

# STATE OF NORTH CAROLINA

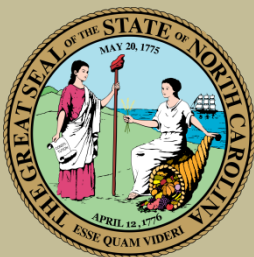
OFFICE OF THE STATE AUDITOR  
BETH A. WOOD, CPA



## NORTH CAROLINA DEPARTMENT OF REVENUE

RALEIGH, NORTH CAROLINA  
FINANCIAL STATEMENT AUDIT REPORT  
AS OF AND FOR THE FISCAL  
YEAR ENDED JUNE 30, 2017

A DEPARTMENT OF THE STATE OF NORTH CAROLINA



**NCOSA**  
The Taxpayers' Watchdog

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



**Beth A. Wood, CPA**  
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## AUDITOR'S TRANSMITTAL

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The Honorable Roy Cooper, Governor  
The General Assembly of North Carolina  
Secretary Ronald G. 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, 2017, 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 cursive script 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, 2017 (with comparative totals as of June 30, 2016) and the Statement of Revenues, Expenditures, and Changes in Fund Balance for fiscal year ended June 30, 2017 (with comparative totals for fiscal year ended June 30, 2016) 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 the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual (Budgetary Basis-Non-GAAP) for the **General Fund** (for the fiscal year ended June 30, 2017).

**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, 2017, with comparative totals for fiscal year ended June 30, 2016).

**"D" Exhibits** present the Statement of Collections (Cash Basis), which details certain tax revenues collected by DOR (for fiscal years ended June 30, 2017 and 2016).

**“E” Exhibits** present the Schedule of Aging of Taxes Receivable for unpaid taxes by tax type sorted by years outstanding (for fiscal years ended June 30, 2017 and 2016).

**“F” Exhibit** presents the Schedule of Operating Expenditures by Purpose, or natural classification (agrees to total general fund expenditures on Exhibit A-2 for fiscal years ended June 30, 2017 and 2016).

**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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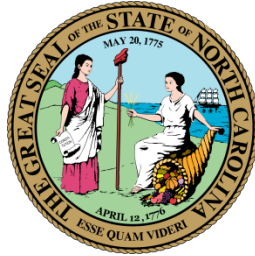
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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency. The Auditor also has the power to summon people to 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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Secretary Ronald G. 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, 2017, 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 an opinion 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 opinion.

### 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, 2017, and the respective changes in financial position for the year then ended 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, 2017, 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, 2016, and the respective changes in financial position for the year then ended, and expressed an unmodified audit opinion on those audited financial statements in our report dated April 4, 2017. The prior year supplementary schedules were derived from and related to the underlying accounting and other records used to prepare the financial statements. The supplementary schedules were subjected to the auditing procedures applied in the audit of the basic financial statements of the prior year and accordingly, we expressed an opinion in relation to the basic financial statement of the governmental funds as a whole for the year ended June 30, 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. 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, as listed in the Table of Contents, 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*

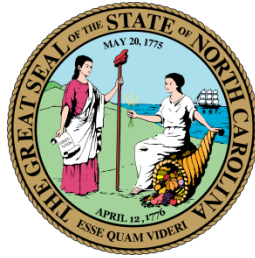
In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2018 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and 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

March 27, 2018



# **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, 2017, with comparative information for the fiscal year ended June 30, 2016. 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 funds' basic financial statements consist of the Balance Sheet, Statement of Revenues, Expenditures, and Changes in Fund Balances, and notes to the financial statements.

The Balance Sheet presents the governmental funds' 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 support 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 Governmental Accounting Standards Board 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, 2017 and 2016:

	<u>2017</u>	<u>2016</u>	<u>Increase (Decrease)</u>
Assets	\$ 2,017,419,986	\$ 2,102,489,507	\$ (85,069,521)
Deferred Outflows of Resources	0	0	0
Total Assets and Deferred Outflows of Resources	<u>\$ 2,017,419,986</u>	<u>\$ 2,102,489,507</u>	<u>\$ (85,069,521)</u>
Liabilities	\$ 1,467,884,519	\$ 1,571,872,668	\$ (103,988,149)
Deferred Inflows of Resources	<u>78,029,914</u>	<u>76,680,976</u>	<u>1,348,938</u>
Fund Balance			
Nonspendable	913,905	986,134	(72,229)
Committed	76,223,244	84,654,083	(8,430,839)
Unassigned	<u>394,368,404</u>	<u>368,295,646</u>	<u>26,072,758</u>
Total Fund Balances	<u>471,505,553</u>	<u>453,935,863</u>	<u>17,569,690</u>
Total Liabilities, Deferred Inflows of Resources, and Fund Balance	<u>\$ 2,017,419,986</u>	<u>\$ 2,102,489,507</u>	<u>\$ (85,069,521)</u>

Total assets decreased by \$85.1 million during the year due to an \$85.6 million decrease in taxes receivable. Taxes receivable decreased \$85.6 million from the prior year due to (1) the amount estimated for individual income tax underpayments in the 2017 fiscal year was \$237.8 million less than the prior fiscal year and (2) delinquent individual income taxes receivable are \$154 million more than the prior fiscal year.

An estimate of underpayments is prepared at the end of each fiscal year to determine the amount of individual income taxes that are owed to the Department of Revenue (Department) for the time period January to June. Underpayments occur when taxpayers either do not have enough taxes withheld from their salary or estimated payments made are not sufficient. Underpayments related to the first half of the fiscal year (July – December) are considered to be settled when tax returns are submitted by April 15th. These payments are considered final payments. To estimate the individual income taxes receivable related to underpayments, the Department collects final payments data for previous fiscal years and uses various trend models to project final payments expected to be received in the next fiscal year. Projected final payments for the 2018 fiscal year are for the 2017 tax year (January 2017 – December 2017). The Department adjusts the projected final payments by one-half because there is the assumption that only one-half of the final payments estimated to be received in the 2018 fiscal year would have been earned by June 30, 2017 (in the time period of January 2017 – June 2017). The final payments estimated to be received in the 2018 fiscal year is also adjusted for any delinquent individual income taxes receivable that have also been accrued. As a result of the trend analysis, the final payments estimated to be received in the 2018 fiscal year were \$167.6 million less than in the prior year. There were two trend models that have historically projected amounts that are closer to actual. The Department chose the more conservative amount from these two trend models. One-half of this amount was taken, resulting in estimated final payments that were \$83.8 million less than the prior fiscal year. The amount was also reduced by delinquent individual income taxes receivable resulting in a net amount of estimated individual income tax underpayments that were \$237.8 million less than the prior fiscal year.

Delinquent individual income taxes receivable increased \$154 million primarily due to an increase in gross delinquent individual income taxes receivable. Gross delinquent individual income taxes receivable increased over \$400 million due to an increase in final assessments billed to taxpayers for individual income tax owed. The increase in final assessments is primarily a result of the Department's write off reversal process and individuals not remitting payment when they filed their 2016 tax year tax returns with a balance due.

The Department has procedures in place to write off receivables when they are deemed uncollectible; however, the liability to the Department does not cease to exist. Through the Department's write off reversal process, the collectability of each receivable is automatically re-evaluated each year. When the program identifies a levy source, a receivable that was previously written off is reversed and an attachment or garnishment is issued. The process was performed during the 2017 fiscal year and generated more than \$200 million in write off reversals for individual income tax. The write off reversal process was not performed during the 2016 fiscal year.

There was also an increase in final assessments due to individuals not remitting payment when they filed their 2016 tax year tax returns with a balance due. There were over 20,000 more individual income tax assessments generated during June 2017 compared to June 2016, with an increased dollar value of \$12.7 million. Returns for the 2016 tax year were due to the Department by April 15, 2017. The majority of assessments to individuals

that did not remit payment with their 2016 tax return by the due date became final in June 2017.

Total liabilities decreased by \$104 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 credits and a decrease in the estimated amount of applied refunds for corporate taxpayers (unearned revenue). The amount due to the NCHFA decreased from \$29.8 million in the prior year to zero in the 2017 fiscal year because of the repeal of General Statute 105-129.42 effective January 1, 2015.

