

North Carolina



Financial Highlights
Fiscal Year End June 30, 2008

David McCoy, State Controller
North Carolina Office of the State Controller
<http://www.osc.nc.gov>



I am pleased to present you with the **North Carolina Financial Highlights** for the fiscal year ended June 30, 2008. This **popular report** represents our continuing commitment in providing the highest standards of financial management and reporting, as well as fiscal accountability of the resources of the State of North Carolina reporting entity. We hope that you find this report both informative and beneficial and we welcome any questions or comments. If you need additional copies, or have questions about this report, please contact either me or our Statewide Accounting Division staff at (919) 981-5454.

Thank you for your interest in the State of North Carolina.

Sincerely,

A handwritten signature in black ink that reads "David McCoy".

David McCoy
State Controller
December 19, 2008

Introduction

This popular report, *North Carolina Financial Highlights*, is intended to summarize basic financial information about our State. This information is supported in more detail in the State's Comprehensive Annual Financial Report (CAFR). The CAFR is prepared in accordance with generally accepted accounting principles and is independently audited by the North Carolina Office of the State Auditor. Much of the information in the CAFR is necessarily technical and complex. As a result, the full financial statements and note disclosures may not be as useful to the citizens of the State wishing to gain a more general understanding of the State's finances. Our report provides information at the government-wide level in addition to the major fund level, and certain selected statistical information cited in our CAFR. Coverage of legally separate, but related organizations is limited to universities and community colleges and is at a very high level.

The *popular report* is a report for the people. *North Carolina Financial Highlights* is the product of a coordinated effort on the part of state and local governments to issue simplified financial reports. It is our intent to provide you with information about the State's financial condition, without overwhelming detail and technical accounting terminology. This report contains financial information for the State's fiscal year ended June 30, 2008. The State's fiscal year starts July 1, and ends the following June 30. Information is presented in this report on the basis of generally accepted accounting principles (GAAP). This popular report and the State's complete financial statements, known as the CAFR, can be obtained on the internet at <http://www.osc.nc.gov>, by telephone at (919) 981-5454, or by writing to the N.C. Office of the State Controller, 1410 MAIL SERVICE CENTER, Raleigh, N.C. 27699-1410.



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 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
- ◆ general government services

North Carolina State Flag

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

The Economy

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 economists 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.

Financial Highlights — Fiscal Year 2008



North Carolina Economic Indicators

(% Change)

	<u>FY2006-07</u>	<u>FY2007-08</u>	<u>FY2008-09</u>	<u>FY2009-10</u>
	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 technical 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

North Carolina Sand Dunes

Photo Courtesy of NC Division of Tourism, Film, and
Sports Development.
Bill Russ, Photographer



Financial Highlights

Government-wide

- ◆ The State's total net assets increased by \$337.17 million or 1.07% as a result of this year's operations. Net assets of governmental activities increased by \$154.87 million, or 0.52%, and the lack of growth is attributable to the slowdown in the national and State economy. Net assets of business-type activities increased by \$182.29 million, or 10.63%, primarily due to the financial results of the Unemployment Compensation Fund. At year-end, net assets of governmental activities and business-type activities totaled \$29.97 billion and \$1.9 billion, respectively.
- ◆ Component units reported net assets of \$16.58 billion, an increase of \$986.22 million or 6.32% from the previous year.

Fund Financials

- ◆ The fund balance of the General Fund decreased from \$2.607 billion at June 30, 2007 (as restated) to \$1.679 billion at June 30, 2008, a decrease of 34.84%. For fiscal year 2008, the General Assembly authorized the drawdown of beginning unreserved fund balance to finance the deficiency of total revenues under total expenditures of \$958.166 (excluding other financing sources and uses).
- ◆ The fund balance of the State Highway Fund increased from \$678.9 million at June 30, 2007 to \$891.75 million at June 30, 2008, an increase of 31.35%. The significant increase is attributable to \$287.57 million in grant anticipation revenue vehicle bonds (GARVEE's) issued in October 2007.
- ◆ The fund balance of the Highway Trust Fund decreased from negative \$67.81 million at June 30, 2007 to negative \$74.62 million at June 30, 2008, a decrease of 10.03%. Total revenues decreased by \$59.53 million or 5.27% due to decreases in gasoline tax and highway use tax revenues.
- ◆ The net assets of the Unemployment Compensation Fund (Trust Fund) increased from \$746.11 million at June 30, 2007 to \$847.69 million at June 30, 2008, an increase of 13.61%. However, the Trust Fund's financial performance has weakened because of the recent downturn in the national and State economy.
- ◆ The N.C. Education Lottery (NCEL) began selling instant game tickets in March 2007 and Powerball tickets in May 2007. Net ticket sales surpassed \$1 billion, a 21.7% increase from the previous fiscal year. The NCEL transferred \$349.31 million in 2008 to support educational programs.



Air Show

*Photo Courtesy of NC Division of
Tourism, Film, and
Sports Development.
Bill Russ, Photographer*

Capital Assets

- ◆ The State's investment in capital assets (net of accumulated depreciation) was \$32.655 billion, an increase of 5.54% from the previous fiscal year-end.
- ◆ This year's major capital asset additions were for highway construction (\$1.5 billion), highway land improvements (\$525 million), construction/improvements of correctional facilities (\$34 million), and construction of a new psychiatric hospital (\$46 million).

Long-Term Debt

- ◆ The State had total long-term debt (bonds and similar debt payable) outstanding of \$7.055 billion, an increase of 2.08% from the previous fiscal year-end. The long-term debt balance includes \$1.2 billion of special obligation (non-voted) debt issued for governmental activities.
- ◆ The State regained Moody's Rating Service Aaa rating status in January 2007 after having been downgraded to Aa1 in August 2002. In support of the upgrade, Moody's cited strong financial performance, replenishment of depleted reserves, recent economic gains that surpass national averages, and the State's effective fiscal management and healthy financial outlook.
- ◆ The State maintained its AAA bond rating with Standard and Poor's and Fitch Ratings.



Government-wide Financials

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better off or worse off as a result of this year's activities?

Both statements report three activities:

- ◆ *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services.
- ◆ *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund, the N.C. State Lottery Fund, and the EPA Revolving Loan Fund are the predominant business-type activities.
- ◆ *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the State are financially accountable. All component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State.



William B. Umstead State Park

Photo Courtesy of NC Division of Tourism, Film, and Sports Development. Bill Russ, Photographer

Statement of Net Assets

The Statement of Net Assets presents all of the State's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating. The State's combined net assets increased \$337.166 million or 1.07% over the course of this fiscal year's operations. The net assets of the governmental activities increased \$154.873 million or 0.52% and business-type activities increased \$182.293 million or 10.63%. The following table was derived from the government-wide Statement of Net Assets:

Net Assets **June 30, 2008 and 2007** *(dollars in thousands)*

	Governmental Activities		Business-type Activities		Total Primary Government	
	2008	2007	2008	2007	2008	2007
Current and other non-current assets.....	\$ 15,223,629	\$ 17,524,607	\$ 2,252,278	\$ 2,118,160	\$ 17,475,907	\$ 19,642,767
Capital assets, net.....	32,622,721	30,915,226	32,515	26,673	32,655,236	30,941,899
Total assets	47,846,350	48,439,833	2,284,793	2,144,833	50,131,143	50,584,666
Long-term liabilities.....	8,571,615	7,676,773	4,682	3,885	8,576,297	7,680,658
Other liabilities.....	9,303,820	10,947,018	383,342	426,472	9,687,162	11,373,490
Total liabilities	17,875,435	18,623,791	388,024	430,357	18,263,459	19,054,148
Net assets:						
Invested in capital assets, net of related debt.....	30,931,799	29,715,168	32,515	26,673	30,964,314	29,741,841
Restricted.....	878,856	1,094,352	1,773,018	1,612,943	2,651,874	2,707,295
Unrestricted.....	(1,839,740)	(993,478)	91,236	74,860	(1,748,504)	(918,618)
Total net assets	\$ 29,970,915	\$ 29,816,042	\$ 1,896,769	\$ 1,714,476	\$ 31,867,684	\$ 31,530,518

