

# STATE OF NORTH CAROLINA

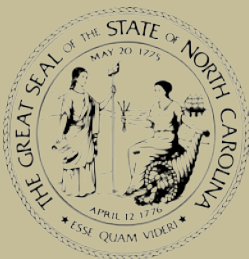
OFFICE OF THE STATE AUDITOR  
BETH A. WOOD, CPA



## NORTH CAROLINA DEPARTMENT OF REVENUE

RALEIGH, NORTH CAROLINA  
FINANCIAL STATEMENT AUDIT REPORT  
AS OF AND FOR THE FISCAL  
YEAR ENDED JUNE 30, 2016

A DEPARTMENT OF THE STATE OF NORTH CAROLINA



**NC OSA**  
The Taxpayers' Watchdog

STATE OF NORTH CAROLINA  
**Office of the State Auditor**



**Beth A. Wood, CPA**  
State Auditor

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## AUDITOR'S TRANSMITTAL

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The Honorable Roy Cooper, Governor  
The General Assembly of North Carolina  
Acting Secretary Ronald Penny  
Department of Revenue

We have completed a financial statement audit of the North Carolina Department of Revenue as of and for the year ended June 30, 2016, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in black ink that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

## AN OVERVIEW OF HOW TO USE THIS REPORT

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This report provides audited financial information on the Department of Revenue (DOR) and is designed to provide the information at a summarized departmental level in the beginning and in more detail further into the report. This report is made up of various components as listed in the Table of Contents. The Department of Revenue reports financial activities in two governmental funds. The governmental funds are used to report all activity of the DOR.

It is important to note that while the financial statements report all the activity of the DOR, most of the activity reported in the general fund is collections and disbursements in support of the State of North Carolina's general fund and is not a part of the budgeted activity of the Department. The distinctions between these activities are reflected in the company number. Company 99 reflects the State's overall general fund and Company 45 reflects DOR's budgeted activity.

Where some numbers need further explanation, additional detail is provided in supplementary schedules or "Notes to the Financial Statements" which are referenced next to the line item caption.

**Required Information** (Information required to be reported by a state agency per Governmental Reporting Standards):

The **Independent Auditor's Report** presents the auditor's opinion on the financial statements, which is that the financial statements, as presented, are materially correct.

The **Management's Discussion and Analysis** presents a discussion of the reasons for significant financial changes between years that is prepared by the agency and has not been audited.

**"A" Exhibits** present the Balance Sheet as of June 30, 2016 (with comparative totals as of June 30, 2015) and the Statement of Revenues, Expenditures, and Changes in Fund Balance for fiscal year ended June 30, 2016 (with comparative totals for fiscal year ended June 30, 2015) for the **DOR governmental funds as a whole**.

**Notes to the Financial Statements** are designed to give the reader additional information concerning the DOR and further support the financial statements.

**"B" Exhibit** presents budget-to-actual comparisons for the **General Fund** (for the fiscal year ended June 30, 2016).

### **Supplementary Information:**

**"C" Exhibits** present the Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance **by Company** (for fiscal year ended June 30, 2016, with comparative totals for fiscal year ended June 30, 2015).

**"D" Exhibits** present details of tax revenues collected by DOR (for fiscal years ended June 30, 2016 and 2015).

**“E” Exhibits** present schedules of unpaid taxes by tax type sorted by years outstanding (for fiscal years ended June 30, 2016 and 2015).

**“F” Exhibit** presents expenditures by purpose or natural classification (agrees to total general fund expenditures on Exhibit A-2 for fiscal years ended June 30, 2016 and 2015).

**Required Information:**

The Independent Auditor’s Report on Internal Control and Compliance – this report is not an opinion on internal control or compliance but rather a report on the matters related to internal control and compliance that were noted as a part of the audit of the financial statements.



**Beth A. Wood, CPA**  
**State Auditor**

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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency. The Auditor also has the power to summon people to produce records and to answer questions under oath.

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# **INDEPENDENT AUDITOR'S REPORT**

STATE OF NORTH CAROLINA  
**Office of the State Auditor**



**Beth A. Wood, CPA**  
State Auditor

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## **INDEPENDENT AUDITOR'S REPORT**

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Acting Secretary Ronald Penny  
and Management of the North Carolina Department of Revenue

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental funds of the North Carolina Department of Revenue (Department) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Department's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental funds of the North Carolina Department of Revenue, as of June 30, 2016, and the respective changes in financial position for the year ended June 30, 2016, in accordance with accounting principles generally accepted in the United States of America.

### Emphasis of Matter

As discussed in Note 1, the financial statements of the North Carolina Department of Revenue are intended to present the financial position and changes in financial position that are attributable to the transactions of the North Carolina Department of Revenue. They do not purport to, and do not, present fairly the financial position of the State of North Carolina as of June 30, 2016, or the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### Other Matters

#### *Prior Period Information*

We have previously audited the accompanying financial statements of the governmental funds of the Department as of June 30, 2015 and the respective changes in financial position for the year then ended June 30, 2015, and expressed an unmodified audit opinion on those audited financial statements in our report dated July 7, 2016.

#### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and other required supplementary information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### *Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements for the general and special revenue funds. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The accompanying supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional

procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information, as listed in the table of contents, is fairly stated, in all material respects, in relation to the basic financial statements of the governmental funds as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 2017 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.



Beth A. Wood, CPA  
State Auditor

Raleigh, North Carolina

April 4, 2017



# **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Management's Discussion and Analysis section of the North Carolina Department of Revenue's (Department) financial report is provided as an overview of the financial performance of the governmental funds for the fiscal years ended June 30, 2016 and 2015. This discussion and analysis should be read in conjunction with the financial statements and related notes which follow this section.

### **Overview of the Financial Statements**

The Department's financial statements are comprised of governmental funds (General Fund and Special Revenue Fund). The governmental fund's basic financial statements consist of the Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances.

The Balance Sheet presents the governmental fund's assets and liabilities that are considered relevant to an assessment of near-term liquidity. The difference between assets and liabilities is reported as fund balances.

The Statement of Revenues, Expenditures, and Changes in Fund Balances reports the resource flow (revenues and expenditures) of the governmental funds.

Notes to the financial statements are designed to give the reader additional information concerning the Department and further supports the statements noted above.

Required Supplementary Information (RSI) follows the basic financial statements and notes to the financial statements. The RSI is mandated by the GASB and includes General Fund budgetary comparison schedules reconciling the statutory to the generally accepted accounting principles fund balances at fiscal year-end.

Other supplementary information includes the combining financial statements for the Governmental Funds, Statement of Collections, Schedule of Aging of the Taxes Receivable, as well as the Schedule of Operating Expenditures by Purpose.

**Governmental Funds****Condensed Balance Sheet**

The following condensed balance sheet shows the governmental funds' financial positions at June 30, 2016 and 2015.

	<u>2016</u>	<u>2015</u>	<u>Change</u>
Assets	<u>\$ 2,102,489,507</u>	<u>\$ 2,016,352,497</u>	<u>\$ 86,137,010</u>
Deferred Outflows of Resources	<u>0</u>	<u>0</u>	<u>0</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 2,102,489,507</u>	<u>\$ 2,016,352,497</u>	<u>\$ 86,137,010</u>
Liabilities	<u>\$ 1,571,872,668</u>	<u>\$ 1,597,393,116</u>	<u>\$ (25,520,448)</u>
Deferred Inflows of Resources	<u>76,680,976</u>	<u>72,231,906</u>	<u>4,449,070</u>
Fund Balance			
Nonspendable	986,134	1,972,450	(986,316)
Committed	84,654,083	88,600,021	(3,945,938)
Assigned		2,330,252	(2,330,252)
Unassigned	<u>368,295,646</u>	<u>253,824,752</u>	<u>114,470,894</u>
Total Fund Balances	<u>453,935,863</u>	<u>346,727,475</u>	<u>107,208,388</u>
Total Liabilities, Deferred Inflows, and Fund Balance	<u>\$ 2,102,489,507</u>	<u>\$ 2,016,352,497</u>	<u>\$ 86,137,010</u>

Total assets increased by \$86.1 million during the year due to a \$96.6 million increase in taxes receivable. Taxes receivable increased \$96.6 million from the prior year primarily due to an increase in final assessments billed to taxpayers for individual income tax owed. The increase in final assessments is a result of individuals not remitting payment when they filed their 2014 tax year tax returns with a balance due. There were over 200,000 more individual income tax assessments generated during the 2016 fiscal year than in the prior fiscal year, with an increased dollar value of \$131 million. The increased number of individual income tax returns filed that had a balance due, but no remittance of payment, is attributed to tax law changes that became effective for the 2014 tax year. Returns for the 2014 tax year were due to the Department by April 15, 2015. The majority of assessments to individuals that did not remit payment with their 2014 tax return by the due date became final in July 2015. There was an increase of \$127 million in assessments in July 2015 compared to July 2014.

Total liabilities decreased by \$25.5 million compared to prior year. Decrease is primarily due to the decrease in the amount due to the North Carolina Housing Finance Agency (NCHFA) for low income housing tax credits pursuant to General Statute 105-129.42. The Department owed the NCHFA over \$80 million at the end of the 2015 fiscal year for tax credits earned during the 2013 and 2014 taxable years. Over \$50 million of this amount was paid to the NCHFA during the 2016 fiscal year. The amount due to the NCHFA at 2016 fiscal year end would typically equal the unpaid amount that was owed at the end of the 2015 fiscal year plus any additional credits earned by the NCHFA during the 2015 taxable year. However, there were no new credits earned during the 2015 taxable year as General Statute 105-129.42 was repealed effective January 1, 2015. As a result, only the unpaid balance from the 2015 fiscal year of approximately \$30 million was still owed at the end of the 2016 fiscal year. This amount was paid to the NCHFA during the 2017 fiscal year. Therefore, there will not be any amounts due to the NCHFA pursuant to General Statute 105-129.42 in future years.

Deferred inflows of resources increased \$4.4 million compared to prior year due to an increase in unavailable revenue. Unavailable revenue is the amount of taxes owed that are

not expected to be collected within a specified time period after fiscal year-end. The majority of the unavailable revenues reported come from franchise taxes, sales and use taxes, tobacco products taxes, and corporate income taxes. These amounts are deferred and recognized as revenues in the period that the amounts become available.

Overall fund balance increased by \$107.2 million as of fiscal year end 2016 with the largest increase in unassigned fund balance of \$114.5 million attributable to the overall current year activity – see further details on the following Statement of Revenues, Expenditures, and Changes in Fund Balances. Assigned fund balance decreased \$2.3 million from the prior year due to a change in the carry forward process. Session Law 2014-100 directed the Office of State Budget and Management, the Office of the State Controller, and the Fiscal Research Division of the General Assembly to review practices related to the carryforward process. A pilot project was conducted for the 2015 fiscal year and was rolled out to all state agencies, including the Department of Revenue, for the 2016 fiscal year. The new process required carryforward funds be transferred from the Department's General Fund and placed into the State Reserve Fund held at the Office of the State Controller. Prior to the 2016 fiscal year, the cash carryforward funds remained in the Department's General Fund.

### Condensed Statements of Revenues, Expenditures, and Changes in Fund Balances

The following condensed statement shows the governmental funds' resource flows at June 30, 2016 and 2015.