Applied refunds occur when taxpayers choose to apply the refunds they are due from the Department to future tax periods in lieu of receiving a cash refund. Estimates are prepared at the end of each fiscal year to determine the amount of applied refunds for individual and corporate taxpayers. The estimate of applied refunds for corporate income taxes is determined by multiplying gross collections less final payments for January – June by an estimated applied refund ratio. The applied refund ratio is estimated using historical data on refunds and net collections. The decrease in the estimated amount of corporate income tax applied refunds is due to gross collections less final payments for January 2017 – June 2017 decreasing by \$178.1 million. The decrease in gross collections less final payments is attributable to changes in the North Carolina Revenue Laws effective for tax years 2016 and 2017. The corporate income rate was reduced from 5% to 4% for tax year 2016 and from 4% to 3% for tax year 2017.

Deferred inflows of resources increased \$1.3 million compared to prior year due to an increase in unavailable revenue. Unavailable revenue is the amount of taxes receivable that is not expected to be collected within a specified period after fiscal year-end. The majority of the unavailable revenues come from franchise taxes, sales and use taxes, unauthorized substance 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 \$17.6 million as of fiscal year end 2017 with the largest increase in unassigned fund balance of \$26.1 million attributable to the overall current year activity – see further details on the following Statement of Revenues, Expenditures, and Changes in Fund Balances.

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

The following condensed statement shows the governmental funds' resource flows at June 30, 2017 and 2016:

	2017	2016	Increase (Decrease)
Revenues			
Tax Revenues	\$ 22,536,712,512	\$ 22,161,026,283	\$ 375,686,229
Fees	2,464,254	4,318,553	(1,854,299)
Revenues from Other State Agencies	5,481,901	5,683,161	(201,260)
Other Revenues	2,058,367	2,100,437	(42,070)
Total Revenues	<u>22,546,717,034</u>	<u>22,173,128,434</u>	<u>373,588,600</u>
Expenditures:			
Expenditures to Other State Agencies	2,909,370	5,495,685	(2,586,315)
Statutory Tax Distributions	636,773,250	628,400,490	8,372,760
Personal Services	69,872,916	67,682,271	2,190,645
Employee Benefits	26,776,758	25,261,357	1,515,401
Other Expenditures	44,153,230	43,240,249	912,981
Total Expenditures	<u>780,485,524</u>	<u>770,080,052</u>	<u>10,405,472</u>
Excess of Revenues Over Expenditures	<u>21,766,231,510</u>	<u>21,403,048,382</u>	<u>363,183,128</u>
Other Financing Sources (Uses)			
State Appropriation	81,784,574	79,762,784	2,021,790
Sale of Capital Assets	820	1,652	(832)
Transfers In	1,387,154	594,623	792,531
Transfers Out	(21,831,834,368)	(21,376,199,053)	455,635,315
Total Other Financing Sources (Uses)	<u>(21,748,661,820)</u>	<u>(21,295,839,994)</u>	<u>452,821,826</u>
Net Change in Fund Balance	17,569,690	107,208,388	(89,638,698)
Fund Balance - July 1	<u>453,935,863</u>	<u>346,727,475</u>	<u>107,208,388</u>
Fund Balance - June 30	<u>\$ 471,505,553</u>	<u>\$ 453,935,863</u>	<u>\$ 17,569,690</u>

**Tax Revenues**

Total tax revenues were \$22.5 billion at June 30, 2017, an increase of \$375.7 million from prior year. This increase is due to an increase in net sales and use tax revenues of \$449.4 million, a decrease in net corporate income tax revenues of \$310.8 million, and an increase in net franchise tax revenues of \$223.1 million.

**Sales and Use Tax**

Sales and use tax revenues on a modified accrual basis increased by \$449.4 million or 6.3% from the 2016 fiscal year. This increase is due to an increase in net revenues on a cash basis which increased by \$463.7 million or 6.5%. This increase can be attributed to an improved economy as well as changes in tax laws related to sales and use taxes.

The improvements in the economy over the last year, as evidenced by the growing number of jobs in the State and higher personal income, have increased the disposable incomes of consumers. The number of payroll jobs in North Carolina has steadily increased, according

to data compiled by the Bureau of Labor Statistics. In June 2017, there were 70,900 more jobs than in June 2016 and 170,200 more than in June 2015. The unemployment rate in North Carolina has continued to fall throughout most of the 2017 fiscal year, dropping from 4.9% in June 2016 to 4.2% in June 2017. Finally, as reported by the Bureau of Economic Analysis, North Carolina's personal income increased 3.23% between 2015 and 2016.

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 per 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, sales of certain service contracts were not subject to tax. This tax law change positively impacted sales and use tax revenues during the 2017 fiscal year.

Section 38.5 of Session Law 2016-94, as amended by Part XI of Session Law 2016-123, also had provisions that had an overall positive impact on sales and use tax revenues during the 2017 fiscal year. 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.

### **Corporate Income Tax**

Corporate income tax revenues decreased by \$310.8 million or 27.8% on a modified accrual basis in the 2017 fiscal year as compared to the 2016 fiscal year. This decrease is due to a decrease in net revenues on a cash basis. Net revenues of corporate income tax on a cash basis decreased by \$306 million or 28.9% from the 2016 fiscal year. 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, from 6% to 5% for tax year 2015, and from 5% to 4% for tax year 2016.

In addition to the tax rate changes, the decrease in corporate income tax revenues can be attributed to an increased amount of transfers to taxpayers' franchise tax accounts. The timing of transfers from corporate income tax to franchise tax increased during the 2017 fiscal year, leading to lower corporate collections. This is also discussed under Franchise Tax below.



**Franchise Tax**

Franchise tax revenues increased by \$223.1 million or 42.5% on a modified accrual basis in the 2017 fiscal year as compared to the 2016 fiscal year. This increase is due to an increase in gross revenues on a cash basis during the 2017 fiscal year. Gross franchise tax revenues on a cash basis increased by \$222.7 million or 41.1% from the 2016 fiscal year. The increase in gross franchise tax revenues is due to an increase in payments directly to franchise tax of \$81.5 million and an increase in transfers of payments from corporate income tax to franchise tax of \$141.2 million.

The increase in franchise tax revenues from the 2016 fiscal year to the 2017 fiscal year most likely occurred because of the following tax law changes in Session Law 2015-241:

- Increase in the minimum tax from \$35 to \$200 and an increase in the cap on holding companies from \$75,000 to \$150,000.
- Repeal of the deduction for debt incurred for purchase or improvement of real estate in computing the tangible property base.
- Repeal of credits in G.S. 105-122(d1).

Transfers from corporate income tax accounts to franchise tax accounts occur when the corporate tax returns are processed. The timing of when the corporate return is received and processed impacts the fiscal year in which transfers of franchise tax from corporate income tax occurs. The increase in transfers from corporate income tax to franchise tax can largely be attributed to increased franchise tax liabilities for tax years 2014 and 2015 being transferred in the 2017 fiscal year.

**Fees**

Fees decreased \$1.9 million from the prior year due to a decrease in certification fees. The decrease in certification fees is 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 during the 2016 fiscal year was \$1.9 million.

**Expenditures**

Total expenditures increased \$10.4 million from the prior year due primarily to an increase in statutory tax distributions. Statutory tax distributions increased \$8.4 million from the prior year because Medicaid hold harmless distributions to local governments per General Statute 105-523 increased significantly in the 2017 fiscal year. Local governments' sales and use tax revenue was reduced when General Statutes 105-515 through 105-520 under Article 44 of the North Carolina Revenue Laws were repealed effective October 1, 2009. In addition, the local governments' cost of administering the Medicaid program was reduced as the State assumed responsibility for the administration of Medicaid. The intent of General Statute 105-523 is that each county be held harmless from the exchange of a portion of the local sales and use taxes for the State's agreement to assume the responsibility for the non-administrative costs of Medicaid. The Department is charged with comparing the lost sales and use tax revenue to the lost cost of administering the Medicaid program for each county. If the lost revenue is higher than the lost cost, then a distribution is made to the

county. The increase in Medicaid hold harmless distributions can be attributed to provisions passed by the North Carolina General Assembly that broadened the sales and use tax base. The increase in the sales and use tax base increased the amount of lost sales and use tax revenue for local governments.

### **Other Financing Sources (Uses)**

Total other financing uses increased \$452.8 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 \$21.3 billion at the end of fiscal year 2016 to \$21.7 billion at the end of fiscal year 2017. 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.

#### *Variations – Original and Final Budget:*

The final budgeted revenues were \$772,000 more than the original budget. The increase is primarily due to increases in the budgeted revenues for credit card and debit card transaction fees.

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 \$1.2 million.

The final budgeted expenditures increased \$1.5 million from the original budget. The increase is primarily due to increases in the final budgets for contracted services, expenditures to other state agencies, and capital outlay as well as a decrease in the final budget for personal services.