The largest component of the State's net assets (\$30.964 billion) reflects its investment in capital assets (land, buildings, machinery and equipment, state highway system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. Restricted net assets are the next largest component (\$2.652 billion). Net assets are restricted when constraints placed on their use are 1) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or 2) legally imposed through constitutional provisions. The remaining portion, unrestricted net assets, consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Financial Highlights — Fiscal Year 2008

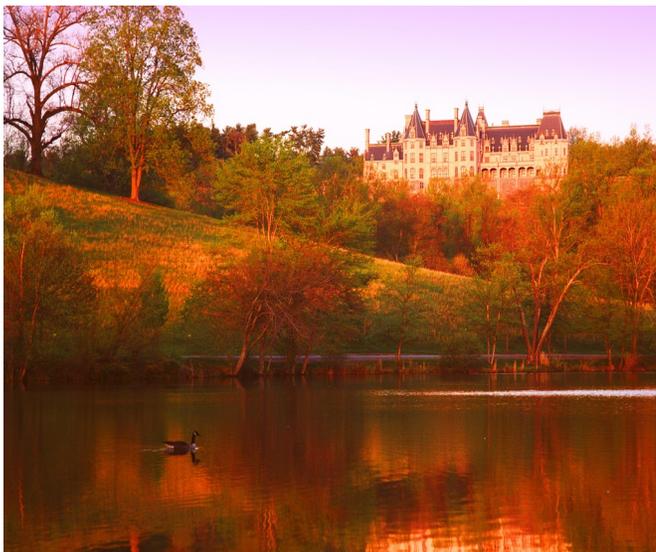


Statement of Activities

The Statement of Activities presents information showing how the State's net assets changed during the most recent fiscal year. The following financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year:

Condensed Statement of Activities
Primary Government
For the Fiscal Year Ended June 30, 2008
(dollars in thousands)

	Primary Government		
	Governmental Activities	Business-type Activities	Total
Net (expense) revenue	\$ (22,241,164)	\$ 529,141	\$ (21,712,023)
General revenues:			
Taxes			
Individual income tax.....	10,676,156	—	10,676,156
Corporate income tax.....	1,357,670	—	1,357,670
Sales and use tax.....	5,159,453	—	5,159,453
Gasoline tax.....	1,579,847	—	1,579,847
Franchise tax.....	738,741	—	738,741
Highway use tax.....	566,132	—	566,132
Insurance tax.....	505,936	—	505,936
Beverage tax.....	258,193	—	258,193
Inheritance tax.....	158,178	—	158,178
Tobacco products tax.....	249,664	—	249,664
Other taxes.....	339,158	—	339,158
Tobacco settlement.....	168,583	—	168,583
Unrestricted investment earnings.....	238,239	—	238,239
Miscellaneous.....	49,345	—	49,345
Contributions to permanent funds.....	3,894	—	3,894
Transfers.....	346,848	(346,848)	—
Total general revenues, contributions and transfers..	<u>22,396,037</u>	<u>(346,848)</u>	<u>22,049,189</u>
Change in net assets.....	154,873	182,293	337,166
Net assets - July 1, as restated (Note 22).....	29,816,042	1,714,476	31,530,518
Net assets - June 30.....	<u>\$ 29,970,915</u>	<u>\$ 1,896,769</u>	<u>\$ 31,867,684</u>



Biltmore Estate

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
 Bill Russ, Photographer*

Governmental Activities:

- ◆ For fiscal year 2008, revenues outpaced expenses and when combined with transfers from the State's business-type activities, an increase of \$154.873 million in net assets resulted for governmental activities.
- ◆ Total revenues increased 0.93% in fiscal year 2008 to \$37.355 billion.
- ◆ Total expenditures grew much faster at 6.82% to \$37.551 billion.
- ◆ Transfers-in were higher in fiscal year 2008 due to the larger net profits achieved by the N.C. Education Lottery.

Business-type Activities:

- ◆ Business-type activities reflect an overall increase in net assets of \$182.293 million or 10.63%, primarily because of the financial results of the Unemployment Compensation Fund.
- ◆ For fiscal year 2008, the Unemployment Compensation Fund had an operating income (excess of operating revenues over operating expenses) of \$90.439 million.
- ◆ The Unemployment Compensation Fund and the EPA Revolving Loan Fund comprise 93% of the total net assets of business-type activities.
- ◆ The N.C. State Lottery Fund has no net assets since its net profits are distributed to the State's governmental activities, as required by statute.

Financial Highlights — Fiscal Year 2008



Statement of Activities (cont'd)

The 6.82% increase in total expenses is attributable to growth in the State's two largest functional areas, primary and secondary education and health and human services. In 2008, primary and secondary education increased 16.53%, due, in part, to a recent court judgment made against the State. A Superior Court judge ruled that the State owed \$749.89 million for certain civil fines and penalties that should have been remitted to North Carolina public schools and not diverted to other uses. Education funding also increased because of enrollment increases at the State's universities, community colleges, and public schools and to salary increases for teachers and faculty. Despite enrollment and other funding increases, higher education expenses fell in fiscal year 2008 due to larger distributions of higher education bond proceeds in the prior year. Distributions of bond proceeds to colleges and universities for capital projects were \$609.63 million in 2007 compared to \$67.28 million in 2008.

Total health and human services (HHS) spending increased 5.94% in 2008. The growth in health and human services is the result of increased spending for Medicaid (the State's largest public assistance program) and the opening of the new Central Regional psychiatric hospital in Butner. Because the State receives federal matching funds for the Medicaid Program, there was also a corresponding increase in program revenues (e.g., operating grants and contributions).

Condensed Schedule of Expenses & Program Revenues

Primary Government

For the Fiscal Year Ended June 30, 2008

(dollars in thousands)

Functions/Programs	Expenses	Program Revenues	Net Expense/Revenue
Governmental Activities:			
General government.....	\$ 1,248,228	\$ 611,269	\$ (636,959)
Primary and secondary education.....	10,635,026	1,249,106	(9,385,920)
Higher education.....	4,207,421	20,496	(4,186,925)
Health and human services.....	14,956,584	10,244,621	(4,711,963)
Economic development.....	746,660	351,921	(394,739)
Environment and natural resources.....	771,783	370,022	(401,761)
Public safety, corrections, and regulation.....	2,623,835	656,242	(1,967,593)
Transportation.....	1,938,394	1,770,936	(167,458)
Agriculture.....	119,395	35,569	(83,826)
Interest on long-term debt.....	304,020	-	(304,020)
Total Governmental Activities.....	<u>37,551,346</u>	<u>15,310,182</u>	<u>(22,241,164)</u>
Business-type Activities:			
Unemployment Compensation.....	1,002,866	1,113,234	110,368
N.C. State Lottery.....	712,718	1,062,028	349,310
EPA Revolving Loan.....	12,454	62,218	49,764
Regulatory commissions.....	34,791	38,297	3,506
Insurance programs.....	17,539	23,469	5,930
North Carolina State Fair.....	12,601	15,397	2,796
Other business-type activities.....	6,139	13,606	7,467
Total Business-type Activities.....	<u>1,799,108</u>	<u>2,328,249</u>	<u>529,141</u>
Total Primary Government.....	<u>\$ 39,350,454</u>	<u>\$ 17,638,431</u>	<u>\$ (21,712,023)</u>