	2016	2015	Change
Revenues			
Tax Revenues	\$ 22,161,026,283	\$ 21,326,012,680	\$ 835,013,603
Fees	4,318,553	2,118,213	2,200,340
Revenues from Other State Agencies	7,033,434	6,874,573	158,861
Other Revenues	750,164	313,252	436,912
Total Revenues	22,173,128,434	21,335,318,718	837,809,716
Expenses:			
Expenses to Other State Agencies	5,495,685	1,548,561	3,947,124
Statutory Tax Distributions	628,400,490	604,370,256	24,030,234
Personal Services	67,682,271	62,646,996	5,035,275
Employee Benefits	25,261,357	22,872,463	2,388,894
Other Expenditures	43,240,249	41,300,622	1,939,627
Total Expenditures	770,080,052	732,738,898	37,341,154
Excess of Revenues Over Expenditures	21,403,048,382	20,602,579,820	800,468,562
Other Financing Sources(Uses)			
State Appropriation	79,762,784	80,074,647	(311,863)
Sale of Capital Assets	1,652	522	1,130
Transfers In	594,623	537,095	57,528
Transfers Out	(21,376,199,053)	(20,507,685,404)	(868,513,649)
Total Other Financing Uses	(21,295,839,994)	(20,427,073,140)	(868,766,854)
Net Change in Fund Balance	107,208,388	175,506,680	(68,298,292)
Fund Balance - July 1	346,727,475	171,220,795	175,506,680
Fund Balance - June 30	\$ 453,935,863	\$ 346,727,475	\$ 107,208,388

### Tax Revenues

Total tax revenues were \$22.2 billion at June 30, 2016, an increase of \$835 million from prior year. This increase is due to an increase in net individual income tax revenues of \$686.6, an

increase in net sales and use tax revenues of \$292.4 million, and a decrease in net corporate income tax revenues of \$153.1 million

### **Individual Income Tax**

Individual income tax revenues on a modified accrual basis increased \$686.6 million or 6.1% from the 2015 fiscal year. This increase is due to an increase in gross revenues on a cash basis which increased by \$835.8 million or 6.8%. Significant increases in withholding and estimated tax payments account for the majority of this increase. The growth in withholding and estimated tax payments can be attributed to an improved economy, as evidenced by the growing number of jobs in North Carolina. According to data compiled by the Bureau of Labor Statistics, the number of jobs in the State has steadily increased. In June 2016, there were 88,500 more jobs than in June 2015 and 192,400 more than in June 2014. The unemployment rate in North Carolina has continued to fall throughout most of the 2016 fiscal year, dropping from 5.8% in June 2015 to 4.9% in June 2016

### **Sales and Use Tax**

Sales and use tax revenues on a modified accrual basis increased by \$292.4 million or 4.7% from the 2015 fiscal year. This increase is due to an increase in net revenues on a cash basis which increased by \$307.5 million or 4.9%. This increase can be attributed to an improved economy and provisions passed by the 2013 Session of the North Carolina General Assembly that broadened the sales and use tax base. The improvement in the economy over the last year, as evidenced by the growing number of jobs in the State, has increased the disposable incomes of consumers.

In addition, effective March 1, 2016, sales and use tax is levied on the sales price of the gross receipts derived from repair, maintenance, and installation services in accordance with Session Law 2015-241. Additionally, the sale of a service contract for tangible personal property is subject to the 4.75% general State rate of tax even if the tangible personal property may be attached to or becomes part of real property. Prior to March 1, 2016, sale of certain service contracts were not subject to tax. This tax law change positively impacted sales and use tax revenues during the 2016 fiscal year.

### **Corporate Income Tax**

Corporate income tax revenues decreased by \$153.1 million or 12.1% on a modified accrual basis in the 2016 fiscal year compared to the 2015 fiscal year. This decrease is due to a decrease in revenues on a cash basis during the 2016 fiscal year. Gross revenues for corporate income tax on a cash basis decreased by \$146.3 million, or 9.3%, from fiscal year 2015. This decrease is attributable to changes in the North Carolina Revenue Laws effective for tax years beginning January 1, 2014. The corporate income tax rate was reduced from 6.9% to 6% for tax year 2014 and from 6% to 5% for tax year 2015.

### **Fees**

Fees increased \$2.2 million from the prior year due to an increase in certification fees. The increase in certification fees is primarily due to Session Law 2015-11 (Senate Bill 372) providing a safe harbor for renewable energy projects, by extending the tax credit for renewable energy property one year for those projects substantially completed by January 1, 2016. Taxpayers were eligible for the delayed sunset if they filed an application for the extension, paid the application fee, and met conditions as set forth in Session Law 2015-11. The application and fee had to be filed with the Department on or before October 1, 2015. The total application fees collected by the Department was \$1.9 million.



**Expenditures**

Total expenditures increased \$37.3 million from the prior year due primarily to an increase in personal services, statutory tax distributions, and expenses to other state agencies. Personal services increased \$5 million due to market rate salary increases for auditors. House Bill 97 (The Joint Conference Committee Report on the Base, Expansion, and Capital Budgets) authorized the Department to fund salary increases for auditors from the Collection Assistance Fee.

Statutory tax distributions increased \$24 million from the prior year. During the 2013 Session of the General Assembly, legislation was enacted that positively impacted sales and use tax revenues. Specifically, effective July 1, 2014, the combined general sales and use tax rate of 7% was levied on the gross receipts derived from the sales of electricity billed on or after July 1, 2014. However, the Department did not see the full impact of this new legislation until the 2016 fiscal year due to the effective date of the legislation. Amounts billed are remitted to the Department the following month. Total collections by the Department on the sales of electricity for the 2015 fiscal was \$692.6 million compared to \$738.9 million in the 2016 fiscal year. Statute requires that a portion of the net proceeds of the tax collected on sales of electricity be distributed to cities. Therefore, the increase in revenues collected on the sales of electricity during the 2016 fiscal year increased the amount distributed to local governments. The amount of the net proceeds of the tax collected on sales of electricity distributed to local governments during the 2016 fiscal year increased approximately \$19 million from the prior year.

Expenses to other state agencies increased \$3.9 million from the prior year. The application fees of \$1.9 million collected by the Department per Session Law 2015-11 (discussed above) were transferred to the Office of the State Controller as non-tax revenue for the General Fund. In addition, the Department was authorized per House Bill 97 (The Joint Conference Committee Report on the Base, Expansion, and Capital Budgets) to use \$2 million from the Collection Assistance Fee to enter into a contract with a vendor to perform tax fraud analysis using the Government Data Analytics Center. The funds were transferred to the Department of Information Technology instead of being paid directly to the vendor.

**Other Financing Sources (Uses)**

Total other financing uses increased \$868.8 million from the prior year due to an increase in the year-end transfer of net revenues to the Office of the State Controller. This transfer amount increased from \$20.4 billion at the end of fiscal year 2015 to \$21.3 billion at the end of fiscal year 2016. This increase is attributable to the increase in tax revenues as discussed above.

**Budget Variations**

Data for the budget variances is presented in Schedule B-1: Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual (Budgetary Basis – Non-GAAP) of this report.

*Variances – Original and Final Budget:*

The final budgeted revenues were \$2.9 million more than the original budget. The increase is primarily due to increases in the budgeted revenues for certification fees and credit card and debit card transaction fees.

The final budgeted revenues for certification fees were \$1.6 million more than the original budget, because the original budget did not include application fees the Department received



during the 2016 fiscal year as a result of Session Law 2015-11 (Senate Bill 372). As discussed above, taxpayers were eligible for the delayed sunset of the tax credit for renewable energy property if they filed an application for the extension, paid the application fee, and met conditions as set forth in Session Law 2015-11.

The increase in the final budgeted revenues for credit card and debit card transactions fees relates directly to an increase in credit card transactions. Tax payments can be made online by bank draft, credit card or debit card. There is a convenience fee to remit payments by credit card or debit card. The incremental fee is calculated as \$2 for every \$100 of payment. Actual credit or debit card transaction fees collected were significantly higher than the original certified budget of \$674,000. Therefore, the final budget was increased by \$871,000.

The final budgeted expenditures increased \$4.6 million from the original budget. The increase is primarily due to increases in the final budgets for expenditures to other state agencies, other fixed charges, and capital outlay.

The final budget for expenditures to other state agencies was \$3.6 million more than the original budget. As discussed above, the application fees collected by the Department per Session Law 2015-11 were transferred to the Office of the State Controller. The transfer of the application fees were not accounted for in the original budget. Total fees transferred were \$1.9 million. In addition, as discussed above; the Department was authorized to use \$2 million from the Collection Assistance Fee to enter into a contract with a vendor to perform tax fraud analysis. The \$2 million was originally budgeted as miscellaneous contractual services. However, the funds were transferred to the Department of Information Technology instead of being paid directly to the vendor. Therefore, the budget was moved from miscellaneous contractual services to an account within expenditures to other state agencies.

The Department was authorized to use funds from the Integrated Tax Administration System (ITAS) replacement fund to fund maintenance costs for the Department's two tax systems and to fund an existing contract for the development of a corporate electronic tax filing system. The majority of the budget within the ITAS replacement fund was originally budgeted as other information technology services and later moved to maintenance agreements (other fixed charges) and PC and server software expenditures (capital outlay). The adjustments to the original budgets within the ITAS replacement fund make up the majority of the increase in other fixed charges and capital outlay expenditures.

### *Variances – Final Budget and Actual Results:*

Actual total revenue collected was \$429.6 million above budgeted revenue amounts. This result occurred due to greater than anticipated individual income tax collections, which more than offset lower than expected sales and use and corporate income tax collections. For individual income taxes, which account for more than half of total general fund tax revenue collections, robust wage growth boosted withholding payments above expectations throughout the fiscal year. Final payments also came in higher than expected, while refunds were lower than expected. Sales and use tax collections, which comprise 31% of total general fund tax revenue collections, fell below the budgeted amount due to lower than expected growth in retail sales and higher than expected refunds and transfers. Gross corporate income tax collections exceeded expectations, but a very large one-time refund pushed net corporate income tax collections slightly below the budgeted amount.

Actual total expenditures were \$24.1 million less than budgeted expenditures. Budgeted expenditures were unrealized primarily because \$18.4 million less was spent on contracted

services, personal services, and employee benefits than budgeted. House Bill 97 (The Joint Conference Committee Report on the Base, Expansion, and Capital Budgets) authorized the Department to use \$10 million of receipts from the Collection Assistance Fee to upgrade e-service capabilities. The \$10 million was budgeted as contracted services. During the 2016 fiscal year, the Department spent approximately \$540,000 on the E-Services project. The entire project must be complete by March 1, 2017 per House Bill 97.

Variances between the budgeted and actual expenditures for personal services and employee benefits are largely due to vacancies that are paid for from receipt supported funds.

Actual total other financing sources (uses) was \$393.7 million above budgeted amounts due to transfers to the State's General Fund. Transfers to the State's General Fund consist solely of the year-end transfer of net revenues to the Office of the State Controller. This increase is attributable to the increase in revenues as discussed above.

## **Future Outlook**

### **General Operations**

Session Law 2016-94 of the 2016 Session of the N.C. General Assembly was enacted in July 2016 to modify the 2015 Appropriations Act. Session Law 2016-94 increased the amount appropriated to the Department of Revenue for general operations for the fiscal year ending June 30, 2017 by \$1.9 million. The majority of this increase was because funds were provided for a 1.5% annual recurring salary increase and a 0.5% nonrecurring bonus for permanent full-time employees. The Department was also authorized to spend \$12 million from the ITAS replacement fund for operations and maintenance costs of tax systems. Authority to use \$2 million of receipts from the Collection Assistance Fee was also given to the Department for tax fraud analysis.

### **Tax Changes**

The State individual income tax rate of 5.75% will decrease to 5.499% on January 1, 2017. Effective January 1, 2016, withholding tax tables were adjusted such that the tax rate on wages was set at 0.1% higher than the actual individual income tax rate. In addition, the standard deduction amounts increased January 1, 2016 from \$15,000 to \$16,500 for married couples filing jointly, \$7,500 to \$8,250 for single taxpayers, and from \$12,000 to \$13,200 for head of household. Effective January 1, 2017, the standard deduction amounts will increase to \$17,500 for married couples filing jointly, \$8,750 for single taxpayers, and \$14,000 for head of household. The total impact of these tax law changes for the 2016 and 2017 tax years will not be known until final individual income tax payments are remitted by taxpayers in the spring of 2017 and 2018.

Section 38.5 of Session Law 2016-94, as amended by Part XI of Session Law 2016-123, has some additional provisions that are expected to have an overall positive impact on future revenues of sales and use tax. These include:

- Effective July 1, 2016, a use tax exemption is allowed equal to the amount of the installation charges and sales price of, or gross receipts derived from, the repair, maintenance, and installation services that exceed \$25,000 for a boat, aircraft, or qualified jet engine.
- Effective July 14, 2016, a grace period is provided for retailers who provide repair, maintenance, and installation services. The relief provided for related transactions applies retroactively to January 1, 2015.