The final budget for contracted services was \$1.1 million more than the original budget. The increase is primarily due to a decrease in the final budget for other information technology services and increases in the final budgets for temporary agency services and security service agreements.

The final budget for other information technology services decreased by \$3.5 million and the final budgets for capital outlay and expenditures to other state agencies increased \$3.8 million and \$1.3 million, respectively. The Department was authorized to use funds from the Integrated Tax Administration System (ITAS) replacement fund for costs related to the Department's tax systems. 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 Department was also authorized to use \$2 million from the Collection Assistance Fee during the 2017 fiscal year to continue a contract with a vendor to perform tax fraud analysis and to pay for identity theft protection information technology upgrades. The \$2 million was

originally evenly budgeted between other information technology services and miscellaneous contractual services. The majority of the \$2 million was later moved to server software expenditures (capital outlay) and to an account within expenditures to other state agencies. These adjustments to the original budgets make up the majority of the decrease in other information technology services, the increase in capital outlay expenditures, and the increase in expenditures to other state agencies.

The final budgets for temporary agency services and security service agreements increased \$4.2 million. The increase in these contracted services' accounts directly relates to the decrease in the final budget for personal services, which decreased \$4.9 million. Amounts originally budgeted as personal services were moved to temporary agency services and security service agreements.

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

Actual total revenue collected was \$469.6 million above budgeted revenue amounts. The majority of this increase is due to greater than anticipated individual income tax collections. Individual income taxes, which account for more than half of total general fund tax revenue collections, were \$351.4 million above the \$11.6 billion forecast. Withholding on wage and salary income was \$204.2 million above expectations due to stronger than expected wage growth. Final payments on the 2016 tax year also came in higher than expected.

Actual total expenditures were \$15.7 million less than budgeted expenditures. Budgeted expenditures were unrealized primarily because \$10.1 million less was spent on contracted services, personal services, and employee benefits than budgeted. The amount spent on contracted services was \$2.2 million less than budgeted primarily due to less being spent on other information technology services than budgeted for the E-services project.

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 \$435.4 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**

The 2017 Session of the North Carolina General Assembly enacted Session Law 2017-57 (2017 Appropriations Act), which appropriated \$84.6 million to the Department of Revenue for general operations in the fiscal year ending June 30, 2018. The Department was also authorized to spend \$5.3 million from the ITAS replacement fund and \$7.2 million from the Collections Assistance Fee to support operations and maintenance upgrades for Portfolio Warehouse, Modernize eFile, and tax systems. In addition, the Department was authorized to spend \$20 million from the Collections Assistance Fee to implement a new tax collection system. Authority to use \$4.4 million of receipts from the Collection Assistance Fee was also given to the Department for identity theft and tax fraud analysis.

## **Tax Changes**

### **Individual Income Tax**

The State individual income tax rate decreased from 5.75% to 5.499% on January 1, 2017. Effective January 1, 2016, withholding tax tables are adjusted such that the tax rate on wages is set at 0.1% higher than the actual individual income tax rate. In addition, the standard deduction amounts increased January 1, 2017 from \$16,500 to \$17,500 for married couples filing jointly, \$8,250 to \$8,750 for single taxpayers, and from \$13,200 to \$14,000 for head of household.

Effective January 1, 2018, a taxpayer who is allowed a federal child tax credit for the taxable year is allowed a deduction for each independent child for whom the taxpayer is allowed the federal tax credit. The amount of the deduction depends on the taxpayer's filing status and adjusted gross income. The deduction replaces an existing child tax credit, which allowed a credit up to \$125 for each eligible child. The tax credit was also dependent on the taxpayer's filing status and adjusted gross income.

Effective January 1, 2019, the individual income tax rate will decrease from 5.499% to 5.25%. In addition, the standard deduction amounts will increase to \$20,000 for married couples filing jointly, \$10,000 for single taxpayers, and \$15,000 for head of household. The total impact of these tax law changes for the 2017, 2018, and 2019 tax years will not be known until final individual income tax payments are remitted by taxpayers in the spring of 2018, 2019, and 2020.

### **Sales and Use Tax**

Effective in the fiscal year ending June 30, 2018, Session Law 2017-57 rewrote General Statute 105-187.9(a) to credit \$10 million of the taxes collected from the 8% motor vehicle lease tax to the Highway Fund annually. Prior to this change, the 8% motor vehicle lease taxes were included as sales and use tax in the General Fund.

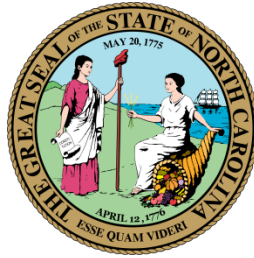
There were additional tax law changes per Session Laws 2017-57 and 2017-204 that will impact sales and use tax revenue in future years. However, the impact of these tax law changes are unknown at this time or not considered significant.

### **Corporate Income Tax**

The corporate income tax rate for tax years beginning on or after January 1, 2017 was reduced from 4% to 3%. This rate will be further reduced from 3% to 2.5% for tax years beginning on or after January 1, 2019.

### **Major Contracts**

Session Law 2017-57 (Conference Report on the Base, Capital, and Expansion Budget) authorized the Department of Revenue to spend \$20 million from the Collections Assistance Fee to implement a new tax collection system. A Request for Proposal was posted in January 2018 and vendor offers have been received as of March 1, 2018. It is anticipated that a contract will be awarded by August 2018.



# FINANCIAL STATEMENTS

**North Carolina Department of Revenue**  
**Balance Sheet**  
**Governmental Funds**  
**As of June 30, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit A-1**

	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total 2017</u>	<u>Total 2016</u>
<b>ASSETS</b>				
Cash and Cash Equivalents (Note 2)	\$ 94,574,424	\$ 2,795,705	\$ 97,370,129	\$ 95,982,243
Receivables:				
Accounts Receivable	695,561		695,561	1,108,223
Intergovernmental Receivables (Note 6)	11,471,998		11,471,998	11,486,906
Taxes Receivable, Net (Note 3)	1,896,115,971	10,739,322	1,906,855,293	1,992,479,815
Securities Held in Trust (Sureties)	40,300		40,300	388,900
Due from Other Funds	72,800		72,800	57,286
Inventories	913,905		913,905	986,134
Total Assets	<u>2,003,884,959</u>	<u>13,535,027</u>	<u>2,017,419,986</u>	<u>2,102,489,507</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>\$ 2,003,884,959</u>	<u>\$ 13,535,027</u>	<u>\$ 2,017,419,986</u>	<u>\$ 2,102,489,507</u>
<b>LIABILITIES</b>				
Accounts Payable and Accrued Liabilities:				
Accounts Payable (Note 5)	\$ 1,296,001	\$ 0	\$ 1,296,001	\$ 2,137,928
Accrued Payroll	806		806	1,612
Intergovernmental Payables (Note 6)	142,477,858	1,756,638	144,234,496	138,109,152
Funds Held for Others	40,150		40,150	388,750
Due to NC Housing Finance Agency				29,751,890
Due to Fiduciary Funds	28,924,249		28,924,249	26,613,373
Tax Refunds Payable (Note 3)	957,188,817		957,188,817	989,469,963
Unearned Revenue	336,200,000		336,200,000	385,400,000
Total Liabilities	<u>1,466,127,881</u>	<u>1,756,638</u>	<u>1,467,884,519</u>	<u>1,571,872,668</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
Unavailable Revenues (Note 7)	<u>67,661,858</u>	<u>10,368,056</u>	<u>78,029,914</u>	<u>76,680,976</u>
<b>FUND BALANCES (Note 10)</b>				
Nonspendable	913,905		913,905	986,134
Committed	74,812,911	1,410,333	76,223,244	84,654,083
Unassigned	394,368,404		394,368,404	368,295,646
Total Fund Balances	<u>470,095,220</u>	<u>1,410,333</u>	<u>471,505,553</u>	<u>453,935,863</u>
Total Liabilities, Deferred Inflows, and Fund Balances	<u>\$ 2,003,884,959</u>	<u>\$ 13,535,027</u>	<u>\$ 2,017,419,986</u>	<u>\$ 2,102,489,507</u>

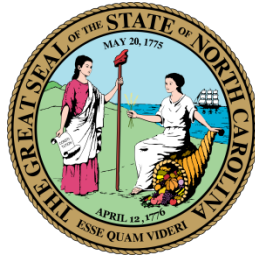
The accompanying notes to the financial statements are an integral part of this statement.