Bodie Island Lighthouse

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

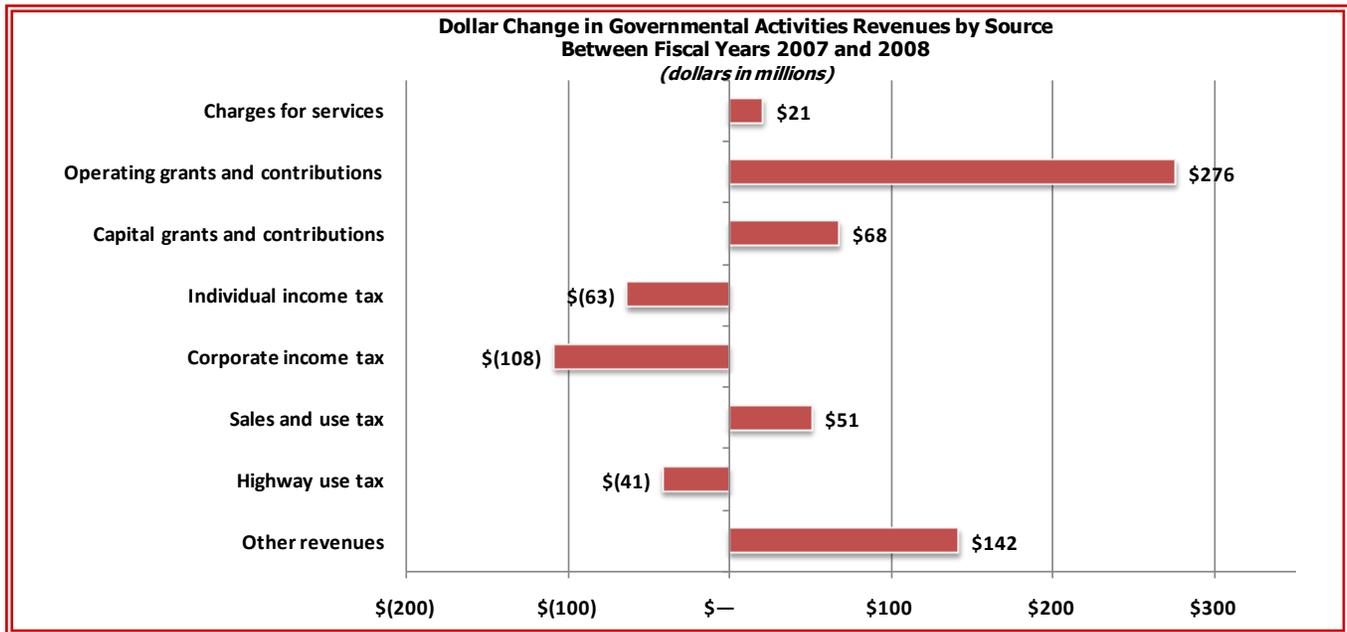


Financial Highlights — Fiscal Year 2008

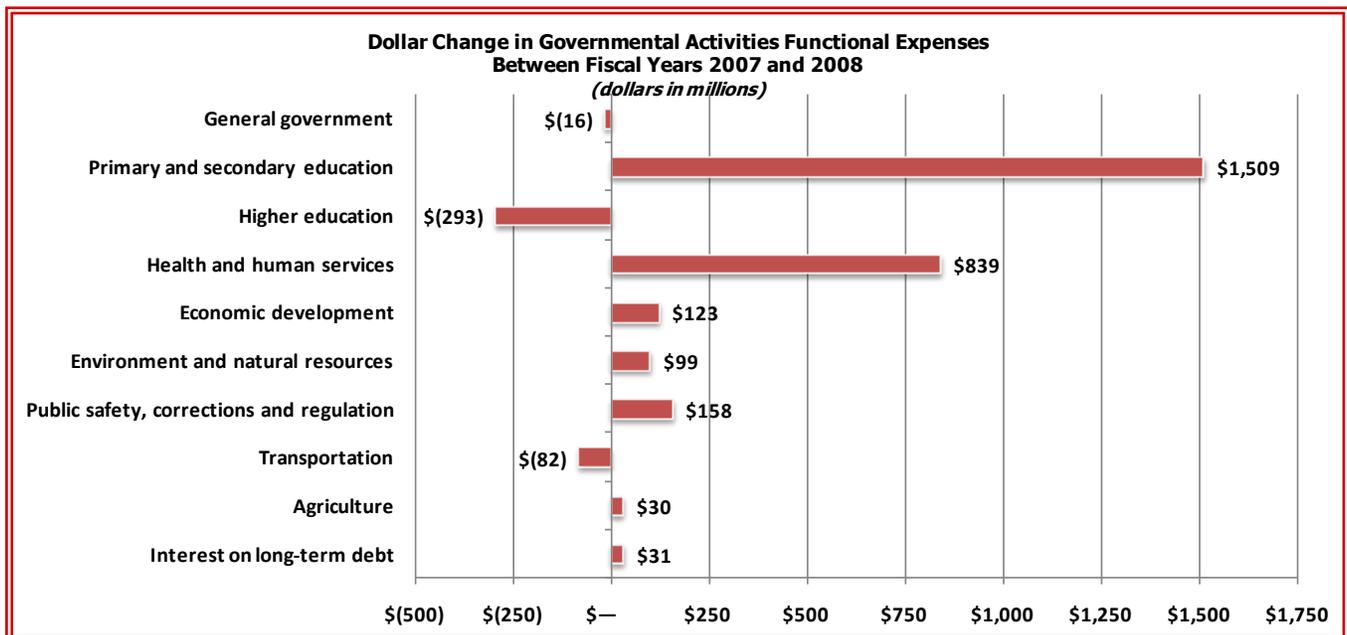


Statement of Activities (cont'd)

The following chart reflects the dollar change in the revenues by source of governmental activities between fiscal years 2007 and 2008.



The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2007 and 2008.