- Effective October 1, 2016, a sales tax exemption is allowed for products made of more than 75% recycled material by weight if the products are sold for use in an accepted wastewater dispersal system.
- Effective January 1, 2017, the sales tax on repair, maintenance, and installation services is amended to treat similar transactions the same and to identify taxable transactions more clearly. In treating similar transactions the same, the act expands the sales tax base to include repair and maintenance of real property.

These combined changes are expected to increase both state and local government sales tax revenue. The revenue increase projected for local governments is sufficient to offset the repeal of G.S. 105-524(e), which was enacted in the 2015 session and would have required the State to redirect \$17.6 million of its sales tax revenue annually to local governments, beginning in the 2016-2017 fiscal year. The net impact of these changes on the 2016-2017 fiscal year State revenues is estimated to be a \$36.9 million increase.

The corporate income tax rate is further reduced to 4% effective for tax years beginning in 2016. A trigger is also in place to further reduce the rate to 3% when the amount of net General Fund tax collected in a fiscal year exceeds the legislated targeted amount of \$20.975 billion effective for the taxable year that begins on the following January 1. Net General Fund tax collected for a fiscal year is the amount of net revenue reported by the Department of Revenue's June Statement of Collections as "Total General Fund Revenue" for the twelve month period that ended the previous June 30th, modified by the reduction of any large one-time, nonrecurring revenue and adjusted by any changes in net collections resulting from the suspension or termination of transfers out of General Fund tax collections. The net General Fund tax collections for fiscal year 2015-2016 exceeded the targeted amount of \$20.975 billion; therefore, the corporate income tax rate for tax years beginning on or after January 1, 2017 will be reduced from 4% to 3%.

The Historic Rehabilitation Tax Credits Investment Program was established under Session Law 2015-241 and became effective January 1, 2016. It replaces the Historic Rehabilitation and Mill Rehabilitation credits that sunset on January 1, 2015. The new credit applies to qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2015. This credit is anticipated to have a negative \$8 million impact.



# FINANCIAL STATEMENTS

**North Carolina Department of Revenue**  
**Balance Sheet**  
**Governmental Funds**  
**As of June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit A-1**

	<b>General Fund</b>	<b>Special Revenue</b>	<b>Total 2016</b>	<b>Total 2015</b>
<b>ASSETS</b>				
Cash and Cash Equivalents (Note 2)	\$ 93,975,962	\$ 2,006,281	\$ 95,982,243	\$ 103,662,410
Receivables:				
Accounts Receivable	1,108,223		1,108,223	755,608
Intergovernmental Receivables (Note 6)	11,481,453	5,453	11,486,906	13,687,088
Taxes Receivable, Net (Note 3)	1,987,485,223	4,994,592	1,992,479,815	1,895,833,087
Securities Held in Trust (Sureties)	388,900		388,900	392,600
Due from Other Funds	57,286		57,286	49,254
Inventories	986,134		986,134	1,972,450
Total Assets	<u>2,095,483,181</u>	<u>7,006,326</u>	<u>2,102,489,507</u>	<u>2,016,352,497</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>				
Total Deferred Outflows of Resources	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 2,095,483,181</u>	<u>\$ 7,006,326</u>	<u>\$ 2,102,489,507</u>	<u>\$ 2,016,352,497</u>
<b>LIABILITIES</b>				
Accounts Payable and Accrued Liabilities:				
Accounts Payable (Note 5)	\$ 2,137,928	\$ 0	\$ 2,137,928	\$ 1,901,526
Accrued Payroll	1,612		1,612	9,851
Intergovernmental Payables (Note 6)	137,162,718	946,434	138,109,152	132,561,034
Funds Held for Others	388,750		388,750	392,450
Due to NC Housing Finance Agency	29,751,890		29,751,890	82,099,679
Due to Fiduciary Funds	26,613,373		26,613,373	26,986,670
Tax Refunds Payable (Note 3)	989,469,963		989,469,963	965,641,906
Unearned Revenue	385,400,000		385,400,000	387,800,000
Total Liabilities	<u>1,570,926,234</u>	<u>946,434</u>	<u>1,571,872,668</u>	<u>1,597,393,116</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
Unavailable Revenues (Note 7)	<u>71,970,797</u>	<u>4,710,179</u>	<u>76,680,976</u>	<u>72,231,906</u>
<b>FUND BALANCES</b> (Note 10)				
Nonspendable	986,134		986,134	1,972,450
Committed	83,304,370	1,349,713	84,654,083	88,600,021
Assigned				2,330,252
Unassigned	368,295,646		368,295,646	253,824,752
Total Fund Balances	<u>452,586,150</u>	<u>1,349,713</u>	<u>453,935,863</u>	<u>346,727,475</u>
Total Liabilities, Deferred Inflows, and Fund Balances	<u>\$ 2,095,483,181</u>	<u>\$ 7,006,326</u>	<u>\$ 2,102,489,507</u>	<u>\$ 2,016,352,497</u>

The accompanying notes to the financial statements are an integral part of this statement.

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balances**  
**Governmental Funds**  
**For the Fiscal Year Ended June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit A-2**

	<b>General Fund</b>	<b>Special Revenue</b>	<b>Total 2016</b>	<b>Total 2015</b>
<b>REVENUES</b>				
Tax Revenues	\$ 22,154,277,600	\$ 6,748,683	\$ 22,161,026,283	\$ 21,326,012,680
Revenues from Other State Agencies (Note 12)	7,033,434		7,033,434	6,874,573
Sales and Services	380,672		380,672	307,128
Fees	4,318,553		4,318,553	2,118,213
Miscellaneous	369,492		369,492	6,124
Total Revenues	22,166,379,751	6,748,683	22,173,128,434	21,335,318,718
<b>EXPENDITURES</b>				
Statutory Tax Distributions	623,639,453	4,761,037	628,400,490	604,370,256
Contracted Services	11,039,556		11,039,556	8,673,562
Personal Services	67,682,271		67,682,271	62,646,996
Employee Benefits	25,261,357		25,261,357	22,872,463
Supplies and Materials	1,795,116		1,795,116	1,167,533
Travel	1,414,660		1,414,660	1,401,306
Communication	3,583,515		3,583,515	3,065,551
Utilities	123,750		123,750	143,026
Data Processing Services	5,344,474		5,344,474	4,205,676
Claims and Benefits	56,380		56,380	70,908
Other Services	4,333,203	45,648	4,378,851	4,069,914
Other Fixed Charges	5,426,522		5,426,522	7,216,767
Expenditures to Other State Agencies (Note 12)	3,906,235	1,589,450	5,495,685	1,548,561
Capital Outlay	5,472,091		5,472,091	7,248,975
Insurance and Bonding	38,351		38,351	35,933
Other Expenditures	4,566,983		4,566,983	4,001,471
Total Expenditures	763,683,917	6,396,135	770,080,052	732,738,898
Excess of Revenues Over Expenditures	21,402,695,834	352,548	21,403,048,382	20,602,579,820
<b>OTHER FINANCING SOURCES (USES)</b>				
State Appropriations	79,762,784		79,762,784	80,074,647
Sale of Capital Assets	1,652		1,652	522
Transfers In (Note 11)	594,623		594,623	537,095
Transfers Out (Note 11)	(21,375,604,430)	(594,623)	(21,376,199,053)	(20,507,685,404)
Total Other Financing Sources (Uses)	(21,295,245,371)	(594,623)	(21,295,839,994)	(20,427,073,140)
Net Change in Fund Balances	107,450,463	(242,075)	107,208,388	175,506,680
Fund Balances - July 1	345,135,687	1,591,788	346,727,475	171,220,795
Fund Balances - June 30	\$ 452,586,150	\$ 1,349,713	\$ 453,935,863	\$ 346,727,475

The accompanying notes to the financial statements are an integral part of this statement.



# NOTES TO THE FINANCIAL STATEMENTS

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

- A. Organization** – The North Carolina Department of Revenue (Department) is a part of the State of North Carolina and is not a separate legal or reporting entity. The Department was created to administer, enforce and collect the taxes due to the State of North Carolina. The Department has approximately 1,500 employees and 11 service centers located throughout the state for walk-in assistance that offer a variety of services ranging from providing tax forms to answering questions.

The operations of the Department are led by the Secretary of Revenue, a member of the Governor's cabinet.

- B. Financial Reporting Entity** – The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The Department is a part of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to or under the stewardship of the Department. The Department's accounts and transactions are included in the State's *Comprehensive Annual Financial Report* as part of the State's governmental funds.

- C. Basis of Presentation** – The Department's records are maintained on a cash basis throughout the year, but adjustments are made at the end of the fiscal year to convert to GAAP for government entities. The financial statements are prepared according to GAAP as follows:

The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* require the presentation of both government-wide and fund level financial statements. The financial statements presented are governmental funds of the Department. Because the Department is not a separate entity, government-wide financial statements are not prepared.

The fund financial statements provide information about the Department's funds. The emphasis of fund financial statements is on each governmental fund.

The Department's financial statements consist of the following governmental funds:

**General Fund** – This is the Department's only major fund and its primary operating fund. The General Fund is made up of two sub-accounts,



Company 99 and Company 45. Company 99 is used to record tax collections on behalf of the State while Company 45 is used to record the Department's general operations. The General Fund accounts for all financial resources of the general government, except those required to be accounted for in another fund. The services, which are administered by the Department and accounted for in the General Fund, include the administration, enforcement, and collection of taxes due to the State of North Carolina.

**Special Revenue Fund** – Authorized by the legislature under North Carolina General Statute 105-113.113, this fund accounts for the excise tax imposed on unauthorized substances. Once these proceeds are unencumbered, 75% of the proceeds are distributed to the state and local law enforcement agencies involved in the arrest and 25% are distributed to the General Fund of the State of North Carolina. This fund does not receive any appropriation from the General Assembly. The Special Revenue Fund is made up of Company 45 – Unauthorized Substance Tax.

- D. Measurement Focus and Basis of Accounting** – Governmental fund financial statements are prepared using the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and liabilities are generally included on the balance sheet. The operating statement presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in spendable resources. General capital asset acquisitions are reported as expenditures.

Under the modified accrual basis of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 31 days of the end of the current fiscal period (an exception is individual income tax revenues, which the Department considers to be available if they are collected within 12 months after year-end). Expenditures are recorded when a liability is incurred, except for compensated absences, workers' compensation, and claims and judgments, which are recognized as expenditures when payment is due. Pension contributions to cost-sharing plans are recognized as expenditures in the period to which the payment relates, even if payment is not due until the subsequent period.

Since capital asset and long-term liability accounts relating to the governmental funds are reported only at the statewide level, these amounts are not included in the Department's governmental fund financial statements. However, these amounts are reported in the Notes to the Financial Statements.

Nonexchange transactions, in which the Department receives (or gives) value without directly giving (or receiving) equal value in exchange includes taxes, fines, and forfeitures. Revenues are recognized, net of

estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

The preparation of financial statements, in conformity with GAAP, requires management of the Department to make estimates and judgments that affect the reported amounts of assets, liabilities and deferred inflows of resources and the disclosures and contingencies at the date of the financial statements and revenues and expenditures recognized during the reporting period. Actual results could differ from those estimates. Should actual results differ from those estimates, changes will flow through the financial statements during the year of change and will be disclosed, if material.

- E. Cash and Cash Equivalents** – This classification includes undeposited receipts and deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- F. Receivables** – Accounts receivable represents amounts owed to the Department that have arisen during the ordinary course of business and are shown at book value with no provision for doubtful accounts considered necessary.

Taxes receivable primarily consist of (1) taxes owed that are expected to be received in approximately 31 days of the year-end but have not been billed (with the exception of individual income taxes which is 12 months after year-end); (2) actual taxpayer assessed unpaid taxes less an allowance for uncollectible taxes; and (3) an estimate of under-withholding for individual income taxes for the first half of the calendar year.

Intergovernmental receivables include amounts due from the state and local governments. All amounts are considered collectible and therefore, no allowance for doubtful accounts is recorded.

