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, 2018

A Department of the State of North Carolina

NCOSA

The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor

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State Auditor

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AUDITOR'S TRANSMITTAL

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, 2018, 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.

Beth A. Wood

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AN OVERVIEW OF HOW TO USE THIS REPORT

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 per the Governmental Accounting Standards Board and *Government Auditing 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, 2018 (with comparative totals as of June 30, 2017) and the Statement of Revenues, Expenditures, and Changes in Fund Balance for fiscal year ended June 30, 2018 (with comparative totals for fiscal year ended June 30, 2017) 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, 2018).

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, 2018, with comparative totals for fiscal year ended June 30, 2017).

"D" Exhibits present the Statement of Collections (Cash Basis), which details certain tax revenues collected by DOR (for fiscal years ended June 30, 2018 and 2017).

“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, 2018 and 2017).

“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, 2018 and 2017).

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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INDEPENDENT AUDITOR'S REPORT

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, 2018, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinions

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, 2018, 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 only 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, 2018, 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.

As discussed in Note 16 to the financial statements, during the year ended June 30, 2018, Department of Revenue adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, as amended by Governmental Accounting Standards Board Statement No. 85, *Omnibus 2017*. 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, 2017, 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 March 27, 2018. 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, 2017.

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 26, 2019 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

Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 26, 2019

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 year ended June 30, 2018, with comparative information for the fiscal year ended June 30, 2017. 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 and 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 supports the statements noted above.

Required Supplementary Information (RSI) follows the basic financial statements and notes to the financial statements. The RSI is mandated by the 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, 2018 and 2017:

	2018	2017	Increase (Decrease)
Assets	$ 2,126,156,531	$ 2,017,419,986	$ 108,736,545
Deferred Outflows of Resources	0	0	0
Total Assets and Deferred Outflows of Resources	$ 2,126,156,531	$ 2,017,419,986	$ 108,736,545
Liabilities	$ 1,532,250,318	$ 1,467,884,519	$ 64,365,799
Deferred Inflows of Resources	84,923,512	78,029,914	6,893,598
Fund Balance			
Nonspendable	2,236,849	913,905	1,322,944
Committed	72,102,653	76,223,244	(4,120,591)
Unassigned	434,643,199	394,368,404	40,274,795
Total Fund Balances	508,982,701	471,505,553	37,477,148
Total Liabilities, Deferred Inflows of Resources, and Fund Balance	$ 2,126,156,531	$ 2,017,419,986	$ 108,736,545

Assets

Total assets increased by $108.7 million during fiscal year end 2018 due to a $108.3 million increase in taxes receivable. Taxes receivable increased $108.3 million from the prior fiscal year primarily due to the amount estimated for individual income tax underpayments was $125.3 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 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 2017 – December 2017) 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 2019 fiscal year are for the 2018 tax year (January 2018 – December 2018). 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 2019 fiscal year would have been earned by June 30, 2018 (in the time period of January 2018 – June 2018). The final payments estimated to be received in the 2019 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 2019 fiscal year were $53 million more than in the prior year. Different trend models are used to perform the trend analysis. The Department chose the trend model whose amount in the prior fiscal year was closest to actual. One-half of this amount was taken, resulting in estimated final payments that were $26.5 million more 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 $125.3 million more than the prior fiscal year.

Delinquent individual income taxes receivable decreased $100.3 million primarily due to a decrease in gross delinquent individual income taxes receivable. Gross delinquent individual income taxes receivable decreased $262.7 million from the prior year due to a decrease in final assessments billed to taxpayers for individual income tax owed and an increase in the amount of taxes receivable written off.

Final assessments in the fiscal year end 2018 decreased $137.7 million from the prior fiscal year. The majority of the decrease in final assessments occurred as a result of when individuals were billed that did not remit payment when they filed their tax returns with a balance due. Individual income tax returns for the 2015, 2016 and 2017 tax years were due to the Department by April 15th of the subsequent tax year. If tax returns are received by the Department with a balance due and no payment is remitted, then a final assessment is billed to the taxpayer. Final assessments for tax returns submitted with no payment usually occur in June or July following the due date of the return. The majority of assessments to individuals that did not remit payment with their 2015 and 2016 tax returns by the due date became final during the 2017 fiscal year (July 2016 and June 2017, respectively). The majority of assessments to individuals that did not remit payment with their 2017 tax return by the due date became final in the 2019 fiscal year (July 2018). As a result, final assessments due to individuals not remitting payment when they filed their tax returns with a balance due were higher in the 2017 fiscal year than in the fiscal year end 2018.

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. In contrast, during the fiscal year end 2018, the Department wrote off over $400 million of taxes receivable. The write off reversal process was not performed during the fiscal year end 2018.