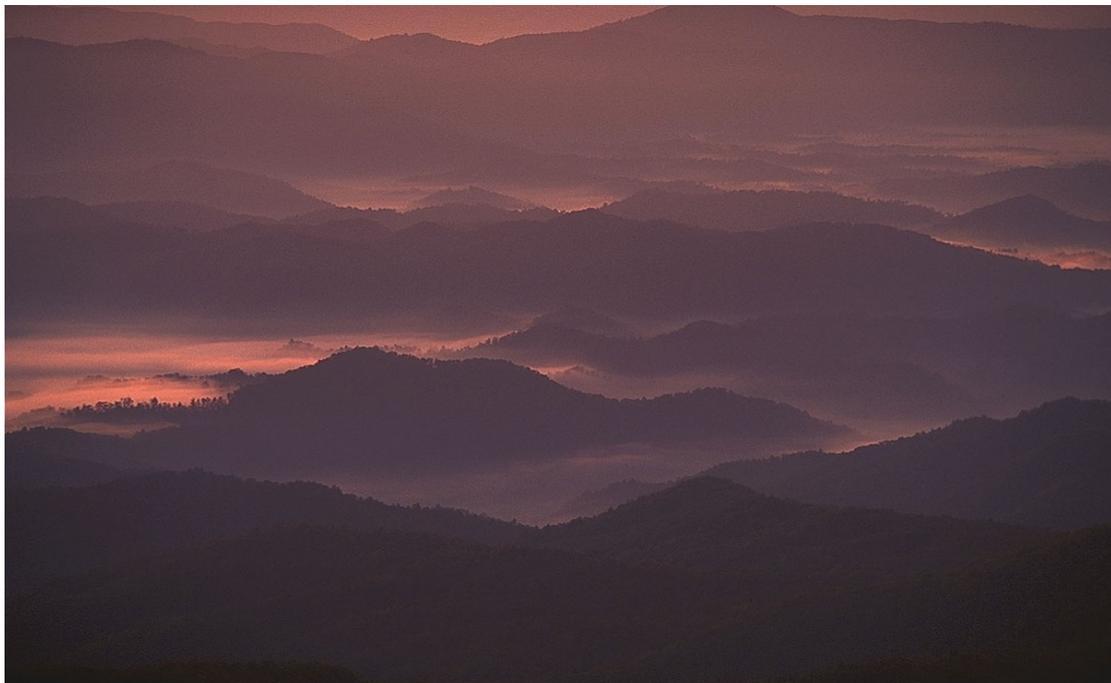
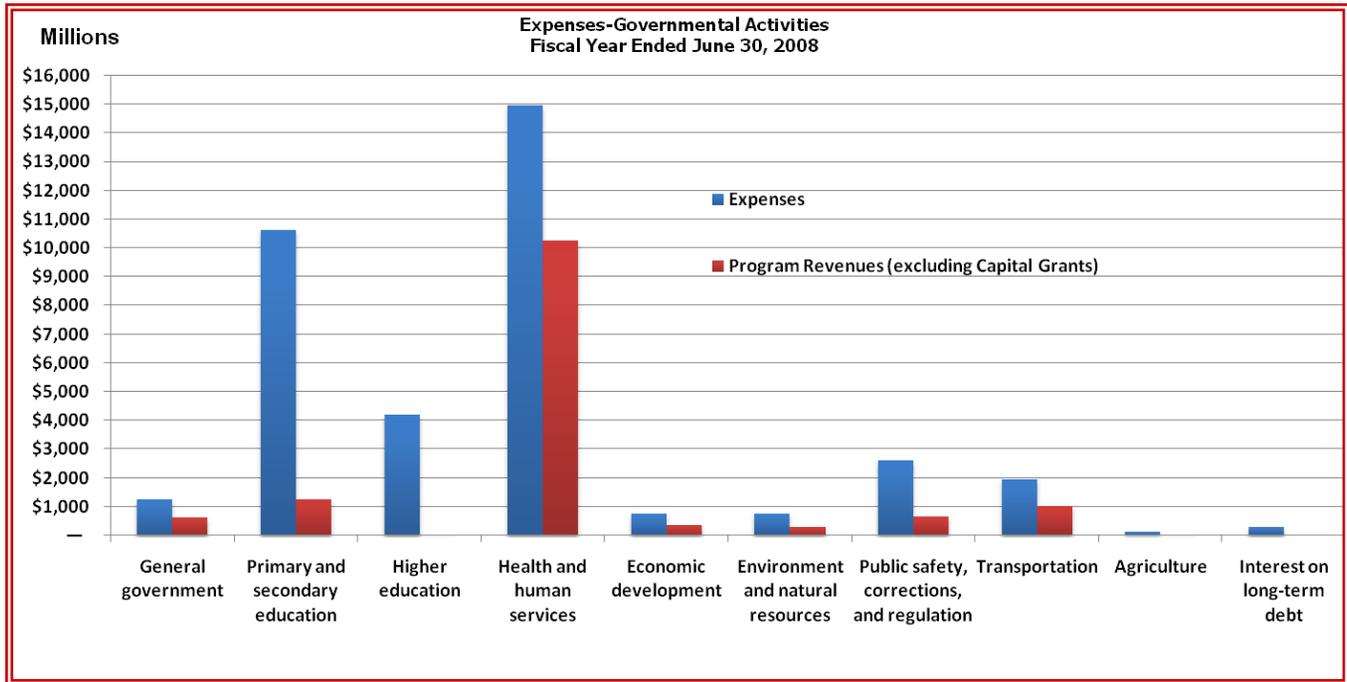


Financial Highlights — Fiscal Year 2008



Statement of Activities (cont'd)

The following chart depicts the total expenses and total program revenues of the State's governmental functions. This format identifies the extent to which each governmental function is self-financing through fees and intergovernmental aid or draws from the general revenues of the State.



Black Mountains

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

Financial Highlights — Fiscal Year 2008



Capital Assets

As of June 30, 2008, the State's investment in capital assets was \$32.655 billion, an increase of 5.54% from the previous fiscal year-end.

Capital Assets as of June 30, 2008
(net of depreciation, dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
Land.....	\$ 10,660,936	\$ 10,083,640	\$ 3,452	\$ 3,114	\$ 10,664,388	\$ 10,086,754
Buildings.....	1,815,826	1,826,814	17,306	12,830	1,833,132	1,839,644
Machinery and equipment.....	671,094	662,798	4,339	3,256	675,433	666,054
Infrastructure:	-	-	-	-	-	-
State highway system.....	17,081,956	16,314,633	—	—	17,081,956	16,314,633
Other infrastructure.....	97,442	98,644	6,886	6,941	104,328	105,585
Intangible assets.....	103,669	105,734	—	—	103,669	105,734
Art, literature, and other artifacts...	66,280	64,823	—	—	66,280	64,823
Construction in progress.....	2,125,518	1,758,140	532	532	2,126,050	1,758,672
Total.....	\$ 32,622,721	\$ 30,915,226	\$ 32,515	\$ 26,673	\$ 32,655,236	\$ 30,941,899

Total percent change between fiscal years 2008 and 2007	5.52 %	21.90 %	5.54 %
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- ◆ This year's major capital asset additions were for highway construction (\$1.5 billion), highway land improvements (\$525 million), construction/improvements of correctional facilities (\$34 million), and construction of a new psychiatric hospital (\$46 million).

- ◆ The largest component of capital assets is the State highway system. North Carolina has a 79 thousand mile highway system, making it the second largest state-maintained highway system in the nation. The most recent report on the condition of the State highway system (December 2006) noted that while the system continues to grow, the traditional highway maintenance funds necessary to maintain it have not changed significantly when adjusted for inflation.



Shackelford

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

- ◆ The State completed construction of a 1,000 bed close custody prison in Columbus County in May 2008. The total cost of the facility was \$102.4 million. The primary funding source for this facility was certificates of participation (COPs). In addition, COPs have been authorized for the planning and construction of a new regional 120 bed medical center and 216 bed mental health center to be located at Central Prison in Raleigh. The estimated cost for the construction of the medical and mental health centers is \$153.4 million, of which \$132.2 million will be financed by COPs. The remaining balance will be financed by capital appropriations and federal grants. At year-end, construction in progress for the Central Prison medical center totaled \$10.06 million.

- ◆ The Department of Correction is undertaking construction initiatives to address a prison cell shortfall and to allow for the implementation of sentencing reform. The State's correctional facility population has more than doubled since 1980 to approximately 40 thousand inmates as of November 2008. The rapid growth in inmates is attributable to increases in the State's population, increases in length of stay in correctional facilities, and changes in criminal laws.

- ◆ The State has commitments of \$1.22 billion for the construction of highway infrastructure, which are expected to be financed by gasoline tax collections, motor vehicle fees, and federal funds. Other commitments for the construction and improvement of state government facilities totaled \$618.83 million, which are expected to be financed primarily by debt proceeds (COPs), state appropriations, and federal funds.