- G. Inventories** – Inventories consisting of general supplies and materials are valued at cost using the first-in, first-out (FIFO) method. Inventories of the governmental fund are recorded as expenditures when consumed rather than when purchased.
- H. Intergovernmental Payables** – Intergovernmental payables consist primarily of tax distributions due to local governments and law enforcement agencies.
- I. Unearned Revenue** – Unearned revenue for the governmental fund represents the cumulative excess of cash received for various taxes that is to be applied in a future year.
- J. Tax Refund Liabilities** – Tax refund liabilities consist primarily of accrued income and sales and use tax refunds due to taxpayers. During the calendar year, the Department collects employee withholdings and taxpayers' payments for income taxes. At June 30, the Department

estimates the amount it owes taxpayers for income tax overpayments during the preceding six months. Sales and use tax refund liabilities are also estimated at June 30. These liabilities are recorded as "Tax refunds payable."

- K. Long-Term Liabilities** – General long-term liabilities for the governmental funds are not recognized in the governmental fund until they become due. Consequently, general long-term liabilities not yet due are not reported on the face of the financial statements. The noncurrent portion represents amounts that will not be paid within the next fiscal year. The Department's claims and judgments payable, compensated absences and net pension liability are the only significant general long-term liabilities of the Department.

**Claims and Judgments Payable** – The North Carolina Supreme Court ruled in *North Carolina School Boards Association v. Moore* that certain specified tax penalties collected from July 1, 1996, to June 30, 2005, must be paid to the State Civil Penalty and Forfeiture Fund for the benefit of public schools, rather than to the State's General Fund. The court found that the civil penalties collected during this time totaled \$767,814,048, of which \$585,741,703 represented amounts collected by the Department of Revenue (\$583,340,162 after deducting the costs of collection). The Supreme Court remanded the case to the Superior Court for implementation. The Superior Court issued an order requiring the prospective payments to commence effective July 1, 2005; however, compliance with the Superior Court's judgment is currently dependent on legislative action.

**Net Pension Liability** – The net pension liability represents the Department's proportionate share of the collective net pension liability reported in the State of North Carolina's 2015 *Comprehensive Annual Financial Report*. This liability represents the Department's portion of the collective total pension liability less the fiduciary net position of the Teachers' and State Employees' Retirement System. See Note 13 for further information regarding the Department's policies for recognizing liabilities, expenses, and deferred outflows and inflows related to pensions.

**Compensated Absences** – Employees of the Department are permitted to accumulate earned but unused vacation pay benefits. In the governmental fund, a liability for these amounts is reported only as payments come due each period upon the occurrence of relevant events such as employee resignations and retirements. Consequently, compensated absence balances are not reported on the face of the governmental fund financial statements but are reported in the Notes to the Financial Statements. When determining the vacation pay liability due within one year, leave is considered taken on a last in, first out (LIFO) basis. The Department's policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at calendar year end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the

leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not part of the 30 day maximum applicable to regular vacation leave and is not subject to conversion to sick leave.

There is no liability for unpaid accumulated sick leave because the Department has no obligation to pay sick leave upon employee termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

- L. Fund Balance** – Fund balance for the governmental funds is reported in the following classifications depicting the relative strength of the constraints that control how specific amounts can be spent.

The nonspendable fund balance classification includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

Restricted fund balance have constraints placed on the use of resources that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or (b) imposed by law through constitutional provisions.

Committed fund balances can only be used for specific purposes pursuant to constraints imposed by formal action of the North Carolina General Assembly, the State's highest level of decision-making authority. The North Carolina General Assembly establishes commitments through the passage of legislation that becomes State law. Commitments may be changed or lifted only by taking the same formal action that imposed the constraint originally. The Department has fund balance committed for the following purposes:

- **Project Collect Tax** – Collection assistance fee imposed by the General Assembly under General Statute 105-243.1. Fee is imposed on an overdue tax debt that remains unpaid 30 days or more after the fee notice is mailed to the tax payer. The proceeds of the fee must be deposited into a special account and must be applied to the costs of collecting overdue tax debts. The proceeds of the fee may not be used for any purpose that is not directly and primarily related to collecting overdue tax debts.
- **Transaction Fees** – Imposed by the North Carolina General Assembly under General Statute 66-58.12. A transaction fee is charged on a tax transaction made via a merchant card. The proceeds derived from the fee may be expended only for e-commerce initiatives and projects.

- Operations and Maintenance for Tax Systems – Imposed by the General Assembly under House Bill 1473 to use funds to support the remediation and ongoing support and maintenance of the Tax Information Management System (TIMS) and the Integrated Tax Administration System (ITAS).
- Unauthorized Substance Tax – An excise tax is imposed by the General Assembly under General Statute 105-113.113 on unauthorized substances. When proceeds are unencumbered, 75% of the proceeds are distributed to state and local law enforcement agencies involved in the arrest. The remaining 25% of proceeds are distributed to the General Fund.

Assigned fund balance are constrained by intent to be used for specific purposes, but are neither restricted nor committed. The Office of State Budget and Management (OSBM) is authorized to assign unexpended funds at year-end as a carryforward of budget authority to the subsequent fiscal year. The North Carolina Constitution (Article III, Sec. 5(3)) provides that the "budget as enacted by the General Assembly shall be administered by the Governor." The Governor has delegated the authority to perform certain powers and duties of this role to the State Budget Director.

Unassigned fund balance is the residual classification for the General Fund. Other governmental funds cannot report positive unassigned fund balance but can report negative unassigned fund balance if expenditures incurred for specific purposes exceeded the amounts restricted or committed to those purposes.

Expenditures are considered to be made from the most restrictive resource (i.e., restricted, committed, assigned, and unassigned in that order) when more than one fund balance classification is available for use.

- M. Deferred Inflows of Resources** – An acquisition of net position applicable to a future period(s) that will not be recognized as revenue until that time. The Department has unavailable revenues reported in this category which represent taxes owed at the fiscal year end that do not qualify for recognition as revenue as they are not yet considered to be available.
- N. Revenues and Expenditures From/To Other State Agencies** – Revenues and expenditures from/to other state agencies for the governmental fund represent funds that the Department obtains from or transfers to other agencies, institutions, or entities within the State of North Carolina. These transfers are not considered other financing sources or uses per GAAP, nor are they considered interfund transfers. These revenues and expenditures are eliminated at the statewide reporting level in the State's *Comprehensive Annual Financial Report*.
- O. Statutory Tax Distributions** – Statutory Tax Distributions represent legislatively mandated amounts transferred to local governments or law enforcement agencies for their portion of tax collections for sales and

use, white goods, scrap tire, solid waste, beverage, and unauthorized substances.

## NOTE 2 - DEPOSITS AND FAIR VALUE MEASUREMENTS

- A. Deposits** – Unless specifically exempt, the Department is required by North Carolina General Statute 147-77 to deposit any funds collected or received that belong to the State of North Carolina with the State Treasurer or with a depository institution in the name of the State Treasurer. General Statute 147-69.1, applicable to the General Fund, and General Statute 147-69.2, applicable to the Special Revenue Fund, authorize the State Treasurer to invest all deposits in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; specified repurchase agreements; obligations of the State of North Carolina; certificates of deposit and other deposit accounts of specified financial institutions; prime quality commercial paper; asset-backed securities with specified ratings, specified bills of exchange or time drafts, and corporate bonds/notes with specified ratings; general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

The North Carolina Administrative Code (20 NCAC 7) requires all depositories to collateralize public deposits in excess of federal depository insurance coverage by using one of two methods, dedicated or pooled. Under the dedicated method, a separate escrow account is established by each depository under the Department's name and the responsibility of monitoring collateralization rests with each depository. Under the pooling method, each depository establishes an escrow account in the name of the State Treasurer to secure all of its public deposits. This method shifts the monitoring responsibility from the Department to the State Treasurer.

Custodial credit risk is the risk that in the event of a bank failure, the Department's deposits may not be returned to it. As of June 30, 2016, the Department's bank balance in excess of federal depository insurance coverage was covered under the pooling method.

At June 30, 2016, the governmental fund's Balance Sheet reported cash and cash equivalents of \$95,982,243. This amount represents the Department's equity position in the State Treasurer's Short-Term Investment Fund (STIF). The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.5 years as of June 30, 2016. Assets and shares of the STIF are valued at fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's STIF) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.



- B. Fair Value Measurements** – To the extent available, the Department's investments are recorded at fair value as of June 30, 2016. GASB Statement No. 72, Fair Value Measurement and Application, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

- |         |   |
|---------|---|
| Level 1 | Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date. |
| Level 2 | Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset either directly or indirectly.                  |
| Level 3 | Investments classified as Level 3 have unobservable inputs and may require a degree of professional judgment.   |

**Short-Term Investment Fund** – At year-end, all of the Department's investments valued at \$95,982,243 were held in the STIF which is a Level 2 investment. Ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian.

**NOTE 3 - TAXES RECEIVABLE AND TAX REFUNDS PAYABLE**

Taxes receivable at June 30, 2016, were reported as follows:

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
<b>Taxes Receivable:</b>			
General Fund			
Individual	\$ 361,900,000	\$ 0	\$ 361,900,000
Sales and Use Tax	340,600,000		340,600,000
Corporate	30,200,000		30,200,000
Underwithholding - Individual	607,600,000		607,600,000
Other	111,824,633		111,824,633
Delinquent Receivables			
Individual	990,663,420	558,473,865	432,189,555
Sales and Use Tax	163,360,184	84,177,283	79,182,901
Corporate	25,739,171	18,121,307	7,617,864
Tobacco Products	24,068,708	16,412,802	7,655,906
Franchise	7,227,919	1,770,414	5,457,505
Estate	8,048,834	7,942,757	106,077
License and Excise	4,290,459	2,532,357	1,758,102
Alcoholic Beverage	1,075,256	792,550	282,706
Other	1,479,589	369,615	1,109,974
<b>Total Taxes Receivable</b>	<b>\$ 2,678,078,173</b>	<b>\$ 690,592,950</b>	<b>\$ 1,987,485,223</b>

Within the General Fund, the significant receivables not expected to be collected within one year were \$571 million of taxes receivable.

See Exhibit E-1 Schedule of Aging of the Taxes Receivable (Gross)

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
<b>Taxes Receivable:</b>			
Special Revenue Fund			
Unauthorized Substance Tax	\$ 499,459,200	\$ 494,464,608	\$ 4,994,592
<b>Total Taxes Receivable</b>	<b>\$ 499,459,200</b>	<b>\$ 494,464,608</b>	<b>\$ 4,994,592</b>

Tax refunds payable at June 30, 2016 were reported as follows:

	2016
<b>Tax Refunds Payable</b>	
Individual	\$ 604,700,000
Sales and use Tax	246,000,000
Corporate	124,000,000
Other	14,769,963
<b>Total Tax Refunds Payable</b>	<b>\$ 989,469,963</b>



#### NOTE 4 - CAPITAL ASSETS

Capital assets, which include property, plant, and equipment, are reported as expenditures in governmental funds. Consequently, capital asset balances are not reported on the face of the fund financial statements. Purchased or constructed capital assets are reported at cost or estimated historical cost. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend its useful life are not capitalized. Donated capital assets are recorded at their estimated fair value at the date of donation.

Generally, capital assets are defined by the Department as assets with an initial value or cost greater than or equal to \$5,000 and an estimated useful life of two or more years, except for internally generated computer software and other intangible assets, which are capitalized when the value or cost is greater than or equal to \$1 million and \$100 thousand, respectively.

Depreciation, which is recorded at the statewide level, is computed using the straight-line method over the estimated useful lives of the assets, generally 2 to 30 years for machinery and equipment and computer software.