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balances**  
**Governmental Funds**  
**For the Fiscal Year Ended June 30, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit A-2**

	<b>General Fund</b>	<b>Special Revenue</b>	<b>Total 2017</b>	<b>Total 2016</b>
<b>REVENUES</b>				
Tax Revenues	\$ 22,529,614,924	\$ 7,097,588	\$ 22,536,712,512	\$ 22,161,026,283
Revenues from Other State Agencies (Note 12)	5,481,901		5,481,901	5,683,161
Services	1,918,930		1,918,930	1,730,945
Fees	2,464,254		2,464,254	4,318,553
Miscellaneous	139,437		139,437	369,492
<b>Total Revenues</b>	<b>22,539,619,446</b>	<b>7,097,588</b>	<b>22,546,717,034</b>	<b>22,173,128,434</b>
<b>EXPENDITURES</b>				
Statutory Tax Distributions	631,978,429	4,794,821	636,773,250	628,400,490
Contracted Services	13,174,923		13,174,923	11,039,556
Personal Services	69,872,916		69,872,916	67,682,271
Employee Benefits	26,776,758		26,776,758	25,261,357
Supplies and Materials	842,944		842,944	1,795,116
Travel	1,165,950		1,165,950	1,414,660
Communication	2,837,773		2,837,773	3,583,515
Utilities	135,232		135,232	123,750
Data Processing Services	4,651,941		4,651,941	5,344,474
Claims and Benefits	59,365		59,365	56,380
Other Services	4,561,765	56,915	4,618,680	4,378,851
Other Fixed Charges	5,883,473		5,883,473	5,426,522
Expenditures to Other State Agencies (Note 12)	1,318,260	1,591,110	2,909,370	5,495,685
Capital Outlay	5,736,632		5,736,632	5,472,091
Insurance and Bonding	42,012		42,012	38,351
Other Expenditures	4,998,852	5,453	5,004,305	4,566,983
<b>Total Expenditures</b>	<b>774,037,225</b>	<b>6,448,299</b>	<b>780,485,524</b>	<b>770,080,052</b>
Excess of Revenues Over Expenditures	21,765,582,221	649,289	21,766,231,510	21,403,048,382
<b>OTHER FINANCING SOURCES (USES)</b>				
State Appropriations	81,784,574		81,784,574	79,762,784
Sale of Capital Assets	820		820	1,652
Transfers In (Note 11)	588,669		588,669	594,623
Transfers Out (Note 11)	(21,830,118,070)	(588,669)	(21,830,706,739)	(21,375,400,568)
Transfers from State Reserve Fund	798,485		798,485	
Transfers to State Reserve Fund	(1,127,629)		(1,127,629)	(798,485)
<b>Total Other Financing Sources (Uses)</b>	<b>(21,748,073,151)</b>	<b>(588,669)</b>	<b>(21,748,661,820)</b>	<b>(21,295,839,994)</b>
Net Change in Fund Balances	17,509,070	60,620	17,569,690	107,208,388
Fund Balances - July 1	452,586,150	1,349,713	453,935,863	346,727,475
Fund Balances - June 30	<u>\$ 470,095,220</u>	<u>\$ 1,410,333</u>	<u>\$ 471,505,553</u>	<u>\$ 453,935,863</u>

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 1,300 employees and 12 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* requires 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 judgements, 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, include 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. These estimates and judgments affect (1) the reported amounts of assets, liabilities, and deferred inflows of resources, (2) the disclosures and contingencies at the date of the financial statements, and (3) 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 2016 *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 balances 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 of the State of North Carolina.

Assigned fund balances 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, committed, or assigned 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 represent nonexchange transactions and 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.
- P. **Transfers From/To State Reserve Fund** – 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 Department budget codes. The Office of the State Controller (OSC) then transfers the funds to the Carryforward 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 Department budget codes. The Department then makes an entry to NCAS recording the revenue in the subsequent fiscal year.

## 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; 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.

At June 30, 2017, the governmental funds' Balance Sheet reported cash and cash equivalents of \$97,370,129. 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 formal oversight other than that of the legislative body and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2017. 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 North Carolina Department of State Treasurer Investment Programs' separately issued audit report. This separately issued report can be obtained from the Department of State Treasurer, 3200 Atlantic Avenue, Raleigh, NC 27604 or can be accessed from the Department of State Treasurer's website at <https://www.nctreasurer.com/inv/Pages/Annual-Supplemental-Reports.aspx> in the Audited Financial Statements section.

**B. Fair Value Measurements** – To the extent available, the Department's investments are recorded at fair value as of June 30, 2017. 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 for an asset and may require a degree of professional judgment.

**Short-Term Investment Fund** – At year-end, all of the Department's investments valued at \$97,370,129 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 for the General Fund at June 30, 2017, were reported as follows:

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
<b>Taxes Receivable:</b>			
Individual	\$ 346,200,000	\$ 0	\$ 346,200,000
Sales and Use Tax	363,300,000		363,300,000
Corporate	24,200,000		24,200,000
Underwithholding - Individual	369,800,000		369,800,000
Other	104,714,461		104,714,461
<b>Delinquent Receivables</b>			
Individual	1,394,924,494	808,717,298	586,207,196
Sales and Use Tax	176,952,896	91,479,348	85,473,548
Corporate	17,806,263	11,601,767	6,204,496
Tobacco Products	24,145,166	23,591,144	554,022
Franchise	8,293,790	1,767,672	6,526,118
Estate	11,323,253	11,210,020	113,233
License and Excise	4,523,120	3,547,286	975,834
Alcoholic Beverage	639,323	469,080	170,243
Other	2,041,240	364,420	1,676,820
<b>Total Taxes Receivable</b>	<u>\$ 2,848,864,006</u>	<u>\$ 952,748,035</u>	<u>\$ 1,896,115,971</u>

Within the General Fund, the significant receivables not expected to be collected within one year were \$988 million of taxes receivable (gross).

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

Taxes receivable for the Special Revenue Fund at June 30, 2017, were reported as follows:

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
<b>Taxes Receivable:</b>			
Unauthorized Substance Tax	\$ 536,966,106	\$ 526,226,784	\$ 10,739,322
<b>Total Taxes Receivable</b>	<u>\$ 536,966,106</u>	<u>\$ 526,226,784</u>	<u>\$ 10,739,322</u>

Tax refunds payable at June 30, 2017, were reported as follows:

	<u>2017</u>
<b>Tax Refunds Payable</b>	
Individual	\$ 606,300,000
Sales and use Tax	233,100,000
Corporate	116,900,000
Other	888,817
<b>Total Tax Refunds Payable</b>	<u>\$ 957,188,817</u>

**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, 2017, is presented as follows:

	Balance July 1, 2016	Additions	Disposals	Balance June 30, 2017
Capital Assets, Nondepreciable:				
Computer Software in Development	\$ 3,549,862	\$ 2,466,817	\$ 0	\$ 6,016,679
<b>Total Capital Assets, Nondepreciable</b>	<b>3,549,862</b>	<b>2,466,817</b>		<b>6,016,679</b>
Capital Assets, Depreciable:				
Equipment	11,444,736	165,516	596,697	11,013,555
Computer Software	28,136,986			28,136,986
<b>Total Capital Assets, Depreciable</b>	<b>39,581,722</b>	<b>165,516</b>	<b>596,697</b>	<b>39,150,541</b>
Less Accumulated Depreciation for:				
Equipment	3,605,380	474,707	225,411	3,854,676
Computer Software	3,458,504	1,406,849		4,865,353
<b>Total Accumulated Depreciation</b>	<b>7,063,884</b>	<b>1,881,556</b>	<b>225,411</b>	<b>8,720,029</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>32,517,838</b>	<b>(1,716,040)</b>	<b>371,286</b>	<b>30,430,512</b>
<b>Capital Assets, Net</b>	<b>\$ 36,067,700</b>	<b>\$ 750,777</b>	<b>\$ 371,286</b>	<b>\$ 36,447,191</b>

**NOTE 5 - ACCOUNTS PAYABLE**

Accounts payable at June 30, 2017, were reported as follows:

Accounts Payable	<u>2017</u>
Accounts Payable	\$ 1,213,198
Due to Employees	<u>82,803</u>
<b>Total Accounts Payable</b>	<b><u>\$ 1,296,001</u></b>

**NOTE 6 - INTERGOVERNMENTAL RECEIVABLES AND PAYABLES**

Intergovernmental receivables and payables at June 30, 2017, were reported as follows:

	<u>2017</u>	
	<u>General Fund</u>	<u>Special Revenue</u>
<b>Intergovernmental Receivables</b>		
Local Governments - Medicaid Hold Harmless Distribution Returned	\$ 721,134	\$ 0
State Agencies - Payroll Taxes	<u>10,750,864</u>	
<b>Total Intergovernmental Receivables</b>	<b><u>\$ 11,471,998</u></b>	<b><u>\$ 0</u></b>
<b>Intergovernmental Payables</b>		
Local Government Tax Distributions:		
Medicaid Hold Harmless	\$ 7,222,025	\$ 0
Alcoholic Beverage	8,694,132	
Real Estate Conveyance, White Goods Disposal, Scrap Tire Disposal, and Solid Waste Disposal	3,219,407	
Electricity	67,478,391	
Video Program	19,520,940	
Telecom	12,140,881	
Piped Natural Gas	3,780,729	
Unauthorized Substance		<u>1,129,923</u>
<b>Total to Local Governments</b>	<b><u>122,056,505</u></b>	<b><u>1,129,923</u></b>
Statutory Tax Distribution to the General Fund:		
White Goods Disposal	738,413	
Scrap Tire Disposal	3,579,372	
Solid Waste Disposal	1,767,892	
Unauthorized Substance		<u>626,715</u>
<b>Total to General Fund</b>	<b><u>6,085,677</u></b>	<b><u>626,715</u></b>
State Agencies:		
Department of Transportation - Aviation Fuel Taxes	6,936,152	
Department of Environmental Quality - Solid Waste Taxes	4,234,062	
Department of Information Technology - 911 Service Charges	2,582,730	
Department of Information Technology - Other Payments	541,296	
Department of Administration - Motor Fleet	<u>41,436</u>	
<b>Total to State Agencies</b>	<b><u>14,335,676</u></b>	<b><u>0</u></b>
<b>Total Intergovernmental Payables</b>	<b><u>\$ 142,477,858</u></b>	<b><u>\$ 1,756,638</u></b>

**NOTE 7 - DEFERRED INFLOWS OF RESOURCES**

The various components of deferred inflows of resources at June 30, 2017, were reported as follows:

	Unavailable at June 30, 2016	Current Year Unavailable Increase	Prior Year Unavailable Earned in Current Year	Unavailable at June 30, 2017
<b>General Fund:</b>				
Estate Taxes	\$ 106,076	\$ 104,994	\$ (106,076)	\$ 104,994
Gift Taxes	2,022	2,428	(2,022)	2,428
License Taxes	1,735,741	935,993	(1,735,741)	935,993
Tobacco Taxes	7,615,906	475,510	(7,615,906)	475,510
Beverage Taxes	282,456	169,929	(282,456)	169,929
Franchise Taxes	4,766,897	6,157,121	(4,766,897)	6,157,121
Sales & Use Taxes	49,359,824	53,338,296	(49,359,824)	53,338,296
Corporate Taxes	7,082,626	4,936,601	(7,082,626)	4,936,601
White Goods Taxes	808	734	(808)	734
Scrap Tire Taxes	383,729	415,272	(383,729)	415,272
Manufacturing Taxes	405,465	103,879	(405,465)	103,879
Solid Waste Taxes	21,024	1,752	(21,024)	1,752
Insurance Taxes	208,223	1,019,349	(208,223)	1,019,349
	<u>\$ 71,970,797</u>	<u>\$ 67,661,858</u>	<u>\$ (71,970,797)</u>	<u>\$ 67,661,858</u>
<b>Special Revenue Fund:</b>				
Unauthorized Substance Taxes	\$ 4,710,179	\$ 10,368,056	\$ (4,710,179)	\$ 10,368,056
	<u>\$ 4,710,179</u>	<u>\$ 10,368,056</u>	<u>\$ (4,710,179)</u>	<u>\$ 10,368,056</u>

**NOTE 8 - LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2017, is presented as follows:

General Fund	Balance July 1, 2016	Additions	Reductions	Balance June 30, 2017	Due Within One Year
Claims and Judgments Payable	\$ 583,340,162	\$ 0	\$ 0	\$ 583,340,162	\$ 0
Compensated Absences	9,013,612	5,766,153	5,950,277	8,829,488	761,985
Net Pension Liability <sup>1</sup>	15,619,343	24,504,112		40,123,455	
<b>Total Long-Term Liabilities</b>	<u>\$ 607,973,117</u>	<u>\$ 30,270,265</u>	<u>\$ 5,950,277</u>	<u>\$ 632,293,105</u>	<u>\$ 761,985</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 under noncancellable operating leases consisted of the following at June 30, 2017:

<u>Fiscal Year</u>	<u>General Fund</u>
2018	\$ 2,734,380
2019	2,287,029
2020	2,073,047
2021	1,638,531
2022	1,633,296
2023-2027	<u>4,678,927</u>
Total Minimum Lease Payments	<u>\$ 15,045,210</u>

Rental expense for all operating leases during the year ended June 30, 2017 was \$2,642,116.

**NOTE 10 - FUND BALANCE**

The details of the fund balance classifications for the governmental funds at June 30, 2017, are as follows:

	<u>2017</u>		
	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total</u>
Fund Balance:			
Nonspendable:			
Inventory of Supplies	\$ 913,905	\$ 0	\$ 913,905
Committed to:			
General Government			
Project Collect Tax	64,532,565		64,532,565
Transaction Fees	4,338,799		4,338,799
Operations and Maintenance for			
Tax Systems	5,298,222		5,298,222
Other Committed	643,325		643,325
Unauthorized Substance Tax		1,410,333	1,410,333
Unassigned	<u>394,368,404</u>		<u>394,368,404</u>
<b>Total Fund Balance</b>	<u>\$ 470,095,220</u>	<u>\$ 1,410,333</u>	<u>\$ 471,505,553</u>

**NOTE 11 - INTERFUND TRANSFERS**

Transfers in/out of other funds for the fiscal year ended June 30, 2017, consisted of the following:

	<u>Transfers In</u>			
	<u>General Fund</u>	<u>State General Fund</u>	<u>Other State Funds</u>	
<u>Transfers Out</u>				
General Fund	\$ 0	\$ 21,737,164,616	\$ 92,953,454	\$ 21,830,118,070
Special Revenue	588,669			588,669
<b>Total</b>	<u>\$ 588,669</u>	<u>\$ 21,737,164,616</u>	<u>\$ 92,953,454</u>	<u>\$ 21,830,706,739</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) 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) \$64,360,412 to the Department of Public Instruction for the State Public School Fund per General Statute 105-164.44H, (2) \$24,890,260 to the Department of Insurance for Workers' Compensation and Volunteer Fire Department Funds per General Statute 105-228.5, and (3) \$3,702,782 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, 2017, in the amount of \$41,543,613, 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.

**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, 2017, are as follows:

General Fund:	Purpose	Amount
Revenues from Other State Agencies:		
Department of Transportation	Motor Fuels Reimbursement	\$ 3,518,443
Department of Transportation	Fuel Tax Compliance Reimbursement	1,093,326
Department of Transportation	International Registration Plan Reimbursement	173,209
Department of Transportation	Project Collect Tax	64,030
Department of Information Technology	Information Technology Security Positions	412,019
Department of Insurance	Insurance Reimbursement	91,567
Department of Agriculture and Consumer Services	Forestry Reimbursement	108,447
Department of Commerce	Job Development Investment Grants	20,860
		\$ 5,481,901
	Purpose	Amount
Expenditures to Other State Agencies:		
Department of Information Technology	Government Data Analytics Center	\$ 1,308,760
Office of the State Controller	William S. Lee Fees	9,500
		\$ 1,318,260
	Purpose	Amount
Special Revenue Fund:		
Expenditures to Other State Agencies:		
Office of the State Controller	25% Transfer to General Fund	\$ 1,591,110
		\$ 1,591,110

**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 annual pay. The contribution rate for employers is set each year by the North Carolina 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, 2017 was 9.98% of covered payroll. Employee contributions to the pension plan were \$4,085,071, and the Department's contributions were \$6,794,836 for the year ended June 30, 2017.

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 2016 *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 Fixed Income Asset Class includes the Long-Term Investment and External Fixed Income Investment Portfolios. The Global Equity Asset Class includes the Equity Investment Portfolio. 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 2016 *Comprehensive Annual Financial Report*.

*Net Pension Liability:* At June 30, 2017, the Department reported a liability of \$40,123,455 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015, and update procedures were used to roll forward the total pension liability to June 30, 2016. 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, 2016, the Department’s proportion was .43655%, which was an increase of .01271% from its proportion measured as of June 30, 2015.