Financial Highlights — Fiscal Year 2008



Debt Administration

At year-end, the State had total long-term debt (bonds and similar debt payable) outstanding of \$7.055 billion, an increase of 2.08% from the previous fiscal year-end.

Outstanding Debt as of June 30

(dollars in thousands)

	Governmental Activities	
	2008	2007
General obligation bonds.....	\$ 5,533,760	\$ 5,902,330
Special Indebtedness:		
Lease-purchase revenue bonds.....	235,045	245,045
Certificates of participation.....	965,880	727,640
GARVEE bonds.....	287,565	—
Notes payable.....	33,187	36,901
Total.....	<u>\$ 7,055,437</u>	<u>\$ 6,911,916</u>
 Total percent change between fiscal years 2008 and 2007		 2.08 %

During the 2007-08 fiscal year, the State issued \$275 million in certificates of participation (COPs) and \$287.565 million in grant anticipation revenue vehicle bonds (GARVEEs). The proceeds of the COPs will be used to finance various State and university capital improvement projects (\$200 million) and projects for the repair and renovation of State facilities and related infrastructure (\$75 million), which were authorized for special indebtedness financing by previous sessions of the General Assembly. The repair and renovation projects were prioritized based on those projects related to life safety code requirements and water intrusion remediation. The proceeds of the GARVEEs will be used to accelerate the funding of various transportation projects identified in the current State Transportation Improvement Plan.

The State issues two types of tax-supported debt: general obligation bonds and various types of "special indebtedness" (i.e., debt not subject to a vote of the people). General obligation bonds are secured by the full faith, credit, and taxing power of the State. The payments on special indebtedness (e.g., lease-purchase revenue bonds and COPs) and equipment installment purchase contracts are subject to appropriation by the General Assembly. Some appropriated-supported debt may also be secured by a lien on facilities or equipment. Article 9 of Chapter 142 of the General Statutes prohibits the issuance of special indebtedness except for projects specifically authorized by the General Assembly. The use of alternative financing methods provides financing flexibility to the State and permits the State to take advantage of changing financial and economic environments. The GARVEEs are a revenue bond-type debt instrument where the debt service is to be paid solely from federal transportation revenues.

The State's long-term debt (bonds and similar debt payable) has increased significantly in recent years, rising from \$1.521 billion in 1997 to \$7.055 billion in 2008, in part due to large issuances for higher education capital projects. Prior to 2004, the State only issued general obligation debt.



Snow Skiing

*Photo Courtesy of NC Division of Tourism,
Film, and Sports Development.
Bill Russ, Photographer*



BEACON Update

North Carolina has completed an historic upgrade of its business systems with the implementation this year of a new HR/Payroll system that integrates those two critical business functions into a single, seamless computer network. The transition began in December 2007 when about 14,000 employees at the Department of Transportation switched to the new system. Another 6,000 employees in smaller agencies transferred to the new system on January 1, 2008. In April 2008, more than 66,000 employees transferred to the new system, which centralizes personnel and payroll information across State government.



The \$76 million project, which had been in the planning and development stages for five years, replaces the State's outdated personnel system and two payroll systems that had operated for more than 25 years and had become increasingly difficult to maintain. The new system allows state employees, for the first time, to update their personal and benefits information, check previous payroll data and record their working time from any computer with an Internet connection. The information technology network created for the HR/Payroll system also provides a platform for future integration of the State's business processes. The General Assembly has approved funding for an electronic recruiting system, which will keep track of state job applicants; and electronic training, which will handle a number of training-related functions, to the new system.

OSC's BEACON division has started planning for the next phase of the BEACON project, which will add budgeting, accounting and cash management functions if the Legislature approves additional funding. "We continue to make improvements to the HR/Payroll system as it becomes stabilized," said State Controller David McCoy. "Implementing this system was a first, and badly needed step to move North Carolina's business operations into the modern era of information technology."

Full details on the BEACON program are available on the Office of the State Controller website at: <http://www.beacon.nc.gov/>.



Acro

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*



Higher Education Highlights

In the spring of 2008, the North Carolina Community College System (NCCCS) began a process to streamline the various industrial training programs into one program in order to bring flexibility into this important part of the state's economic development mission.

Now three programs have been combined into the Customized Training Program, which supports the economic development efforts of the state by providing education and training opportunities for eligible businesses and industries. Amended by the State Board of Community Colleges with the support and approval of the General Assembly in 2008, this program combines New and Expanding Industry Training, the Customized Industry Training, and the former Focused Industry Training Programs. It shall offer programs and training services to assist new and existing business and industry to remain productive, profitable, and within North Carolina.

The program was developed in recognition of the fact that one of the most important factors for a business or industry considering locating, expanding, or remaining in North Carolina is the ability of the State to ensure the presence of a well-trained workforce. The newly-combined program is designed to react quickly to the needs of businesses; to provide customized training assistance in support of full-time production positions created in North Carolina; to enhance the growth potential of companies located in the state while simultaneously preparing North Carolina's workforce with the skills essential to successful employment in emerging industries.

The NCCCS also restructured the North Carolina Community Colleges economic development team and created two positions to ensure that regional issues would be taken into account. These positions, along with their staffs work with eligible businesses and industries throughout the state to ensure that the skills of workers will be enhanced through the program's assistance.

North Carolina Community College System				
Customized Training for Job Growth (formerly New & Expanding Industry Training)				
Top Five Companies by Total Trainees				
2006-2007 through 2007-2008				
<u>Fiscal Year</u>	<u>College</u>	<u>Company</u>	<u>Industry Classification</u>	<u>Total Trained</u>
2006-2007	Gaston	Dole Foods	Fruit, Vegetable, Preserv.	1,037
	Catawba Valley	Getrag Corporation	Motor Vehicle Parts Mfg	958
	Durham	Cree Research, Inc.	Semiconductor & Other Electronic Components	595
	Wake	Credit Suisse/First Boston	Data Processing Serv.	498
	Wake	Red Hat	Software Publishers	496
Total				3,584
2007-2008	Wake	Fidelity Investments	Business Support Serv.	1,483
	Central Carolina	Caterpillar, Inc.	Agricultural, Construction & Mining Mach.	540
	Catawba Valley	Getrag Corporation	Motor Vehicle Parts Mfg	519
	Guilford	Time Warner Cable-Greensboro	Business Support Serv.	463
	Wake	Time Warner Cable	Business Support Serv.	442
Total				3,447

Customized Training Program Summary

2006-2008

<u>Year</u>	<u>Number of Projects</u>	<u>Number of Trainees</u>
2006-2007	795	31,361
2007-2008	686	24,759
Two-year Totals	1,481	56,120

Those businesses and industries eligible for support through the Customized Training Program include manufacturing, technology intensive (i.e., information technology, life sciences), regional or national warehousing and distribution centers, customer support centers, air courier services, national headquarters with operations outside North Carolina, and civil service employees providing technical support to US military installations located in North Carolina. To receive assistance, eligible businesses and industries must demonstrate two or more of the following criteria: the business is making an appreciable capital investment; the business is deploying new technology; the business is creating jobs, expanding an existing workforce, or enhancing the productivity and profitability of the operations within the state; and the skills of the workers will be enhanced by the assistance.