A summary of changes in the Department's capital assets for the year ended June 30, 2016 is presented as follows:

	Balance July 1, 2015 (As Restated) <sup>1</sup>	Additions	Disposals	Balance June 30, 2016
Capital Assets, Nondepreciable:				
Computer Software in Development	\$ 1,417,102	\$ 2,132,760	\$ 0	\$ 3,549,862
<b>Total Capital Assets, Nondepreciable</b>	<b>1,417,102</b>	<b>2,132,760</b>		<b>3,549,862</b>
Capital Assets, Depreciable:				
Equipment <sup>1</sup>	13,427,977	67,369	2,050,610	11,444,736
Computer Software	28,136,986			28,136,986
<b>Total Capital Assets, Depreciable</b>	<b>41,564,963</b>	<b>67,369</b>	<b>2,050,610</b>	<b>39,581,722</b>
Less Accumulated Depreciation for:				
Equipment <sup>1</sup>	4,443,788	595,538	1,433,946	3,605,380
Computer Software	2,051,655	1,406,849		3,458,504
<b>Total Accumulated Depreciation</b>	<b>6,495,443</b>	<b>2,002,387</b>	<b>1,433,946</b>	<b>7,063,884</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>35,069,520</b>	<b>(1,935,018)</b>	<b>616,664</b>	<b>32,517,838</b>
<b>Capital Assets, Net</b>	<b>\$ 36,486,622</b>	<b>\$ 197,742</b>	<b>\$ 616,664</b>	<b>\$ 36,067,700</b>

<sup>1</sup> The July 1, 2015 Equipment balance has been restated by \$608,550 and the Accumulated Depreciation balance for Equipment has been restated by \$40,971. These restatements are due to warranty replacements and equipment purchased and placed in service in fiscal year 2015, but not entered in the fixed asset system until fiscal year 2016.

**NOTE 5 - ACCOUNTS PAYABLE**

Accounts payable at June 30, 2016 were reported as follows:

Accounts Payable	2016
Accounts Payable	\$ 2,000,328
Due to Employees	137,600
<b>Total Accounts Payable</b>	<b>\$ 2,137,928</b>

**NOTE 6 - INTERGOVERNMENTAL RECEIVABLES AND PAYABLES**

Intergovernmental receivables and payables at June 30, 2016, were reported as follows:

	2016	
	General Fund	Special Revenue
<b>Intergovernmental Receivables</b>		
Local Governments:		
Fines and Forfeitures Overpaid	\$ 0	\$ 5,453
Medicaid Hold Harmless Distribution Returned	69,589	
<b>Total from Local Governments</b>	69,589	5,453
State Agencies - Payroll Taxes	11,411,864	
<b>Total Intergovernmental Receivables</b>	<b>\$ 11,481,453</b>	<b>\$ 5,453</b>
<b>Intergovernmental Payables</b>		
Local Government Tax Distributions:		
Medicaid Hold Harmless	\$ 9,280,369	\$ 0
Alcoholic Beverage	8,847,754	
Real Estate Conveyance, White Goods Disposal, Scrap Tire Disposal, and Solid Waste Disposal	3,389,559	
Electricity	67,509,253	
Video Program	19,815,651	
Telecom	13,473,768	
Piped Natural Gas	3,001,058	
Unauthorized Substance		715,624
<b>Total to Local Governments</b>	<b>125,317,412</b>	<b>715,624</b>
Statutory Tax Distribution to the General Fund:		
White Goods Disposal	613,543	
Scrap Tire Disposal	3,405,939	
Solid Waste Disposal	1,741,920	
Unauthorized Substance		230,810
<b>Total to General Fund</b>	<b>5,761,402</b>	<b>230,810</b>
State Agencies:		
Department of Environmental Quality - Solid Waste Taxes	4,498,630	
Department of Information Technology - 911 Service Charges	899,938	
Department of Information Technology - Other Payments	646,312	
Department of Administrations - Motor Fleet	39,024	
<b>Total to State Agencies</b>	<b>6,083,904</b>	<b>0</b>
<b>Total Intergovernmental Payables</b>	<b>\$ 137,162,718</b>	<b>\$ 946,434</b>

# NOTE 7 - DEFERRED INFLOWS OF RESOURCES

The various components of deferred inflows of resources at June 30, 2016, were reported as follows:

	Unavailable at June 30, 2015	Current year Unavailable increase	Prior Year Unavailable earned in current year	Unavailable at June 30, 2016
<b>General Fund:</b>				
Estate Taxes	\$ 188,880	\$ 106,076	\$ (188,880)	\$ 106,076
Gift Taxes	417	2,022	(417)	2,022
License Taxes	1,554,242	1,735,741	(1,554,242)	1,735,741
Tobacco Taxes	2,743,067	7,615,906	(2,743,067)	7,615,906
Beverage Taxes	203,333	282,456	(203,333)	282,456
Franchise Taxes	8,105,986	4,766,897	(8,105,986)	4,766,897
Sales & Use Taxes	50,319,981	49,359,824	(50,319,981)	49,359,824
Corporate Taxes	4,528,885	7,082,626	(4,528,885)	7,082,626
White Goods Taxes	356	808	(356)	808
Scrap Tire Taxes	324,138	383,729	(324,138)	383,729
Manufacturing Taxes	66,017	405,465	(66,017)	405,465
Solid Waste Taxes	16,159	21,024	(16,159)	21,024
Insurance Taxes		208,223		208,223
	<u>\$ 68,051,461</u>	<u>\$ 71,970,797</u>	<u>\$ (68,051,461)</u>	<u>\$ 71,970,797</u>
<b>Special Revenue Fund:</b>				
Unauthorized Substance Taxes	\$ 4,180,445	\$ 4,710,179	\$ (4,180,445)	\$ 4,710,179
	<u>\$ 4,180,445</u>	<u>\$ 4,710,179</u>	<u>\$ (4,180,445)</u>	<u>\$ 4,710,179</u>

# NOTE 8 - LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2016, is presented as follows:

General Fund	Balance July 1, 2015	Additions	Reductions	Balance June 30, 2016	Due Within One Year
Claims and Judgments Payable	\$ 583,340,162	\$ 0	\$ 0	\$ 583,340,162	\$ 0
Compensated Absences	8,546,447	5,750,666	5,283,501	9,013,612	740,919
Net Pension Liability <sup>1</sup>	4,975,637	10,643,706		15,619,343	
<b>Total Long-Term Liabilities</b>	<u>\$ 596,862,246</u>	<u>\$ 16,394,372</u>	<u>\$ 5,283,501</u>	<u>\$ 607,973,117</u>	<u>\$ 740,919</u>

<sup>1</sup> See Note 13, Pension Plans, for more information on the net pension liability.

**NOTE 9 - OPERATING LEASE OBLIGATIONS**

The Department entered into operating leases for facilities. Future minimum lease payments for noncancellable operating leases consisted of the following at June 30, 2016:

<u>Fiscal Year</u>	<u>General Fund</u>
2017	\$ 1,682,000
2018	1,570,682
2019	1,510,472
2020	1,493,847
2021	1,493,847
2022-2026	<u>2,069,963</u>
Total Minimum Lease Payments	<u>\$ 9,820,811</u>

Rental expense for all operating leases during the year ended June 30, 2016 was \$2,381,718.

**NOTE 10 - FUND BALANCE**

The details of the fund balance classifications for the governmental funds at June 30, 2016 are as follows:

	<u>2016</u>		
	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total</u>
Fund Balance:			
Nonspendable:			
Inventory of Supplies	\$ 986,134	\$ 0	\$ 986,134
Committed to:			
General Government			
Project Collect Tax	61,888,516		61,888,516
Transaction Fees	3,938,267		3,938,267
Operations and Maintenance for			
Tax Systems	16,849,262		16,849,262
Other Committed	628,325		628,325
Unauthorized Substance Tax		1,349,713	1,349,713
Unassigned	<u>368,295,646</u>		<u>368,295,646</u>
Total Fund Balance	<u>\$ 452,586,150</u>	<u>\$ 1,349,713</u>	<u>\$ 453,935,863</u>

# NOTE 11 - INTERFUND TRANSFERS

Transfers in/out of other funds for the fiscal year ended June 30, 2016 consisted of the following:

	Transfers In				Total
	General Fund	State General Fund	State Reserve Fund	Other State Funds	
<u>Transfers Out</u>					
General Fund	\$ 0	\$ 21,291,901,883	\$ 798,485	\$ 82,904,062	\$ 21,375,604,430
Special Revenue	594,623				594,623
Total	<u>\$ 594,623</u>	<u>\$ 21,291,901,883</u>	<u>\$ 798,485</u>	<u>\$ 82,904,062</u>	<u>\$ 21,376,199,053</u>

Transfers are primarily used to (1) transfer revenues from the fund required by state statute or budget to collect the revenue to the fund required by state statute or budget to expend them, (2) to provide unrestricted revenues collected in the General Fund to finance operating and capital programs accounted for in other funds in accordance with budgetary authorizations, and (3) reflect reversions of State funds from other funds to the General Fund in accordance with Office of State Budget and Management or legislative requirements.

The Department made legislatively mandated transfers to other state funds as follows: (1) \$61,163,099 to the Department of Public Insurance for the State Public School Fund per General Statute 105-164.44H, (2) \$18,301,588 to the Department of Insurance for Workers' Compensation and Volunteer Fire Department Funds per General Statute 105-228.5, and (3) \$3,439,375 to the Department of the State Treasurer to reimburse costs of Local Government Commission collections per General Statute 105-501.

The Department had intrafund transfers from Company 99 to Company 45 for fiscal year ended June 30, 2016 in the amount of \$41,614,841, which has been eliminated on the governmental funds financial statements. These General Fund transfers primarily consist of a 20 percent collection assistance fee authorized by General Statute 105.243.1, which the Department uses to offset the costs of collecting and reducing the incidence of overdue tax debts.

The Department requested to carry forward unspent appropriations for specifically identified expenditures that will be paid in the next fiscal year. This is accomplished by the Department requesting the carryforward amount through the Office of State Budget and Management (OSBM) and making required entries to the North Carolina Accounting System (NCAS) in the current year expensing the funds from the agency budget codes. The Office of the State Controller (OSC) then transfers the funds to the State Reserve Fund. The funds are held by OSC pending approval from OSBM to return the funds to the agencies. Upon OSBM approval, the funds are transferred back to the agency budget codes. The agency then makes an entry to NCAS recording the revenue in the subsequent fiscal year.

**NOTE 12 - REVENUES AND EXPENDITURES FROM/TO OTHER STATE AGENCIES**

The governmental funds' revenues and expenditures from/to other state agencies by entity and purpose at June 30, 2016 are as follows:

General Fund:		Purpose	Amount
Revenues from Other State Agencies:			
Department of Transportation	Motor Fuels Reimbursement	\$	3,537,644
Department of Transportation	Fuel Tax Compliance Reimbursement		1,297,113
Department of Transportation	International Registration Plan Reimbursement		141,406
Department of Transportation	Motor Tax Project Reimbursement		1,350,273
Department of Transportation	Project Collect Tax		48,615
Department of Information Technology	Information Technology Security Positions		424,974
Department of Insurance	Insurance Reimbursement		112,781
Department of Agriculture and Consumer Services	Forestry Reimbursement		102,543
Department of Commerce	Job Development Investment Grants		18,085
Total Revenues from Other State Agencies			<u>\$ 7,033,434</u>
		Purpose	Amount
Expenditures to Other State Agencies:			
Office of the State Controller	William S. Lee Fees	\$	1,906,235
Department of Information Technology	Government Data Analytics Center		2,000,000
Total Expenditures to Other State Agencies			<u>\$ 3,906,235</u>
Special Revenue Fund:		Purpose	Amount
Expenditures to Other State Agencies:			
Office of the State Controller	25% Transfer to General Fund	\$	1,589,450
Total Expenditures to Other State Agencies			<u>\$ 1,589,450</u>

**NOTE 13 - PENSION PLANS****Defined Benefit Plan**

*Plan Administration:* The State of North Carolina administers the Teachers' and State Employees' Retirement System (TSERS) plan. This plan is a cost-sharing, multiple-employer, defined benefit pension plan established by the State to provide pension benefits for general employees and law enforcement officers (LEOs) of the State, general employees and LEOs of its component units, and employees of Local Education Agencies (LEAs) and charter schools not in the reporting entity. Membership is comprised of employees of the State (state agencies and institutions), universities, community colleges, and certain proprietary component units along with the LEAs and charter schools that elect to join the Retirement System. Benefit provisions are established by General Statute 135-5 and may be amended only by the North Carolina General Assembly.