Liabilities

Total liabilities increased by $64.4 million compared to prior year. The majority of this increase is due to an increase in tax refunds payable. Tax refunds payable increased due to the $42.2 million increase in sales and use tax revenues estimated to be refunded in some future period. The majority of the $42.2 million increase is attributed to estimated refunds of sales and use tax to nonprofit entities. The refund estimate prepared by the Department in the prior year for nonprofit entities to be refunded in a future period was lower than actual. As a result, the Department re-evaluated how the estimate was calculated and determined some additional refund information should be included. *North Carolina General Statute* 105-164.14(b) allows nonprofit entities a semi-annual refund of sales and use taxes paid by them. A request for refund for the first six months of a calendar year is due the following Oct 15th; a request for refund for the second six months of a calendar year is due the following April 15th. Previously, it was assumed that any sales and use tax revenues paid by nonprofit entities during the second six months of a calendar year would be refunded prior to the fiscal year end. However, it was determined that this is not always the case. The fiscal year end 2018 calculation of the amount estimated to be refunded in a future period was changed from the prior year to include actual nonprofit entities' refunds requested for July 2017 – December 2017 but not paid as of June 30, 2018.

Deferred Inflows of Resources

Deferred inflows of resources increased $6.9 million compared to the prior fiscal 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 tobacco products tax, corporate income taxes, franchise taxes, and sales and use taxes. These amounts are deferred and recognized as revenues in the period that the amounts become available.

Fund Balance

Overall fund balance increased by $37.5 million during fiscal year end 2018. The largest increase of $40.3 million occurred in the unassigned fund balance and was 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, 2018 and 2017:

	2018	2017	Increase (Decrease)
Revenues:			
Tax Revenues	$ 23,471,657,762	$ 22,536,712,512	$ 934,945,250
Revenues from Other State Agencies	6,067,216	5,481,901	585,315
Fees	2,536,082	2,464,254	71,828
Other Revenues	2,051,699	2,058,367	(6,668)
Total Revenues	23,482,312,759	22,546,717,034	935,595,725
Expenditures:			
Statutory Tax Distributions	647,477,474	636,773,250	10,704,224
Salaries and Benefits	99,477,394	96,649,674	2,827,720
Expenditures to Other State Agencies	1,869,364	2,909,370	(1,040,006)
Other Expenditures	46,116,641	44,153,230	1,963,411
Total Expenditures	794,940,873	780,485,524	14,455,349
Excess of Revenues Over Expenditures	22,687,371,886	21,766,231,510	921,140,376
Other Financing Sources (Uses)			
State Appropriation	83,384,770	81,784,574	1,600,196
Sale of Capital Assets	500	820	(320)
Transfers In	1,519,809	1,387,154	132,655
Transfers Out	(22,734,799,817)	(21,831,834,368)	902,965,449
Total Other Financing Sources (Uses)	(22,649,894,738)	(21,748,661,820)	901,232,918
Net Change in Fund Balance	37,477,148	17,569,690	19,907,458
Fund Balance - July 1	471,505,553	453,935,863	17,569,690
Fund Balance - June 30	$ 508,982,701	$ 471,505,553	$ 37,477,148

Tax Revenues

Total tax revenues were $23.5 billion at June 30, 2018, an increase of $934.9 million from the prior fiscal year. This increase is primarily due to an increase in net individual income tax revenues of $650.2 million and net sales and use tax revenues of $291.3 million, which are two significant revenue sources.

Individual Income Tax

Individual income tax revenues on a modified accrual basis increased $650.2 million or 5.5% from the fiscal year end 2017. This increase is primarily due to an increase in gross revenues on a cash basis, which increased by $486.6 million or 3.7%. Significant increases in withholdings and estimated tax payments account for the majority of this increase and can be attributed to an improved economy. Recent national data for personal income and wage and salary income indicate growth in the range of 4.5% for fiscal year end 2018. Growth in personal income and wage and salary income is generally correlated with individual income tax revenue growth.

In addition, a significant portion of the $188.5 million increase in estimated tax payments may be attributed to new repatriation provisions in the federal Tax Cuts and Jobs Act (TCJA). TCJA, enacted in December 2017, made amendments to Internal Revenue Code section 965 that require certain taxpayers to recognize mandatory deemed repatriation income in the 2017 tax year. Estimated tax payments in December 2017 and January 2018 increased over $160 million or 31% from the prior fiscal year.

Sales and Use Tax

Sales and use tax revenues on a modified accrual basis increased by $291.3 million or 4.2% from the fiscal year end 2017. This increase is due to an increase in net revenues on a cash basis, which increased by $333.5 million or 4.8%. 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 as discussed in Economic Conditions section below, have increased the disposable incomes of consumers. Recent national data for personal consumption expenditures indicate growth in the range of 4.5% for fiscal year end 2018. Growth in this area is generally correlated with sales and use tax revenue growth.