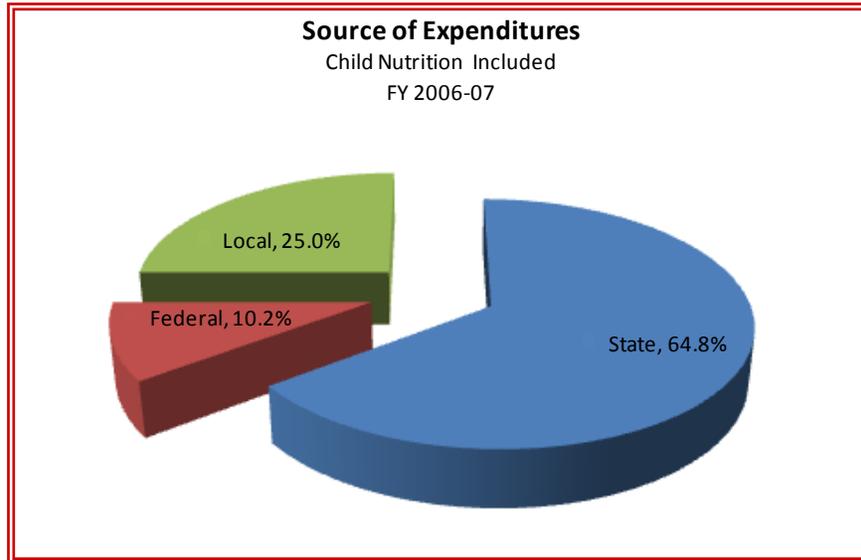
During difficult economic times, community colleges are "North Carolina's economic cavalry," said the president of NCCCS. The Customized Training Program has definitely come to the rescue of many workers, businesses and industries.

Information provided by the North Carolina Community College System.

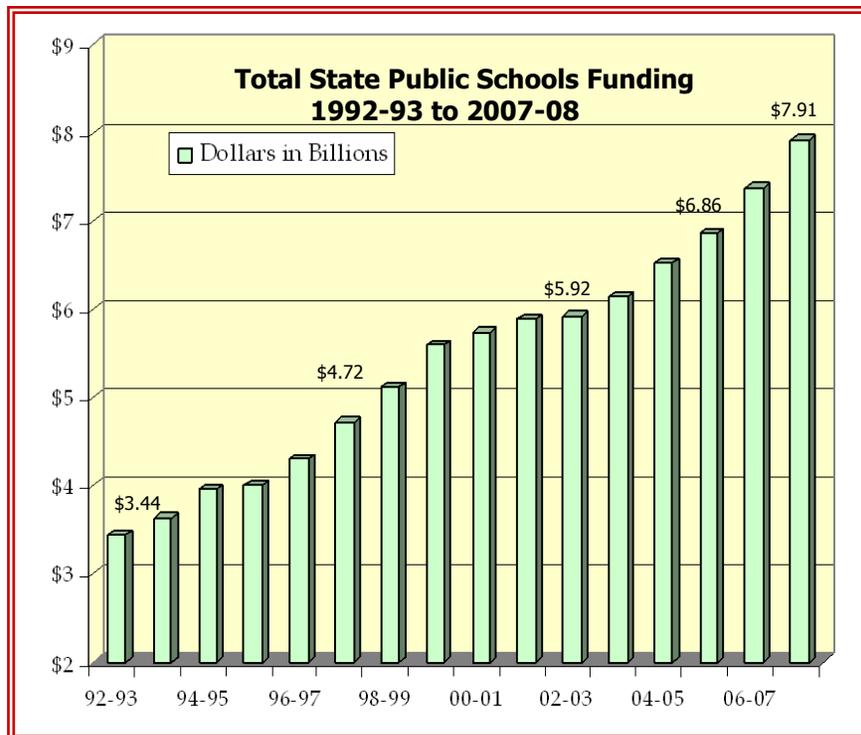


Education Highlights

North Carolina public schools receive 65% of their funding from the State, 25% from local revenue, and 10% from the federal government. North Carolina ranks sixth in the Nation and first in the South for the highest percentage of funds from state revenue. The national average is 47.6%. Most other school systems are primarily funded by locally driven initiatives such as property taxes and local bond issues. The following chart reflects the source of expenditures for North Carolina public schools for the fiscal year 2006-07, the latest data available.



The State funding accounts for 37.3% of the General Fund. The funding from the State totaled \$7.91 billion for the fiscal year 2007-08. As seen in the chart below, funding has continually increased since 1992-93, from \$3.44 billion in 1992-93 to \$7.91 billion in 2007-08, a 130% increase.



Information provided by the NC Department of Public Instruction website, www.ncpublicschools.org.



North Carolina Education Lottery

During fiscal year 2008, the North Carolina Education Lottery (NCEL) added a mid-day drawing to its Carolina Pick 3 online game. The mid-day drawings are conducted Monday through Saturday. It has resulted in a substantial increase in Carolina Pick 3 daily sales. The Carolina Cash 5 top prize has rolled as high as \$856,998. In addition, the North Carolina General Assembly, with the support of the Governor, provided flexibility to the NCEL in prize payout. An increase in payout on instant scratch-off tickets was fully implemented in February and had a big impact on instant ticket sales.

The number of retailers increased to 5,860 by the end of the fiscal year. The lottery introduced new instant scratch-off games every three to four weeks. They offered players highly successful second chance drawings where the prizes were vehicles and gave away Ford Mustangs and Harley-Davidson® Fat Boy® Motorcycles.



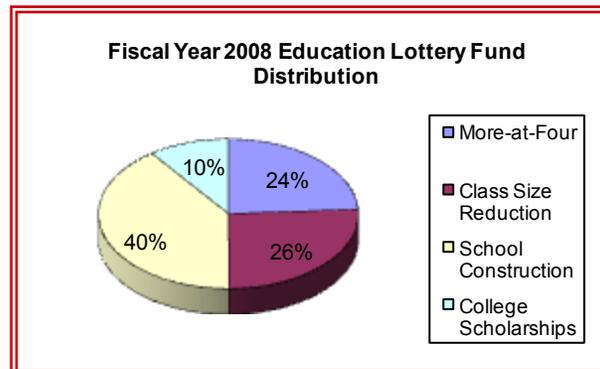
The State Lottery Act prescribes the following guidelines as to how each lottery dollar will be spent, focusing on increasing and maximizing revenues available for education. To the extent practicable, retailers receive a 7% commission for selling tickets; up to 8% may be spent on administration; at least 50% will be paid out in prizes; and 35% will be transferred to the Education Lottery fund at the Office of State Budget and Management. 100% of the net proceeds of the NCEL go to education programs.

Education in North Carolina received more than \$350 million in fiscal year 2008 transfers from the North Carolina Education Lottery. This met the legislative goal as budgeted in the Appropriations Act.

With these dollars, over 18,000 at-risk four year olds received training through the More-at-Four program, classrooms received 2,525 teachers in grades K-3 to reduce class size, schools initiated over 235 construction projects, and approximately 30,000 students received college scholarships.

For fiscal year 2008 the breakdown was as follows:

More-at-Four: \$84,160,709
Class Size Reduction: \$90,364,291
School Construction: \$140,000,000
College Scholarships: \$35,133,992



For School Construction, county specific information may be found at: <http://www.schoolclearinghouse.org>.

Information provided by the North Carolina Education Lottery at www.nc-educationlottery.org.