*Benefits Provided:* TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final

compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of general members who die while in active service or within 180 days of their last day of service and who also have either completed 20 years of creditable service regardless of age, or have completed five years of service and have reached age 60. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

*Contributions:* Contribution provisions are established by General Statute 135-8 and may be amended only by the North Carolina General Assembly. Employees are required to contribute 6% of their compensation. The contribution rate for employers is set each year by the NC General Assembly in the Appropriations Act based on the actuarially-determined rate recommended by the actuary. The Department's contractually-required contribution rate for the year ended June 30, 2016 was 9.15% of covered payroll. The Department's contributions to the pension plan were \$6,183,328, and employee contributions were \$4,054,641 for the year ended June 30, 2016.

The TSERS Plan's financial information, including all information about the plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, is included in the State of North Carolina's fiscal year 2015 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

*TSERS Basis of Accounting:* The financial statements of the TSERS plan were prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. The plan's fiduciary net position was determined on the same basis used by the pension plan.

*Methods Used to Value TSERS Investment:* Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The pension trust funds are the primary participants in the Long-term Investment portfolio and the sole participants in

the External Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Credit Investment, and Inflation Protection Investment portfolios. The investment balance of each pension trust fund represents its share of the fair market value of the net position of the various portfolios within the pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2015 *Comprehensive Annual Financial Report*.

**Net Pension Liability:** At June 30, 2016, the Department reported a liability of \$15,619,343 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2015. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2014, and update procedures were used to roll forward the total pension liability to June 30, 2015. The Department's proportion of the net pension liability was based on the present value of future salaries for the Department relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2015, the Department's proportion was .42384%, which was a decrease of .00055% from its proportion measured as of June 30, 2014.

**Actuarial Assumptions:** The following table presents the actuarial assumptions used to determine the total pension liability for the TSERS plan at the actuarial valuation date:

Valuation Date	12/31/2014
Inflation	3%
Salary Increases*	4.25% - 9.10%
Investment Rate of Return**	7.25%

\* Salary increases include 3.5% inflation and productivity factor.

\*\* Investment rate of return is net of pension plan investment expense, including inflation.

TSERS currently uses mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer) and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2014 valuations were based on the results of an actuarial experience study for the period January 1, 2005 through December 31, 2009.

Future ad hoc Cost of Living Adjustment (COLA) amounts are not considered to be substantively automatic and are therefore not included in the measurement.

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the U.S. Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through



analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2015 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	2.2%
Global Equity	5.8%
Real Estate	5.2%
Alternatives	9.8%
Credit	6.8%
Inflation Protection	3.4%

The information above is based on 30-year expectations developed with the consulting actuary for the 2014 asset, liability and investment policy study for the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.19%. All rates of return and inflation are annualized.

*Discount Rate:* The discount rate used to measure the total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

*Sensitivity of the Net Pension Liability to Changes in the Discount Rate:* The following presents the net pension liability of the plan calculated using the discount rate of 7.25%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.25%) or 1-percentage point higher (8.25%) than the current rate:

Net Pension Liability (Asset)		
1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
\$ 47,009,913	\$ 15,619,343	\$ (11,019,175)

*Deferred Inflows of Resources and Deferred Outflows of Resources Related to Pensions:* For the year ended June 30, 2016, the Department recognized pension expense of \$1,640,407. At June 30, 2016, the Department reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

**Employer Balances of Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions by Classification:**

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Actual and Expected Experience	\$ 0	\$ 1,775,919
Changes of Assumptions		
Net Difference Between Projected and Actual Earnings on Pension Plan Investments		1,692,223
Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions	386,867	
Contributions Subsequent to the Measurement Date	6,183,328	
Total	<u>\$ 6,570,195</u>	<u>\$ 3,468,142</u>

The amount of \$6,183,328 reported as deferred outflows of resources related to pensions will be included as a reduction of the net pension liability in the fiscal year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

**Schedule of the Net Amount of the Employer's Balances of Deferred Outflows of Resources and Deferred Inflows of Resources That will be Recognized in Pension Expense:**

Year ended June 30:	Amount
2017	\$ (1,915,280)
2018	(1,915,280)
2019	(1,861,532)
2020	2,610,817
Total	<u>\$ (3,081,275)</u>

**NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS**

**A. Health Benefits** - The Department participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System (TSERS). Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by Chapter 135, Article 3B, of the General Statutes, and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of TSERS and contributions to the Fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are established by the General Assembly.

For the current fiscal year the Department contributed 5.60% of the covered payroll under TSERS to the Fund. Required contribution rates for the year ended June 30, 2015 and 2014 were 5.49% and 5.40% respectively. The Department made 100% of its annual required contributions to the Plan for the year ended June 30, 2016, 2015, and 2014, which were \$3,784,332, \$3,456,603, and \$3,349,517 respectively. The Department assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

- B. Disability Income** - The Department participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of TSERS. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. By statute, the DIPNC is administered by the Department of State Treasurer and the Board of Trustees of TSERS. The Plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2016, the Department made a statutory contribution of .41% of covered payroll under TSERS to the DIPNC. Required contribution rates for the years ended June 30, 2015, and 2014, were .41% and .44% respectively. The Department made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2016, 2015, and 2014, which were \$277,067, \$258,143, and \$272,924, respectively. The Department assumes no liability for long-term disability benefits under the Plan other than its contribution.

Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

**NOTE 15 - RISK MANAGEMENT**

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in state-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

**A. Employee Benefit Plans****1. State Health Plan**

Department employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a discretely presented component unit of the State of North Carolina. The Plan has contracted with third parties to process claims.

**2. Death Benefit Plan of North Carolina**

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

**B. Other Risk Management and Insurance Activities****1. Automobile, Fire, and Other Property Losses**

The Department is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the Department for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

All state-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are \$1,000,000 per claim and \$10,000,000 per occurrence. The Department pays premiums to the North Carolina Department of Insurance for the coverage.

**2. Public Officers' and Employees' Liability Insurance**

The risk of tort claims of up to \$1,000,000 per claimant is retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private insurance company. The Department pays the premium, based on a composite rate, directly to the private insurer.

### 3. Employee Dishonesty and Computer Fraud

The Department is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. The Department is charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$100,000 deductible.

### 4. Statewide Workers' Compensation Program

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the Department's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The Department is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The Department retains the risk for workers' compensation.

Additional details on the state-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

## NOTE 16 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2016, the Department implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 72, *Fair Value Measurement and Application*

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*

GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*

GASB Statement No. 72 provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

GASB Statement No. 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

GASB Statement No. 79 establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes.



# **REQUIRED SUPPLEMENTARY INFORMATION**

**North Carolina Department of Revenue**  
**Schedule of Revenues, Expenditures, and Changes in Fund Balance**  
**Budget and Actual (Budgetary Basis-Non-GAAP) - General Fund**  
**For the Fiscal Year Ended June 30, 2016**

**Exhibit B-1**

	Budgeted Amounts			Favorable (Unfavorable)
	Original	Final	Actual	
<b>REVENUES</b>				
Tax Revenues <sup>1</sup>	\$ 20,899,600,000	\$ 20,899,600,000	\$ 21,331,966,561	\$ 432,366,561
Revenues from Other State Agencies	9,501,331	9,969,630	7,033,788	(2,935,842)
Sales and Services	500,435	500,435	380,672	(119,763)
Fee	1,023,007	3,498,025	4,318,553	820,528
Miscellaneous	591,541	591,541	97,900	(493,641)
Total Revenues	20,911,216,314	20,914,159,631	21,343,797,474	429,637,843
<b>EXPENDITURES</b>				
Contracted Services	22,634,102	22,026,594	11,378,694	10,647,900
Personal Services	79,758,200	73,809,186	67,681,313	6,127,873
Employee Benefits	28,784,456	26,816,583	25,197,060	1,619,523
Supplies and Materials	817,179	1,037,477	833,272	204,205
Travel	1,446,263	1,680,383	1,385,569	294,814
Communication	3,422,556	4,041,515	3,557,095	484,420
Utilities	186,195	182,866	129,888	52,978
Data Processing Services	5,568,460	6,288,309	5,287,804	1,000,505
Claims and Benefits	14,323	56,383	56,380	3
Other Services	4,281,136	4,645,834	4,330,531	315,303
Other Fixed Charges	3,241,686	6,083,324	5,303,470	779,854
Expenditures to Other State Agencies	299,500	3,914,235	3,906,235	8,000
Capital Outlay	3,391,915	7,654,725	5,456,680	2,198,045
Insurance and Bonding	42,889	43,860	38,351	5,509
Other Expenditures	4,718,694	4,934,648	4,576,102	358,546
Total Expenditures	158,607,554	163,215,922	139,118,444	24,097,478
Excess of Revenues Over Expenditures	20,752,608,760	20,750,943,709	21,204,679,030	453,735,321
<b>OTHER FINANCING SOURCES (USES)</b>				
State Appropriations	81,265,300	81,265,300	79,762,784	(1,502,516)
Sale of Capital Assets	1,000	1,000	1,000	
Transfers from Other Departments or Funds	1,485,897	4,228,977	4,323,397	94,420
Transfers to the State Reserve Fund		(798,485)	(798,485)	
Transfers to the State General Fund <sup>1</sup>	(20,899,600,000)	(20,899,600,000)	(21,291,901,883)	(392,301,883)
Total Other Financing Sources (Uses)	(20,816,847,803)	(20,814,903,208)	(21,208,613,187)	(393,709,979)
Net Change in Fund Balance	(64,239,043)	(63,959,499)	(3,934,157)	60,025,342
Fund Balance July 1, 2015, as restated	84,973,326	84,973,326	84,973,326	
Fund Balance June 30, 2016	\$ 20,734,283	\$ 21,013,827	\$ 81,039,169	\$ 60,025,342

The accompanying notes to the required supplementary information are an integral part of this schedule.

<sup>1</sup> The Department of Revenue is required to transfer net tax revenue to the State's general fund. Tax revenues are greater than the transfer to the State's general fund primarily due to the cost for the maintenance of information systems and the 20 percent collection assistance fee which the Department uses to offset the costs of collecting and reducing the incidence of overdue tax debts.

### SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-BUDGET AND ACTUAL (BUDGETARY BASIS-NON-GAAP) – GENERAL FUND

#### A. BUDGETARY PROCESS

The State's annual budget is prepared principally on the cash basis. The 1985 General Assembly enacted certain special provisions which state that the budget as certified in the appropriations act is the legal budget for all agencies. These special provisions also state that agencies may spend more than was certified in various line items provided the over-expenditure meets certain criteria and is authorized by the Director of the Budget. The process of approving these over-expenditures results in the authorized budget amounts.

#### B. RECONCILIATION OF BUDGET/GAAP REPORTING DIFFERENCES

*The Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual (Budgetary Basis – Non-GAAP) – General Fund* presents comparisons of legally adopted budget with actual data on a budgetary basis. Accounting principles applied to develop data on a budgetary basis differ significantly from those principles used to present financial statements in conformity with generally accepted accounting principles (GAAP). The following describes the major differences between budgetary financial data and GAAP financial data.

**Basis differences:** Budgetary fund balance is accounted for on the cash basis of accounting while GAAP fund balance is accounted for on the modified accrual basis of accounting. Accrued revenues and expenditures are recognized in the GAAP financial statements.

**Timing differences:** A significant variance between budgetary practices and GAAP is the authorized carry forward of appropriated funds.



The following table presents a reconciliation of resulting basis and timing differences in the fund balance (budgetary basis) at June 30, 2016 to the fund balance on a modified accrual basis (GAAP).

