A 20% surcharge on unemployment contributions, which has been in effect since January 1, 2005 as required by statute, remained in effect during the current fiscal year. The surcharge is deposited into the State Reserve Fund and one of the allowable uses is to pay the interest on the borrowing. The surcharge is still in effect because the balance in the Trust Fund has not reached the trigger "off" level.

During fiscal year 2011-12, the federal government continued to provide various types of assistance to the unemployed but the total assistance decreased significantly. Consequently, nonoperating revenues decreased 34.22% to \$1.888 billion. The federal Emergency Unemployment Compensation program provided \$1.536 billion in benefits (compared to \$2.271 billion last year). Benefits provided under the American Recovery and Reinvestment Act totaled \$283.718 million (compared to \$600 million last year).

For the tax year 2012, the Federal Unemployment Tax increased by 0.3% because the State had an outstanding loan in January for two consecutive years and did not pay back the borrowing. The funds generated from this federal tax increase go directly towards paying down the loan. The additional federal taxes paid by the State's employers this fiscal year, which were used to reduce the loan, was \$68.329 million (classified as gain on extinguishment of debt). The Federal Unemployment Tax will increase by 0.3% for each succeeding year until the loan is repaid.

N.C. Education Lottery

As required by the enabling legislation, net revenues of the N.C. Education Lottery (NCEL) are transferred four times a year to the General Fund. The NCEL transferred \$459.469 million to the General Fund in 2012 to support educational programs for the State. The amount transferred in 2011 was \$436.241 million.

N.C. Turnpike Authority

The Triangle Expressway System, North Carolina's first modern toll road, is under construction and being completed in three stages. The Triangle Parkway (Phase I) is 3.4 miles of new construction and was completed ahead of schedule and opened to traffic in December 2011. The Western Wake Freeway (Phases II and III) includes 12.6 miles of new construction. Phase II opened in August 2012 and Phase III is expected to open in December 2012. As of June 30, 2012, the project was approximately 80% complete, with a 5.9% estimated savings from the initial financial plan. Additionally, the NCTA has completed the financing for the Monroe Connector System, a 20-mile toll road in Mecklenburg and Union counties. However, construction has been delayed due to litigation challenging the project's environmental documentation.

The gap between what tolling can pay for and the cost of the road requires additional support from the State, known as gap funding. In 2008, the General Assembly enacted legislation authorizing annual transfers from the Highway Trust Fund to the NCTA to pay debt service and fund required reserves on bonds issued to finance turnpike projects. For fiscal years 2012 and 2013, the N.C. General Assembly appropriated \$49 million annually for the Triangle Expressway and Monroe Connector projects.

Capital Assets and Long-term Debt

The State's investment in capital assets was \$42.092 billion, an increase of 4.9% from the previous fiscal year-end. The largest component of capital assets is the State highway system. North Carolina has a 79,415 mile highway system, making it the second largest state-maintained highway system in the nation. This year's major capital asset additions were for State highway system construction (\$1.9 billion), toll road construction (\$325.5 million), and construction of a psychiatric hospital (\$50.3 million). Also, the State completed and placed into service the Green Square Complex and a new regional medical and mental health center at Central Prison.

The State had total long-term debt outstanding (bonds, special indebtedness, and notes payable) of \$8.916 billion, an increase of 5.38% from the previous fiscal year-end. The State issued \$400 million in limited obligation bonds and \$179.54 million in GARVEE bonds for its governmental activities. The proceeds of the limited obligation bonds will be used to finance various State and university capital improvement projects, which were authorized for special indebtedness financing by previous sessions of the General Assembly. The proceeds of the GARVEE bonds will be used to accelerate funding of various transportation projects identified in the current State Transportation Improvement Plan. Additionally, the N.C. Turnpike Authority, a business-type activity, issued \$214.51 million in State appropriation revenue bonds and \$145.54 million in GARVEE bonds. The revenue and GARVEE bond proceeds will be used to finance the construction of the Monroe Connector System. The State refinanced \$382.5 million of its existing debt in fiscal year 2012 to improve cash flow and to take advantage of lower interest rates. By refinancing the debt, the State will reduce its future debt service payments by approximately \$27.3 million over the next 13 years.

In November 2011, all three rating agencies affirmed the triple-A credit rating for the State. The rating agencies recognized the State's historically conservative budgeting, financial management, and debt issuance practices. North Carolina remains one of only eight states with a triple-A rating from all three rating agencies.

The State Controller is North Carolina's chief fiscal officer. The Office of the State Controller serves as an independent resource to ensure the financial integrity of the State by providing accounting, disbursing, payroll, internal control, data management, eCommerce and financial reporting systems that serve state agencies, employees and the public and by maximizing financial return through its statewide cash management plan. The OSC issues numerous financial reports including: General Fund Monthly Financial Report, IT Expenditures Report, Statewide Accounts Receivable Report, the State's Comprehensive Annual Financial Report (CAFR) as well as the short, easy-to-read version of the CAFR known as the "popular" report.