Albemarle Plantation Golf

*Photo Courtesy of NC Division of Tourism,
Film, and Sports Development.
Bill Russ, Photographer*

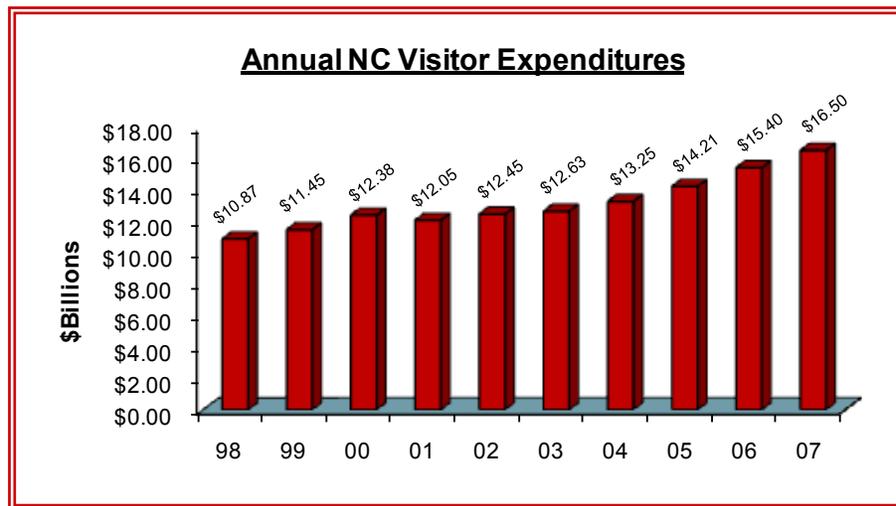


N.C. Tourism Highlights



- ◆ Tourism is one of North Carolina's largest industries. In 2007, domestic travelers spent \$16.5 billion across the State, a 7.2% increase from 2006.
- ◆ International travelers spent \$607 million across the state, a 13.2% increase from 2006.
- ◆ Visitor expenditures directly generated 198,900 jobs and nearly \$4.2 billion in payroll income within North Carolina in 2007.
- ◆ Visitor spending generated over \$2.5 billion in tax receipts, including \$1.2 billion in federal taxes and \$1.3 billion in state and local taxes.

Source: Travel Industry Association of America



Information provided by the NC Department of Commerce website, www.nccommerce.com/tourism/econ.

N.C. Film Industry Highlights

North Carolina has become a powerhouse for film productions, with film, TV and commercial productions adding more than \$160 million to the state's economy last year, according to *The Hollywood Reporter*. North Carolina's incredible diversity of landscape, experienced crew members and infrastructure help to attract outside talent and production companies. In 2007, spending by film, television and commercial productions companies increased to \$160.2 million in North Carolina, a 61% increase from 2006. These figures represent all direct spending, including wages, goods and services used by commercial productions companies in the state. "Commercial film production continues to grow as a statewide economic engine. The increase is related to the high level of talented film and production professionals available in the state. In addition, our film production and other tax credits let businesses in the motion picture and TV industries know North Carolina is a place where they can prosper", says Governor Mike Easley. North Carolina introduced a film incentive program in 2007 that provides a tax credit for production done in the state. A minimum of \$250,000 in-state spending qualifies productions for a 15% tax credit. Notable films shot in North Carolina include: "Last of the Mohicans;" "The Fugitive;" and "Talladega Nights: The Ballad of Ricky Bobby." In 2007 the state hosted Universal Pictures' "Leatherheads" and Warner Brothers' "Nights in Rodanthe," and Twentieth Century Fox's "The Secret Life of Bees," which were all released in 2008.



Information provided by the North Carolina Film Office website, www.ncfilm.com.

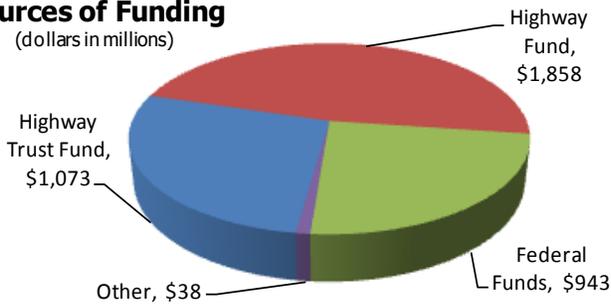


Transportation Highlights

The North Carolina Department of Transportation (NCDOT) has an annual operating budget of nearly \$4 billion. This money comes from three primary sources: the Highway Fund, the Highway Trust Fund, and federal funds. The following pie charts illustrate the sources and uses of these funds.

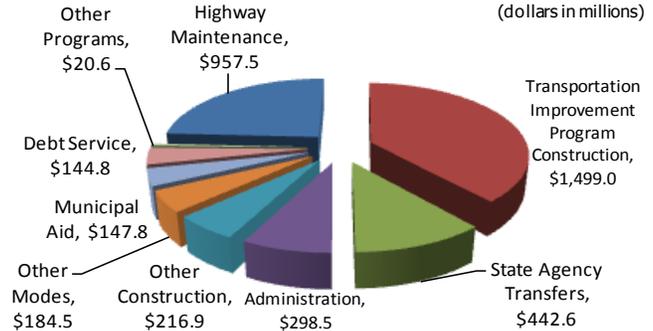
Sources of Funding

(dollars in millions)



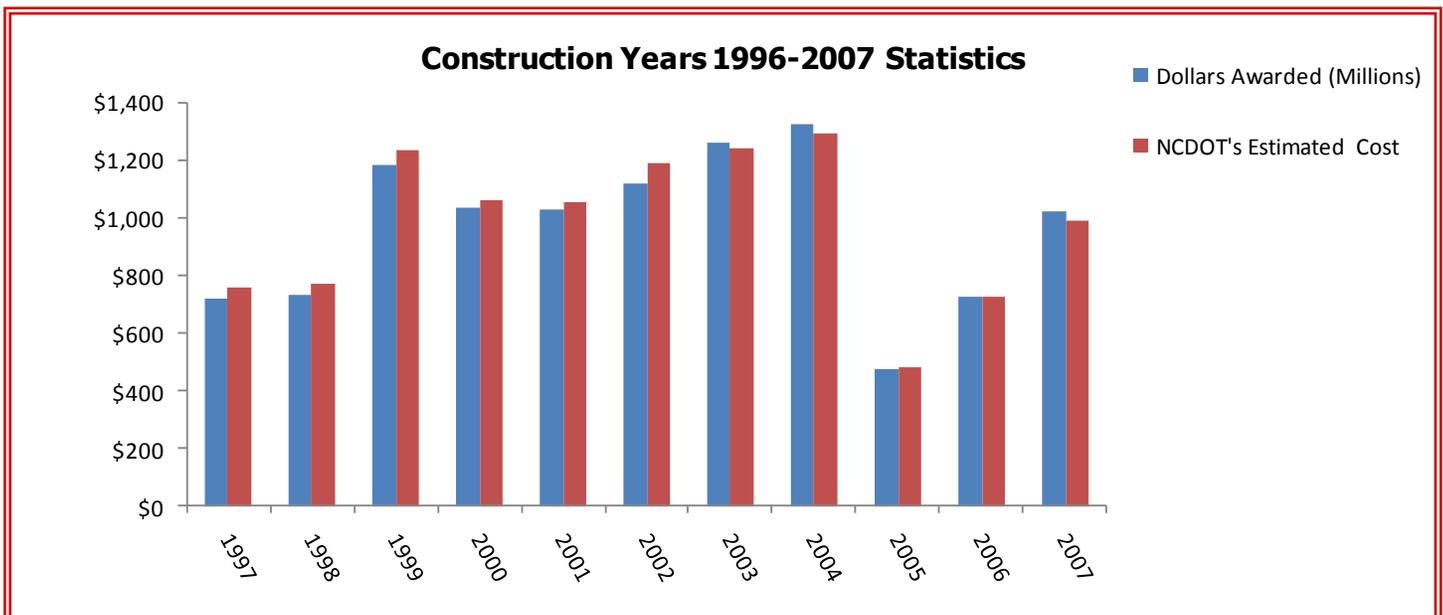
Uses of Funding

(dollars in millions)



- ◆ The Highway Fund dates back to 1921, when the North Carolina General Assembly first imposed the gasoline tax. It accounts for most of the activities of the NCDOT, including the maintenance and construction of the State's primary and secondary road systems, the State Highway Patrol, the Division of Motor Vehicles, and transit and rail. The primary revenue sources of the Highway Fund are federal funds, three-fourths of gasoline taxes, vehicle registration fees, and driver's license fees.
- ◆ Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet a specific set of highway construction needs in North Carolina. Additionally, the Highway Trust Fund provides supplemental allocations for secondary road construction, supplemental assistance to municipalities for local street projects, and pays the debt service on the State's general obligation bonds issued for highway purposes. The principal revenue sources of the Highway Trust Fund are highway use taxes, one-fourth of gasoline taxes, and various title and registration fees. The enabling legislation also specifies that a designated amount will be transferred each year to the General Fund.