	General Fund
Fund Balance (budgetary basis) June 30, 2016	\$ 81,039,169
Reconciling Adjustments:	
<b>Basis Differences:</b>	
<b>Accrued Revenues:</b>	
Accounts Receivable	1,108,223
Intergovernmental Receivable	11,481,453
Due from Other Funds	57,286
Taxes Receivable	1,987,485,223
Other Receivables	
Less:	
Unearned Revenue	(385,400,000)
Total Accrued Revenues	1,614,732,185
<b>Accrued Expenditures:</b>	
Accounts Payable	(2,137,928)
Tax Refund Payable	(989,469,963)
Accrued Payroll	(1,612)
Intergovernmental Payables	(137,162,718)
Total Accrued Expenditures	(1,128,772,221)
<b>Other Adjustments:</b>	
Inventories	986,134
Securities Held in Trust (Sureties)	388,900
Due to NC Housing Finance Agency	(29,751,890)
Due to Fiduciary Funds	(26,613,373)
Funds Held for Others	(388,750)
Unavailable Revenue	(71,970,797)
<b>Timing Differences:</b>	
Undeposited E-911 Funds	899,937
Undeposited Receipts	3,952,893
General Fund Tax Reserves	8,083,963
Fund Balance (GAAP basis) June 30, 2016	\$ 452,586,150



# **SUPPLEMENTARY INFORMATION**

**North Carolina Department of Revenue**  
**Balance Sheet**  
**General Fund - Company 45**  
**As of June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit C-1**

	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and Cash Equivalents and Pooled Cash	\$ 82,845,532	\$ 90,216,976
Accounts Receivable	105,949	25,056
Securities Held in Trust (Sureties)	388,900	392,600
Due from Company 99 <sup>1</sup>	2,706,231	2,562,620
Due from Other Funds	57,286	49,254
Inventories	986,134	1,972,450
Total Assets	87,090,032	95,218,956
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Total Deferred Outflows of Resources	0	0
Total Assets and Deferred Outflows of Resources	\$ 87,090,032	\$ 95,218,956
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 1,974,862	\$ 1,827,748
Accrued Payroll	1,612	9,851
Intergovernmental Payables	1,585,274	2,810,753
Funds Held for Others	388,750	392,450
Total Liabilities	3,950,498	5,040,802
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Total Deferred Inflows of Resources	0	0
<b>FUND BALANCE</b>		
Nonspendable	986,134	1,972,450
Committed	83,304,370	87,008,233
Assigned		2,330,252
Unassigned	(1,150,970)	(1,132,781)
Total Fund Balance	83,139,534	90,178,154
Total Liabilities, Deferred Inflows, and Fund Balance	\$ 87,090,032	\$ 95,218,956

The accompanying notes to the financial statements are an integral part of this statement.

Company 45 General Fund is used to record the Department's general operations.

<sup>1</sup>This account represents the resources owed to Company 45 from Company 99 which are eliminated on the governmental fund financial statements. These resources are owed to Company 45 primarily for a 20 percent collection assistance fee authorized by General Statute 105.243.1, which the Department uses to offset the costs of collecting and reducing the incidence of overdue tax debts.

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balance**  
**General Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit C-2**

	<b>2016</b>	<b>2015</b>
<b>REVENUES</b>		
Revenues from Other State Agencies	\$ 7,033,434	\$ 6,874,573
Revenues from Company 99 <sup>1</sup>	41,614,841	34,739,591
Sales and Services	380,672	307,128
Fees	4,318,553	2,118,213
Miscellaneous	97,770	6,124
Total Revenues	53,445,270	44,045,629
<b>EXPENDITURES</b>		
Contracted Services	11,039,556	8,673,562
Personal Services	67,682,271	62,646,996
Employee Benefits	25,261,357	22,872,463
Supplies and Materials	1,795,116	1,167,533
Travel	1,414,660	1,401,306
Communication	3,583,515	3,065,551
Utilities	123,750	143,026
Data Processing Services	5,344,474	4,205,676
Claims and Benefits	56,380	70,908
Other Services	4,333,203	4,033,094
Other Fixed Charges	5,426,522	7,216,767
Expenditures to Other State Agencies	3,906,235	184,500
Capital Outlay	5,472,091	7,248,975
Insurance and Bonding	38,351	35,933
Other Expenditures	4,566,983	4,001,471
Total Expenditures	140,044,464	126,967,761
Deficit of Revenues Under Expenditures	(86,599,194)	(82,922,132)
<b>OTHER FINANCING SOURCES (USES)</b>		
State Appropriations	79,762,784	80,074,647
Sale of Capital Assets	1,652	522
Transfers In	594,623	537,095
Transfer Out	(798,485)	
Total Other Financing Sources (Uses)	79,560,574	80,612,264
Net Change in Fund Balance	(7,038,620)	(2,309,868)
Fund Balance - July 1	90,178,154	92,488,022
Fund Balance - June 30	\$ 83,139,534	\$ 90,178,154

The accompanying notes to the financial statements are an integral part of this statement.

Company 45 General Fund is used to record the Department's general operations.

<sup>1</sup>This account represents the flow of resources from Company 99 to Company 45 which are eliminated on the governmental fund financial statements. These resource flows primarily consist of a 20 percent collection assistance fee authorized by General Statute 105.243.1, which the Department uses to offset the costs of collecting and reducing the incidence of overdue tax debts.

**North Carolina Department of Revenue**  
**Balance Sheet**  
**Special Revenue Fund - Company 45**  
**As of June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit C-3**

	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and Cash Equivalents and Pooled Cash	\$ 2,006,281	\$ 2,243,271
Receivables:		
Intergovernmental Receivables	5,453	5,453
Taxes Receivables, Net	4,994,592	4,451,250
Total Assets	<u>7,006,326</u>	<u>6,699,974</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Total Deferred Outflows of Resources	<u>0</u>	<u>0</u>
Total Assets and Deferred Outflows of Resources	<u><u>\$ 7,006,326</u></u>	<u><u>\$ 6,699,974</u></u>
<b>LIABILITIES</b>		
Intergovernmental Payables	\$ 946,434	\$ 927,741
Total Liabilities	<u>946,434</u>	<u>927,741</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable Revenues	<u>4,710,179</u>	<u>4,180,445</u>
<b>FUND BALANCE</b>		
Committed	<u>1,349,713</u>	<u>1,591,788</u>
Total Fund Balance	<u>1,349,713</u>	<u>1,591,788</u>
Total Liabilities, Deferred Inflows, and Fund Balance	<u><u>\$ 7,006,326</u></u>	<u><u>\$ 6,699,974</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

Company 45 Special Revenue Fund is used to record the excise taxes imposed on unauthorized substances.

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balance**  
**Special Revenue Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit C-4**

	<b>2016</b>	<b>2015</b>
<b>REVENUES</b>		
Tax Revenues	\$ 6,748,683	\$ 5,894,562
Total Revenues	<u>6,748,683</u>	<u>5,894,562</u>
<b>EXPENDITURES</b>		
Other Services	45,648	36,820
Expenditures to Other Agencies	1,589,450	1,364,061
Statutory Tax Distributions	<u>4,761,037</u>	<u>4,024,542</u>
Total Expenditures	<u>6,396,135</u>	<u>5,425,423</u>
Excess of Revenues Over Expenditures	<u>352,548</u>	<u>469,139</u>
<b>OTHER FINANCING (USES)</b>		
Transfers Out	<u>(594,623)</u>	<u>(537,095)</u>
Total Other Financing (Uses)	<u>(594,623)</u>	<u>(537,095)</u>
Net Change in Fund Balance	(242,075)	(67,956)
Fund Balance - July 1	<u>1,591,788</u>	<u>1,659,744</u>
Fund Balance - June 30	<u><u>\$ 1,349,713</u></u>	<u><u>\$ 1,591,788</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

Company 45 Special Revenue Fund is used to record the excise taxes imposed on unauthorized substances.

**North Carolina Department of Revenue**  
**Balance Sheet**  
**General Fund - Company 99**  
**As of June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit C-5**

	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 11,130,430	\$ 11,202,163
Receivables:		
Accounts Receivable	1,002,274	730,552
Intergovernmental Receivables	11,481,453	13,681,635
Taxes Receivables, Net	1,987,485,223	1,891,381,837
Total Assets	2,011,099,380	1,916,996,187
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Total Deferred Outflows of Resources	0	0
Total Assets and Deferred Outflows of Resources	\$ 2,011,099,380	\$ 1,916,996,187
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 163,066	\$ 73,778
Intergovernmental Payables	135,577,444	128,822,540
Due to NC Housing Finance Agency	29,751,890	82,099,679
Due to Fiduciary Funds	26,613,373	26,986,670
Due to Company 45 <sup>1</sup>	2,706,231	2,562,620
Tax Refunds Payable	989,469,963	965,641,906
Unearned Revenue	385,400,000	387,800,000
Total Liabilities	1,569,681,967	1,593,987,193
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable Revenues	71,970,797	68,051,461
<b>FUND BALANCE</b>		
Unassigned	369,446,616	254,957,533
Total Fund Balance	369,446,616	254,957,533
Total Liabilities, Deferred Inflows, and Fund Balance	\$ 2,011,099,380	\$ 1,916,996,187

The accompanying notes to the financial statements are an integral part of this statement.

Company 99 General Fund is used to record tax collections and distributions on behalf of the state.

<sup>1</sup>This account represents the resources owed to Company 45 from Company 99 which are eliminated on the governmental fund financial statements. These resources are owed to Company 45 primarily for a 20 percent collection assistance fee authorized by General Statute 105.243.1, which the Department uses to offset the costs of collecting and reducing the incidence of overdue tax debts.

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balance**  
**General Fund - Company 99**  
**For the Fiscal Year Ended June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit C-6**

	<b>2016</b>	<b>2015</b>
<b>REVENUES</b>		
Tax Revenues	\$ 22,154,277,600	\$ 21,320,118,118
Miscellaneous	271,722	
Total Revenues	22,154,549,322	21,320,118,118
<b>EXPENDITURES</b>		
Statutory Tax Distributions	623,639,453	600,345,714
Expenditures to Company 45 <sup>1</sup>	41,614,841	34,739,591
Total Expenditures	665,254,294	635,085,305
Excess of Revenues Over Expenditures	21,489,295,028	20,685,032,813
<b>OTHER FINANCING (USES)</b>		
Transfers Out	(21,374,805,945)	(20,507,148,309)
Total Other Financing (Uses)	(21,374,805,945)	(20,507,148,309)
Net Change in Fund Balance	114,489,083	177,884,504
Fund Balance - July 1	254,957,533	77,073,029
Fund Balance - June 30	\$ 369,446,616	\$ 254,957,533

The accompanying notes to the financial statements are an integral part of this statement.

Company 99 General Fund is used to record tax collections and distributions on behalf of the state.

<sup>1</sup>This account represents the flow of resources from Company 99 to Company 45 which are eliminated on the governmental fund financial statements. These resource flows primarily consist of a 20 percent collection assistance fee authorized by General Statute 105.243.1, which the Department uses to offset the costs of collecting and reducing the incidence of overdue tax debts.



**North Carolina Department of Revenue**  
**Statement of Collections (Cash Basis)**  
**General Fund - Company 99 and Special Revenue Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2016**

**Exhibit D-1**

Source of Revenue	Gross Revenue	Refunds	Reserves for		Net Revenue
			Local Government	Other Transfers	
Estate Tax	\$ 5,012,148	\$ 529,156	\$ 0	\$ 124,812	\$ 4,358,180
Privilege License Tax	40,363,506	47,480		390,575	39,925,451
Tobacco Products Tax	287,402,827	1,068,625		28,900,639	257,433,563
Franchise Tax	541,630,815	12,480,240		4,782,281	524,368,294
Individual Income Tax	13,138,056,769	1,062,469,619		170,429,407	11,905,157,743
Sales and Use Tax	10,697,172,868	597,901,567	2,906,137,193	633,650,959	6,559,483,149
Alcoholic Beverage Tax	377,495,319	331,705	37,020,718	46,313	340,096,583
Gift Tax	442,664	409,310		29,801	3,553
Freight Car Lines Tax	256,950				256,950
Insurance Tax	561,690,493	22,314,689		54,287,647	485,088,157
Corporate Income Tax	1,422,146,060	355,350,529		8,580,093	1,058,215,438
Real Estate Conveyance Tax	60,968,254				60,968,254
White Goods Disposal Tax	5,044,915	8,874	2,566,372	333,373	2,136,296
Scrap Tire Disposal Tax	19,283,437	28,468	13,200,850	407,652	5,646,467
Manufacturing Tax	47,414,223	704,463		297,531	46,412,229
Solid Waste Disposal Tax	19,168,743	254,906	7,033,389	9,545,002	2,335,446
Miscellaneous Tax Receipts	16,134			4	16,130
Total General Fund Revenue	<u>\$ 27,223,566,125</u>	<u>\$ 2,053,899,631</u>	<u>\$ 2,965,958,522</u>	<u>\$ 911,806,089</u>	<u>\$ 21,291,901,883</u>
Special Revenue Fund -					
Unauthorized Substances Tax	<u>\$ 7,607,812</u>	<u>\$ 190,703</u>	<u>\$ 0</u>	<u>\$ 7,654,099</u>	<u>\$ (236,990)</u>