*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	12/31/2015
Inflation	3%
Salary Increases*	3.50% - 8.10%
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, 2015 valuations were based on the results of an actuarial experience study for the period January 1, 2010 through December 31, 2014.

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, 2016 (the valuation date) are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Credit	6.0%
Inflation Protection	4.0%

The information in the preceding table is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of 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 3.05%. Return projections do not include any excess return expectations over benchmark averages. 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 at June 30, 2016 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		
1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
\$ 75,464,465	\$ 40,123,455	\$ 10,406,509

*Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions:* For the year ended June 30, 2017, the Department recognized pension expense of \$8,057,344. At June 30, 2017, 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	\$ 1,896,290
Changes of Assumptions	5,917,234	
Net Difference Between Projected and Actual Earnings on Pension Plan Investments	14,309,310	
Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions	1,147,174	
Contributions Subsequent to the Measurement Date	6,788,027	
Total	\$ 28,161,745	\$ 1,896,290

The amount of \$6,788,027 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, 2018. 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
2018	\$ 3,420,048
2019	3,475,720
2020	8,084,167
2021	<u>4,497,493</u>
Total	<u>\$ 19,477,428</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 period July 1, 2016 through December 31, 2016, the Department contributed 5.60% of the covered payroll under TSERS to the Fund, and for the period January 1, 2017 through June 30, 2017, the Department contributed 6.02% of the covered payroll under TSERS to the Fund. Required contribution rates for the years ended June 30, 2016 and 2015 were 5.60% and 5.49%, respectively. The Department made 100% of its annual required contributions to the Plan for the years ended June 30, 2017, 2016, and 2015, which were \$3,955,711, \$3,784,332, and \$3,456,603, 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, 2017, the Department made a statutory contribution of .38% of covered payroll under TSERS to the DIPNC. Required contribution rates for the years ended June 30, 2016, and 2015, were .41% in both years. The Department made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2017, 2016, and 2015, which were \$258,721, \$277,067, and \$258,143, 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 is funded by employer and

employee contributions. 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**

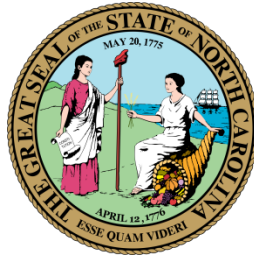
The Department is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. The Department is charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence.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



# **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, 2017**

**Exhibit B-1**

	Budgeted Amounts		Actual	Favorable (Unfavorable)
	Original	Final		
<b>REVENUES</b>				
Tax Revenues <sup>1</sup>	\$ 21,303,700,000	\$ 21,303,700,000	\$ 21,776,368,522	\$ 472,668,522
Revenues from Other State Agencies	8,228,577	7,773,977	5,482,070	(2,291,907)
Services	2,503,401	2,484,135	1,918,930	(565,205)
Fees	1,023,007	2,269,244	2,464,254	195,010
Miscellaneous	591,541	591,541	138,533	(453,008)
Total Revenues	<u>21,316,046,526</u>	<u>21,316,818,897</u>	<u>21,786,372,309</u>	<u>469,553,412</u>
<b>EXPENDITURES</b>				
Contracted Services	14,110,447	15,211,206	13,005,491	2,205,715
Personal Services	81,279,914	76,419,544	69,882,864	6,536,680
Employee Benefits	30,117,615	28,161,427	26,828,768	1,332,659
Supplies and Materials	813,882	1,031,719	803,918	227,801
Travel	1,446,263	1,540,268	1,211,309	328,959
Communication	3,416,054	4,018,195	2,910,468	1,107,727
Utilities	186,195	187,813	137,161	50,652
Data Processing Services	6,626,460	5,990,517	4,703,393	1,287,124
Claims and Benefits	14,323	60,599	59,365	1,234
Other Services	4,275,081	4,854,972	4,562,322	292,650
Other Fixed Charges	5,723,593	6,372,324	6,026,861	345,463
Expenditures to Other State Agencies	299,500	1,608,260	1,318,260	290,000
Capital Outlay	3,303,236	7,139,601	5,924,692	1,214,909
Insurance and Bonding	42,889	47,574	42,012	5,562
Other Expenditures	4,781,749	5,317,972	4,881,590	436,382
Total Expenditures	<u>156,437,201</u>	<u>157,961,991</u>	<u>142,298,474</u>	<u>15,663,517</u>
Excess of Revenues Over Expenditures	<u>21,159,609,325</u>	<u>21,158,856,906</u>	<u>21,644,073,835</u>	<u>485,216,929</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
State Appropriations	83,596,886	83,596,886	81,784,574	(1,812,312)
Sale of Capital Assets	1,000	1,000	1,000	
Transfers from Other Departments or Funds	1,496,516	2,240,480	2,133,495	(106,985)
Transfers from the State Reserve Fund		798,485	798,485	
Transfers to the State Reserve Fund		(1,127,629)	(1,127,629)	
Transfers to the State General Fund <sup>1</sup>	<u>(21,303,700,000)</u>	<u>(21,303,700,000)</u>	<u>(21,737,164,616)</u>	<u>(433,464,616)</u>
Total Other Financing Sources (Uses)	<u>(21,218,605,598)</u>	<u>(21,218,190,778)</u>	<u>(21,653,574,691)</u>	<u>(435,383,913)</u>
Net Change in Fund Balance	(58,996,273)	(59,333,872)	(9,500,856)	49,833,016
Fund Balance - July 1	<u>81,039,169</u>	<u>81,039,169</u>	<u>81,039,169</u>	
Fund Balance - June 30	<u>\$ 22,042,896</u>	<u>\$ 21,705,297</u>	<u>\$ 71,538,313</u>	<u>\$ 49,833,016</u>

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**

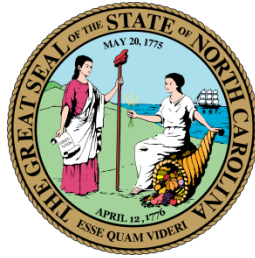
*The Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual (Budgetary Basis – Non-GAAP) – General Fund* presents comparisons of legally adopted budget with actual data on a budgetary basis. Accounting principles applied to develop data on a budgetary basis differ significantly 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.

## NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION

The following table presents a reconciliation of resulting basis differences in the fund balance (budgetary basis) at June 30, 2017 to the fund balance on a modified accrual basis (GAAP).

	General Fund
	<u>                    </u>
Fund Balance (Budgetary Basis) June 30, 2017	\$ 71,538,313
Reconciling Adjustments:	
<b>Basis Differences:</b>	
<b>Accrued Revenues:</b>	
Accounts Receivable	695,561
Intergovernmental Receivable	11,471,998
Due from Other Funds	72,800
Taxes Receivable	1,896,115,971
Other Receivables	
Less:	
Unearned Revenue	<u>(336,200,000)</u>
Total Accrued Revenues	<u>1,572,156,330</u>
<b>Accrued Expenditures:</b>	
Accounts Payable	(1,296,001)
Tax Refund Payable	(957,188,817)
Accrued Payroll	(806)
Intergovernmental Payables	<u>(142,477,858)</u>
Total Accrued Expenditures	<u>(1,100,963,482)</u>
<b>Other Adjustments:</b>	
Inventories	913,905
Securities Held in Trust (Sureties)	40,300
Due to Fiduciary Funds	(28,924,249)
Funds Held for Others	(40,150)
Unavailable Revenue	(67,661,858)
Undistributed E-911 Funds	2,582,730
Undeposited Receipts	12,010,516
General Fund Tax Reserves	<u>8,442,865</u>
Fund Balance (GAAP Basis) June 30, 2017	<u><u>\$ 470,095,220</u></u>



# **SUPPLEMENTARY INFORMATION**

**North Carolina Department of Revenue**  
**Balance Sheet**  
**General Fund - Company 45**  
**As of June 30, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit C-1**

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 74,125,371	\$ 82,845,532
Accounts Receivable	418,931	105,949
Securities Held in Trust (Sureties)	40,300	388,900
Due from Company 99 <sup>1</sup>	3,486,665	2,706,231
Due from Other Funds	72,800	57,286
Inventories	913,905	986,134
Total Assets	<u>79,057,972</u>	<u>87,090,032</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>\$ 79,057,972</u>	<u>\$ 87,090,032</u>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 1,177,762	\$ 1,974,862
Accrued Payroll	806	1,612
Intergovernmental Payables	3,165,462	1,585,274
Funds Held for Others	40,150	388,750
Total Liabilities	<u>4,384,180</u>	<u>3,950,498</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Total Deferred Inflows of Resources	<u>0</u>	<u>0</u>
<b>FUND BALANCE</b>		
Nonspendable	913,905	986,134
Committed	74,812,911	83,304,370
Unassigned	(1,053,024)	(1,150,970)
Total Fund Balance	<u>74,673,792</u>	<u>83,139,534</u>
Total Liabilities, Deferred Inflows, and Fund Balance	<u>\$ 79,057,972</u>	<u>\$ 87,090,032</u>