Statistics for money spent on construction as of December 2007 are as follows:
(Includes resurfacing, design build, roadway and structure contracts)

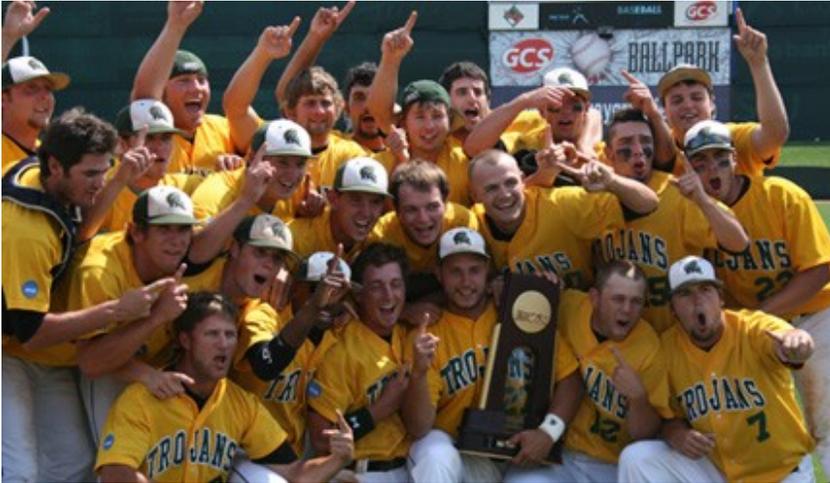


Source: Awards Summary December 2007.

Information provided by the NCDOT website, www.ncdot.org.



North Carolina Accolades



◆ Mount Olive College's men's baseball team, the Trojans, captured their first-ever national championship in any sport with a 6-2 victory over Ouachita Baptist in the Championship Game of the 2008 NCAA Division II Baseball National Finals at Sauget, Illinois in May 2008. Mount Olive finished the season with a 58-6 record, including a perfect 4-0 mark in its first appearance in the National Finals. The Trojans won 24 of their final 26 games. *Information provided by www.moc.edu/athletics.*

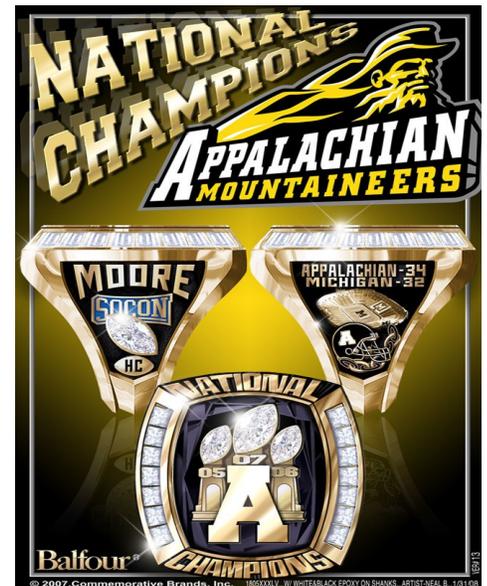
Mount Olive College Trojan Baseball Team 2008 NCAA Division II Baseball Champions

Photo Courtesy of www.moc.edu/athletics.

◆ Governor Mike Easley proclaimed June 10, 2008 "Mountaineer Football Day" in honor of the Appalachian State University (ASU) football team which captured its third consecutive NCAA national championship. "Appalachian State's commitment and determination have created a football dynasty in North Carolina," said Governor Easley. In December 2007, ASU defeated the University of Delaware Fighting Blue Hens 49-21 to earn the 2007 NCAA Division I Football Championship Subdivision. Appalachian finished the season with an overall record of 13-2. *Information provided by www.governor.state.nc.us/News.*

Appalachian State University Mountaineers Back-to-Back-to-Back Champions

Photo Courtesy of www.goasu.com.



◆ Governor Mike Easley announced in November that 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 providing expansion planning information to more than 44,000 corporate executives. "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." Mark Arend, editor in chief of Site Selection said "our readers identified incentives, low taxes and an effective economic development team as the factors behind North Carolina's winning business climate. I would add to that list the governor's commitment to retooling the state's workforce, which companies in some key industry sectors took advantage of this year."

Duke Chapel

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

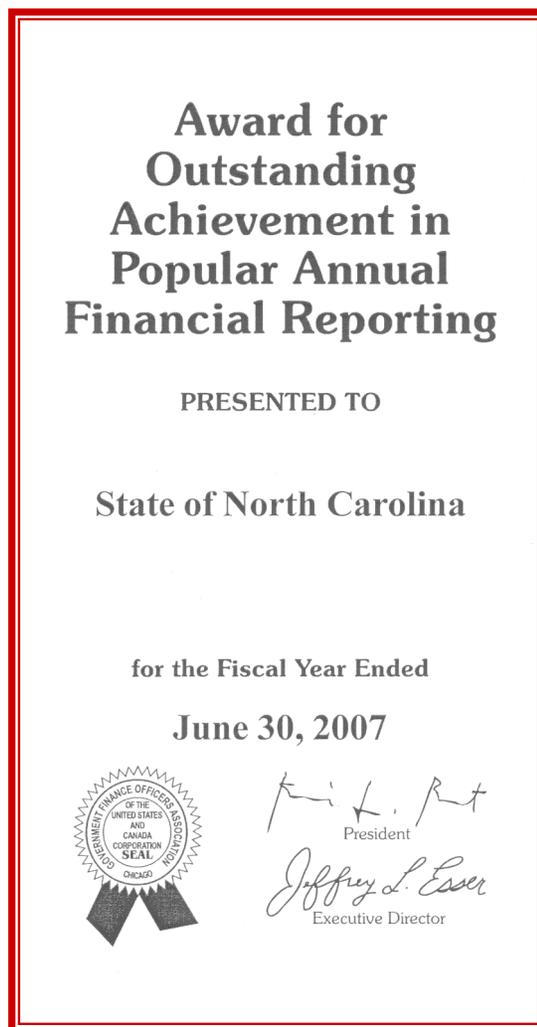


Award for Outstanding Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) has given an Award for Outstanding Achievement in Popular Annual Financial Reporting to the State of North Carolina for its Popular Annual Financial Report for the fiscal year ended June 30, 2007. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular reports.

In order to receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a Popular Annual Financial Report, whose contents conform to program standards of creativity, presentation, understandability and reader appeal.

An Award for Outstanding Achievement in Popular Annual Financial Reporting is valid for a period of one year only. The State of North Carolina has received a Popular Award for the last ten consecutive years (fiscal years ended 1998-2007). We believe our current report continues to conform to the Popular Annual Financial Reporting requirements, and we are submitting it to the GFOA.



300 copies of this public document were printed at a cost of \$1,700.59 or \$5.67 per copy.