**North Carolina Department of Revenue**  
**Statement of Collections (Cash Basis)**  
**General Fund - Company 99 and Special Revenue Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2015**

**Exhibit D-2**

<b>Source of Revenue</b>	<b>Gross Revenue</b>	<b>Refunds</b>	<b>Reserves for Local Government</b>	<b>Other Transfers</b>	<b>Net Revenue</b>
Estate Tax	\$ 3,517,974	\$ 444,128	\$ 0	\$ 84,511	\$ 2,989,335
Privilege License Tax	45,801,820	4,242,634		492,587	41,066,599
Tobacco Products Tax	277,847,392	1,356,265		27,957,032	248,534,095
Franchise Tax	601,361,327	52,237,690		5,001,484	544,122,153
Individual Income Tax	12,302,270,205	1,077,995,161		145,752,612	11,078,522,432
Sales and Use Tax	10,131,781,884	536,890,524	2,732,696,807	610,171,377	6,252,023,176
Alcoholic Beverage Tax	358,563,120	155,951	39,525,134	152,201	318,729,834
Gift Tax	225,734	6,257		7,688	211,789
Freight Car Lines Tax	288,056			163	287,893
Insurance Tax	577,409,045	13,652,813		53,079,938	510,676,294
Piped Natural Gas Tax	6,116,901	6,116,901			
Corporate Income Tax	1,568,418,204	237,987,277		2,742,798	1,327,688,129
Real Estate Conveyance Tax	55,523,630	2,526			55,521,104
White Goods Disposal Tax	4,849,342	213,417	2,388,020	276,318	1,971,587
Scrap Tire Disposal Tax	18,061,718	(145,415)	12,462,677	403,309	5,341,147
Manufacturing Tax	41,609,565	253,891		240,481	41,115,193
Solid Waste Disposal Tax	18,527,842	22,578	6,924,320	9,272,838	2,308,106
Miscellaneous Tax Receipts	19,368				19,368
<b>Total General Fund Revenue</b>	<b>\$ 26,012,193,127</b>	<b>\$ 1,931,432,598</b>	<b>\$ 2,793,996,958</b>	<b>\$ 855,635,337</b>	<b>\$ 20,431,128,234</b>
<b>Special Revenue Fund -</b>					
Unauthorized Substances Tax	\$ 6,586,783	\$ 169,279	\$ 0	\$ 6,625,900	\$ (208,396)

**North Carolina Department of Revenue**  
**Schedule of Aging of the Taxes Receivable**  
**General Fund - Company 99**  
**As of June 30, 2016**

**Exhibit E-1**

Tax Type	Delinquent Receivables (in years)				Total
	Less than 1	1 to 5	5 to 10	More than 10	
Individual	\$ 539,050,445	\$ 322,172,426	\$ 107,009,752	\$ 13,429,973	\$ 981,662,596
Corporate	9,701,840	15,160,379	384,031	45,483	25,291,733
Sales & Use	49,320,560	77,849,132	29,481,882	1,683,652	158,335,226
Franchise	5,013,713	1,764,715	459,218	64,673	7,302,319
Scrap Tire	125,524	289,770	12,474	12	427,780
White Goods	703	62	89		854
Manufacturing	505,706	33,491	919		540,116
Solid Waste	26,165				26,165
License and Excise	702,231	863,035	153,155	5,520	1,723,941
	<u>\$ 604,446,887</u>	<u>\$ 418,133,010</u>	<u>\$ 137,501,520</u>	<u>\$ 15,229,313</u>	<u>1,175,310,730</u>

**Reconciling Adjustments:**

**Non-Aged Taxes Receivable Balances in Enterprise Tax Management (ETM) and Access Database:**

Tobacco Products	\$ 24,068,708	
Estate	8,048,834	
License and Excise	2,568,895	
Alcoholic Beverage	1,075,256	
Gift	239,923	
Insurance	235,676	
<b>Total ETM and Access Taxes Receivable Balance</b>		36,237,292

**Other Adjustments:**

Unposted Accrued Interest for June 30, 2016	24,553,151
July Adjustments	(10,147,633)
<b>Delinquent Receivables (Gross) - General Fund</b>	<u><u>\$ 1,225,953,540</u></u>

**North Carolina Department of Revenue**  
**Schedule of Aging of the Taxes Receivable**  
**General Fund - Company 99**  
**As of June 30, 2015**

**Exhibit E-2**

Tax Type	Delinquent Receivables (in years)				Total
	Less than 1	1 to 5	5 to 10	More than 10	
Individual	\$ 355,839,588	\$ 398,523,529	\$ 102,628,261	\$ 10,211,117	\$ 867,202,495
Corporate	18,669,330	2,404,208	413,157	65,407	21,552,102
Sales & Use	45,469,571	83,949,490	22,819,054	1,187,392	153,425,507
Franchise	7,862,172	1,818,051	443,749	72,022	10,195,994
Scrap Tire	120,799	296,584	21,685	168	439,236
White Goods	306	236	38		580
Manufacturing	168,833	32,025	1,226		202,084
Solid Waste	21,206				21,206
License and Excise	631,867	776,919	123,191	13,849	1,545,826
	<u>\$ 428,783,672</u>	<u>\$ 487,801,042</u>	<u>\$ 126,450,361</u>	<u>\$ 11,549,955</u>	<u>1,054,585,030</u>

**Reconciling Adjustments:**

**Non-Aged Taxes Receivable Balances in Enterprise Tax Management (ETM):**

Tobacco Products	\$ 12,887,003	
Estate	9,153,650	
License and Excise	2,551,268	
Alcoholic Beverage	897,562	
Gift	233,084	
<b>Total ETM Taxes Receivable Balance</b>		25,722,567

**Other Adjustments:**

Unposted Accrued Interest for June 30, 2015	22,049,991
July Adjustments	(13,558,349)
<b>Delinquent Receivables (Gross) - General Fund</b>	<u><u>\$ 1,088,799,239</u></u>

**North Carolina Department of Revenue**  
**Schedule of Operating Expenditures by Purpose**  
**General Fund - Company 99 and Company 45**  
**For the Fiscal Year Ended June 30, 2016**  
**(With Comparative Totals for June 30, 2015)**

**Exhibit F-1**  
**Page 1 of 2**

	2016	2015
<b><u>Expenditures Paid for Department Operations and Administration:</u></b>		
Contracted Services:		
Other Information Technology Services	\$ 4,697,968	\$ 3,524,208
Temporary Agency and Administrative Services	4,338,509	3,290,597
IT Project Management and Analysis Services	131,672	164,437
Legal Services	191,455	223,330
Financial and Audit Services	150,000	147,500
Security Services	557,074	556,242
Janitorial and Waste Services	96,464	99,296
Miscellaneous Contractual Services	876,414	667,952
Total Contracted Services	11,039,556	8,673,562
Personal Services:		
Employee Salaries	64,928,249	60,349,651
Law Enforcement Salaries	1,788,791	1,337,144
Temporary Wages	742,065	750,621
Overtime Wages	90,424	83,679
Board Member Compensation	108,700	88,400
Other Salary Expenses	24,042	37,501
Total Personal Services	67,682,271	62,646,996
Employee Benefits:		
Regular Retirement Contributions	10,352,851	9,576,490
Medical Insurance Contributions	6,989,191	6,684,848
Social Security Contributions	5,110,616	4,665,747
Longevity Pay	1,128,266	1,056,211
Legislative Bonus	976,481	
Employee Educational Expense	179,872	495,789
Unemployment Compensation Payments <sup>1</sup>	143,237	20,370
Workers Compensation Medical Payments	157,308	213,445
Flexible Spending Savings	110,835	102,402
Other Employee Benefits	112,700	57,161
Total Employee Benefits	25,261,357	22,872,463
Supplies and Materials:		
General Office Supplies	506,752	670,207
Data Processing Supplies	226,886	335,793
Other Supplies and Materials	1,061,478	161,533
Total Supplies and Materials	1,795,116	1,167,533
Travel:		
Ground Transportation	927,748	905,866
Air Transportation	82,555	86,027
Lodging	265,893	267,769
Meals	117,992	126,182
Other Travel	20,472	15,462
Total Travel	1,414,660	1,401,306
Communication:		
Telephone Service	1,687,140	1,744,474
Telecommunication Data Charges	1,214,145	1,034,710
Cellular Phone Services	282,118	248,183
Other Telephone Charges	400,112	38,184
Total Communication	3,583,515	3,065,551

<sup>1</sup> The 2016 and 2015 balances are reported net of a \$2,405 and a \$123,231 prior-year overpayment refund, respectively.

**North Carolina Department of Revenue**  
**Schedule of Operating Expenditures by Purpose**  
**General Fund - Company 99 and Company 45**  
**For the Fiscal Year Ended June 30, 2016**

**Exhibit F-1**  
**Page 2 of 2**

	<b>2016</b>	<b>2015</b>
Utilities:		
Energy Services-Electrical	115,061	130,838
Other Utilities	8,689	12,188
Total Utilities	123,750	143,026
Data Processing Services	5,344,474	4,205,676
Claims and Benefits:		
Law Enforcement Separation Allowance	56,380	70,908
Other Services:		
Postage and Delivery	3,539,579	3,333,416
Printing and Binding	457,669	474,206
Other Services	335,955	225,472
Total Other Services	4,333,203	4,033,094
Other Fixed Charges:		
Computer Software Maintenance Agreements	3,956,186	5,894,586
Computer Hardware Maintenance Agreements	481,507	379,402
Duplication Equipment Maintenance Agreements	169,711	220,476
Other Equipment Maintenance Agreements	317,255	347,705
Membership Dues and Subscriptions	306,418	299,096
Other Fixed Charges	195,445	75,502
Total Other Fixed Charges	5,426,522	7,216,767
Expenditures to Other State Agencies (Note 12)	3,906,235	184,500
Capital Outlay:		
Computer Software	3,062,394	2,311,579
Computer Hardware	1,598,829	4,114,014
Office Furniture	232,737	495,211
Voice Communication Equipment	39,648	115,588
Office Equipment	109,496	68,846
Duplication Equipment	66,613	32,287
Other Capital Outlays	362,374	111,450
Total Capital Outlay	5,472,091	7,248,975
Insurance and Bonding	38,351	35,933
Other Expenditures:		
Office Building Rent	2,381,718	2,252,187
Office and Communication Equipment Rents and Leases	118,668	143,095
Other Rents and Leases	42,654	55,237
Electronic Payment Processing Fees	2,023,602	1,550,556
Other Operating Expenses	341	396
Total Other Expenditures	4,566,983	4,001,471
Total Expenditures Paid for Department Operations and Administration	140,044,464	126,967,761
<b>Expenditures Paid by the Department Pursuant to Statutory Tax Allocations:</b>		
Expenditures Paid to Local Governments Pursuant to Statutory Tax Allocations	623,639,453	600,345,714
Total General Fund Expenditures	<u>\$ 763,683,917</u>	<u>\$ 727,313,475</u>



# **INDEPENDENT AUDITOR'S REPORT**

STATE OF NORTH CAROLINA  
**Office of the State Auditor**



**Beth A. Wood, CPA**  
State Auditor

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**INDEPENDENT AUDITOR'S REPORT  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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Acting Secretary Ronald Penny  
and Management of the North Carolina Department of Revenue

We have audited, in accordance with the 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, the financial statements of the governmental funds of the North Carolina Department of Revenue, a department of the State of North Carolina, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated April 4, 2017.

As discussed in Note 1, the financial statements of the North Carolina Department of Revenue are intended to present the financial position and changes in financial position that are attributable to the transactions of the North Carolina Department of Revenue. They do not purport to, and do not, present fairly the financial position of the State of North Carolina as of June 30, 2016, or the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Department's financial statements will not be



prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA  
State Auditor  
Raleigh, North Carolina

April 4, 2017

# ORDERING INFORMATION

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