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, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit C-2**

	<b>2017</b>	<b>2016</b>
<b>REVENUES</b>		
Revenues from Other State Agencies	\$ 5,481,901	\$ 5,683,161
Revenues from Company 99 <sup>1</sup>	41,543,613	41,614,841
Services	1,918,930	1,730,945
Fees	2,464,254	4,318,553
Miscellaneous	139,437	97,770
Total Revenues	<u>51,548,135</u>	<u>53,445,270</u>
<b>EXPENDITURES</b>		
Contracted Services	13,174,923	11,039,556
Personal Services	69,872,916	67,682,271
Employee Benefits	26,776,758	25,261,357
Supplies and Materials	842,944	1,795,116
Travel	1,165,950	1,414,660
Communication	2,837,773	3,583,515
Utilities	135,232	123,750
Data Processing Services	4,651,941	5,344,474
Claims and Benefits	59,365	56,380
Other Services	4,561,765	4,333,203
Other Fixed Charges	5,883,473	5,426,522
Expenditures to Other State Agencies	1,318,260	3,906,235
Capital Outlay	5,736,632	5,472,091
Insurance and Bonding	42,012	38,351
Other Expenditures	4,998,852	4,566,983
Total Expenditures	<u>142,058,796</u>	<u>140,044,464</u>
Deficit of Revenues Under Expenditures	<u>(90,510,661)</u>	<u>(86,599,194)</u>
<b>OTHER FINANCING SOURCES (USES)</b>		
State Appropriations	81,784,574	79,762,784
Sale of Capital Assets	820	1,652
Transfers In	588,669	594,623
Transfers from State Reserve Fund	798,485	
Transfers to State Reserve Fund	(1,127,629)	(798,485)
Total Other Financing Sources (Uses)	<u>82,044,919</u>	<u>79,560,574</u>
Net Change in Fund Balance	(8,465,742)	(7,038,620)
Fund Balance - July 1	<u>83,139,534</u>	<u>90,178,154</u>
Fund Balance - June 30	<u>\$ 74,673,792</u>	<u>\$ 83,139,534</u>

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, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit C-3**

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 2,795,705	\$ 2,006,281
Receivables:		
Intergovernmental Receivables		5,453
Taxes Receivable, Net	10,739,322	4,994,592
Total Assets	<u>13,535,027</u>	<u>7,006,326</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>\$ 13,535,027</u>	<u>\$ 7,006,326</u>
<b>LIABILITIES</b>		
Intergovernmental Payables	<u>\$ 1,756,638</u>	<u>\$ 946,434</u>
Total Liabilities	<u>1,756,638</u>	<u>946,434</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable Revenues	<u>10,368,056</u>	<u>4,710,179</u>
<b>FUND BALANCE</b>		
Committed	<u>1,410,333</u>	<u>1,349,713</u>
Total Fund Balance	<u>1,410,333</u>	<u>1,349,713</u>
Total Liabilities, Deferred Inflows, and Fund Balance	<u>\$ 13,535,027</u>	<u>\$ 7,006,326</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, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit C-4**

	<u>2017</u>	<u>2016</u>
<b>REVENUES</b>		
Tax Revenues	\$ 7,097,588	\$ 6,748,683
Total Revenues	<u>7,097,588</u>	<u>6,748,683</u>
<b>EXPENDITURES</b>		
Other Services	56,915	45,648
Expenditures to Other Agencies	1,591,110	1,589,450
Statutory Tax Distributions	4,794,821	4,761,037
Other Expenditures	<u>5,453</u>	
Total Expenditures	<u>6,448,299</u>	<u>6,396,135</u>
Excess of Revenues Over Expenditures	<u>649,289</u>	<u>352,548</u>
<b>OTHER FINANCING (USES)</b>		
Transfers Out	<u>(588,669)</u>	<u>(594,623)</u>
Total Other Financing (Uses)	<u>(588,669)</u>	<u>(594,623)</u>
Net Change in Fund Balance	60,620	(242,075)
Fund Balance - July 1	<u>1,349,713</u>	<u>1,591,788</u>
Fund Balance - June 30	<u>\$ 1,410,333</u>	<u>\$ 1,349,713</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, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit C-5**

	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 20,449,053	\$ 11,130,430
Receivables:		
Accounts Receivable	276,630	1,002,274
Intergovernmental Receivables	11,471,998	11,481,453
Taxes Receivable, Net	1,896,115,971	1,987,485,223
Total Assets	<u>1,928,313,652</u>	<u>2,011,099,380</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>\$ 1,928,313,652</u>	<u>\$ 2,011,099,380</u>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 118,239	\$ 163,066
Intergovernmental Payables	139,312,396	135,577,444
Due to NC Housing Finance Agency		29,751,890
Due to Fiduciary Funds	28,924,249	26,613,373
Due to Company 45 <sup>1</sup>	3,486,665	2,706,231
Tax Refunds Payable	957,188,817	989,469,963
Unearned Revenue	336,200,000	385,400,000
Total Liabilities	<u>1,465,230,366</u>	<u>1,569,681,967</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable Revenues	<u>67,661,858</u>	<u>71,970,797</u>
<b>FUND BALANCE</b>		
Unassigned	<u>395,421,428</u>	<u>369,446,616</u>
Total Fund Balance	<u>395,421,428</u>	<u>369,446,616</u>
Total Liabilities, Deferred Inflows, and Fund Balance	<u>\$ 1,928,313,652</u>	<u>\$ 2,011,099,380</u>

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, 2017**  
**(With Comparative Totals for June 30, 2016)**

**Exhibit C-6**

	<u>2017</u>	<u>2016</u>
<b>REVENUES</b>		
Tax Revenues	\$ 22,529,614,924	\$ 22,154,277,600
Miscellaneous		271,722
Total Revenues	<u>22,529,614,924</u>	<u>22,154,549,322</u>
<b>EXPENDITURES</b>		
Statutory Tax Distributions	631,978,429	623,639,453
Expenditures to Company 45 <sup>1</sup>	<u>41,543,613</u>	<u>41,614,841</u>
Total Expenditures	<u>673,522,042</u>	<u>665,254,294</u>
Excess of Revenues Over Expenditures	<u>21,856,092,882</u>	<u>21,489,295,028</u>
<b>OTHER FINANCING (USES)</b>		
Transfers Out	<u>(21,830,118,070)</u>	<u>(21,374,805,945)</u>
Total Other Financing (Uses)	<u>(21,830,118,070)</u>	<u>(21,374,805,945)</u>
Net Change in Fund Balance	25,974,812	114,489,083
Fund Balance - July 1	<u>369,446,616</u>	<u>254,957,533</u>
Fund Balance - June 30	<u>\$ 395,421,428</u>	<u>\$ 369,446,616</u>

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, 2017**

**Exhibit D-1**

<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	\$ 879,197	\$ 151,601	\$ 0	\$ 17,973	\$ 709,623
Privilege License Tax	30,848,016	1,004,407		489,436	29,354,173
Tobacco Products Tax	293,029,561	808,898		30,469,077	261,751,586
Franchise Tax	764,353,340	10,650,772		5,625,448	748,077,120
Individual Income Tax	13,344,741,218	1,226,838,717		148,251,550	11,969,650,951
Sales and Use Tax	11,476,478,082	683,327,950	3,131,348,871	657,837,560	7,003,963,701
Alcoholic Beverage Tax	393,775,309	574,683	39,534,929	61,814	353,603,883
Gift Tax	3,027			163	2,864
Freight Car Lines Tax	245,206	288		25	244,893
Insurance Tax	603,618,209	36,512,737		75,007,670	492,097,802
Corporate Income Tax	1,011,860,540	254,513,475		5,173,714	752,173,351
Real Estate Conveyance Tax	67,473,051	6,293			67,466,758
White Goods Disposal Tax	5,797,929	12,652	2,995,952	293,432	2,495,893
Scrap Tire Disposal Tax	19,725,068	74,956	13,464,535	426,135	5,759,442
Manufacturing Tax	48,388,426	733,047		318,569	47,336,810
Solid Waste Disposal Tax	20,192,078	417,190	7,387,961	9,924,274	2,462,653
Miscellaneous Tax Receipts	578,252			565,139	13,113
<b>Total General Fund Revenue</b>	<b>\$ 28,081,986,509</b>	<b>\$ 2,215,627,666</b>	<b>\$ 3,194,732,248</b>	<b>\$ 934,461,979</b>	<b>\$ 21,737,164,616</b>
Special Revenue Fund - Unauthorized Substances Tax	\$ 7,991,868	\$ 364,364	\$ 0	\$ 6,838,080	\$ 789,424

**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-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	\$ 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
<b>Total General Fund Revenue</b>	<b>\$ 27,223,566,125</b>	<b>\$ 2,053,899,631</b>	<b>\$ 2,965,958,522</b>	<b>\$ 911,806,089</b>	<b>\$ 21,291,901,883</b>
Special Revenue Fund - Unauthorized Substances Tax	\$ 7,607,812	\$ 190,703	\$ 0	\$ 7,654,099	\$ (236,990)

**North Carolina Department of Revenue  
Schedule of Aging of Taxes Receivable  
General Fund - Company 99  
As of June 30, 2017**

**Exhibit E-1**

Tax Type	Delinquent Receivables (in years)				Total
	Less than 1	1 to 5	5 to 10	More than 10	
Individual	\$ 537,966,027	\$ 556,365,358	\$ 264,017,543	\$ 29,062,621	\$ 1,387,411,549
Corporate	9,134,653	7,279,084	1,068,974	60,797	17,543,508
Sales and Use	46,480,841	79,473,657	43,022,250	2,847,855	171,824,603
Franchise	4,895,324	2,830,136	472,383	207,790	8,405,633
Scrap Tire	105,925	315,955	41,711	2,209	465,800
White Goods	3,147	318	89		3,554
Manufacturing	245,743	53,785	1,239		300,767
Solid Waste	2,189				2,189
License and Excise	713,455	855,523	201,281	9,717	1,779,976
	<u>\$ 599,547,304</u>	<u>\$ 647,173,816</u>	<u>\$ 308,825,470</u>	<u>\$ 32,190,989</u>	<u>1,587,737,579</u>

**Reconciling Adjustments:**

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

Tobacco Products	\$ 24,145,166	
Estate	11,323,253	
License and Excise	2,760,122	
Alcoholic Beverage	639,323	
Gift	242,850	
Insurance	1,044,212	
<b>Total ETM Receivables Balance</b>		40,154,926

**Other Adjustments:**

Unposted Accrued Interest for June 30, 2017	29,123,088
July Adjustments	(16,366,048)
<b>Delinquent Receivables (Gross) - General Fund</b>	<u>\$ 1,640,649,545</u>

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

**Exhibit E-2**

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 and 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 Tax 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 Receivables Balance</b>		<b>36,237,292</b>

**Other Adjustments:**

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

**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, 2017**  
**(With Comparative Totals for June 30, 2016)**

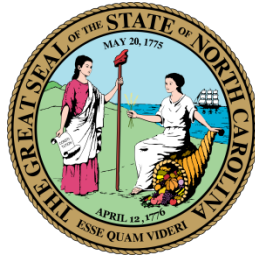
**Exhibit F-1**  
**Page 1 of 2**

	<b>2017</b>	<b>2016</b>
<b><u>Expenditures Paid for Department Operations and Administration:</u></b>		
Contracted Services:		
Other Information Technology Services	\$ 6,827,108	\$ 4,697,968
Temporary Agency and Administrative Services	4,099,959	4,338,509
IT Project Management and Analysis Services	33,354	131,672
Legal Services	205,428	191,455
Financial and Audit Services	222,470	150,000
Security Services	620,073	557,074
Janitorial and Waste Services	97,345	96,464
Miscellaneous Contractual Services	1,069,186	876,414
Total Contracted Services	<u>13,174,923</u>	<u>11,039,556</u>
Personal Services:		
Employee Salaries	67,270,430	64,928,249
Law Enforcement Salaries	1,848,559	1,788,791
Temporary Wages	536,459	742,065
Overtime Wages	96,570	90,424
Board Member Compensation	97,450	108,700
Other Salary Expenses	23,448	24,042
Total Personal Services	<u>69,872,916</u>	<u>67,682,271</u>
Employee Benefits:		
Regular Retirement Contributions	11,118,203	10,019,360
Law Enforcement Retirement Contributions	370,675	333,491
Medical Insurance Contributions	7,188,787	6,989,191
Social Security Contributions	5,267,684	5,110,616
Longevity Pay	1,175,410	1,128,266
Legislative Bonus	894,057	976,481
Employee Educational Expense	178,203	179,872
Unemployment Compensation Payments	60,237	143,237
Workers Compensation Medical Payments	323,879	157,308
Flexible Spending Savings	112,765	110,835
Short Term Disability Payments	66,327	78,608
Other Employee Benefits	20,531	34,092
Total Employee Benefits	<u>26,776,758</u>	<u>25,261,357</u>
Supplies and Materials:		
General Office Supplies	442,757	506,752
Data Processing Supplies	292,983	226,886
Other Supplies and Materials	107,204	1,061,478
Total Supplies and Materials	<u>842,944</u>	<u>1,795,116</u>
Travel:		
Ground Transportation	778,014	927,748
Air Transportation	68,239	82,555
Lodging	198,361	265,893
Meals	102,631	117,992
Other Travel	18,705	20,472
Total Travel	<u>1,165,950</u>	<u>1,414,660</u>
Communication:		
Telephone Service	1,435,421	1,687,140
Telecommunication Data Charges	1,085,866	1,214,145
Cellular Phone Services	274,524	282,118
Other Telephone Charges	41,962	400,112
Total Communication	<u>2,837,773</u>	<u>3,583,515</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, 2017**

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

	<u>2017</u>	<u>2016</u>
Utilities:		
Energy Services-Electrical	125,850	115,061
Other Utilities	9,382	8,689
Total Utilities	<u>135,232</u>	<u>123,750</u>
Data Processing Services	<u>4,651,941</u>	<u>5,344,474</u>
Claims and Benefits:		
Law Enforcement Separation Allowance	<u>59,365</u>	<u>56,380</u>
Other Services:		
Postage and Delivery	3,862,842	3,539,579
Printing and Binding	416,207	457,669
Other Services	<u>282,716</u>	<u>335,955</u>
Total Other Services	<u>4,561,765</u>	<u>4,333,203</u>
Other Fixed Charges:		
Computer Software Maintenance Agreements	4,370,613	3,956,186
Computer Hardware Maintenance Agreements	621,141	481,507
Other Equipment Maintenance Agreements	486,300	486,966
Membership Dues and Subscriptions	355,544	306,418
Other Fixed Charges	<u>49,875</u>	<u>195,445</u>
Total Other Fixed Charges	<u>5,883,473</u>	<u>5,426,522</u>
Expenditures to Other State Agencies (Note 12)	<u>1,318,260</u>	<u>3,906,235</u>
Capital Outlay:		
Computer Software	3,146,831	3,062,394
Computer Hardware	1,978,749	1,598,829
Office Furniture	467,712	232,737
Voice Communication Equipment	164	39,648
Office Equipment	55,724	109,496
Duplication Equipment		66,613
Other Capital Outlays	<u>87,452</u>	<u>362,374</u>
Total Capital Outlay	<u>5,736,632</u>	<u>5,472,091</u>
Insurance and Bonding	<u>42,012</u>	<u>38,351</u>
Other Expenditures:		
Office Building Rent	2,642,116	2,381,718
Office and Communication Equipment Rents and Leases	141,114	118,668
Other Rents and Leases	36,694	42,654
Electronic Payment Processing Fees	2,178,777	2,023,602
Other Operating Expenses	<u>151</u>	<u>341</u>
Total Other Expenditures	<u>4,998,852</u>	<u>4,566,983</u>
Total Expenditures Paid for Department Operations and Administration	<u>142,058,796</u>	<u>140,044,464</u>
<b>Expenditures Paid by the Department Pursuant to Statutory Tax Allocations:</b>		
Expenditures Paid to Local Governments Pursuant to Statutory Tax Allocations	<u>631,978,429</u>	<u>623,639,453</u>
Total General Fund Expenditures	<u>\$ 774,037,225</u>	<u>\$ 763,683,917</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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Secretary Ronald G. 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, 2017, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated March 27, 2018.

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, 2017, 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 opinion 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

March 27, 2018

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For additional information contact:  
Brad Young  
Director of External Affairs  
**919-807-7513**



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This audit required 1,723.5 hours at an approximate cost of \$177,520.50.