Section 38.5 of Session Law 2016-94, as amended by Part XI of Session Law 2016-123, amended the sales tax on repair, maintenance, and installation services 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. This provision was effective January 1, 2017 and had an overall positive impact on sales and use tax revenues during the fiscal year end 2018.

Expenditures

Total expenditures increased $14.5 million from the prior fiscal year due primarily to an increase in statutory tax distributions. Statutory tax distributions increased $10.7 million from the prior year due to an increase in distributions to local governments from the piped natural gas sales and use tax of $4.3 million and white goods disposal tax of $2.1 million. Piped natural gas sales tax revenue collected during the fiscal year end 2018 was higher than in previous years resulting in higher distributions to local governments. Piped natural gas sales fluctuate depending on the weather and North Carolina experienced a very cold winter during the fiscal year end 2018. White goods disposal tax collections increased $3.6 million from the previous fiscal year primarily as a result of audit initiatives. The increased collections resulted in increased distributions.

Other Financing Sources (Uses)

Total other financing uses increased $901.2 million from the prior fiscal 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 $21.7 billion to $22.6 billion during fiscal year end 2018. 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- AAP) of this report.

Variances – Original and Final Budget:

The final budgeted revenues were $7.7 million less than the original budget due primarily to a decrease in budgeted tax revenues of $8.5 million. Budgeted tax revenues decreased by $8.5 million because the budgeted revenues for sales and use tax and insurance tax were reduced.

Budgeted revenues for sales and use tax and insurance tax were reduced due to two provisions in Session Law 2017-204 (Senate Bill 628) that reduced anticipated General Fund tax revenues during fiscal year end 2018. One provision allowed taxpayers who elected to claim a business and energy tax credit against their gross premium tax liability to take an installment or carryforward of the credit against the additional tax on property coverage contracts under *North Carolina General Statute* 105-228.5(d)(3). This provision reduced anticipated insurance premium tax revenues by $8 million in fiscal year end 2018. A second provision reduced the assessment for the failure to properly collect sales and use tax on the rental of linens. This provision reduced anticipated sales and use tax collections by $500 thousand in fiscal year end 2018.

While the final overall budgeted expenditures only decreased $304 thousand, the final budgets for contracted services and other services were $11.1 million and $1.6 million more than the original budgets, respectively. The increases are primarily due to revisions to the final budgets for other information technology services, temporary agency and administrative services, and postage and delivery services. In addition, salaries and benefits, data processing services, and other fixed charges were $6.2 million, $4.4 million, and $2.6 million less than the original budgets, respectively. The decrease in other fixed charges is primarily due to a decrease in maintenance agreements for other software of $4.3 million and an increase in maintenance agreements for computer software of $2.2 million.

The Department was authorized to use $5.3 million and $7.2 million from the Integrated Tax Administration System (ITAS) replacement fund and the Collection Assistance Fee, respectively, for costs related to the Department's tax systems. $10.9 million of the $12.5 million budget was originally budgeted as maintenance agreements for other software and data processing services. The majority of these budgets were later moved to other technology services ($3.7 million), administrative services ($1.1 million), and maintenance agreements for computer software ($2.2 million).

The final budget for administrative services increased by $5.9 million. The majority of this increase is due to the $4.4 million the Department was authorized to use from the Collection Assistance Fee during fiscal year end 2018 to contract with a vendor to perform tax fraud analysis using the Government Data Analytics Center (GDAC) and to pay for identity theft protection information technology upgrades. The $4.4 million was originally budgeted between other information technology services ($2.4 million) and server software ($2 million). All of the $4.4 million was later moved to administrative services to cover the transfer to the Department of Information Technology for GDAC. An additional $1.1 million was moved to administrative services as discussed above. These funds were also transferred to the Department of Information Technology for GDAC.

The final budgets for temporary agency services and postage and delivery services increased $4.4 million. The increase in these accounts directly relates to the decrease in the final budget for salaries and benefits. The majority of amounts originally budgeted as salaries and benefits was moved to temporary agency services and postage and delivery services accounts.

The final amount budgeted for other financing sources (uses) was $7.1 million less than the original budget due primarily to a decrease in budgeted transfers to the State's general fund of $8.5 million. The amount budgeted to transfer to the State's general fund equals total tax revenues anticipated to be collected. Therefore, this decrease is attributable to the decrease in budgeted tax revenues as discussed above.

Variances – Final Budget and Actual Results:

Actual total revenue collected was $401.8 million above budgeted revenue amounts. The majority of this increase is due to greater than anticipated individual income tax collections, insurance premium tax collections, and franchise tax collections. Individual income taxes, which account for more than half of total general fund tax revenue collections, were $176.1 million above the $12.3 billion forecast. Quarterly payments from individuals came in much higher than expected in December and January as a result of the strong 2018 stock market performance, and due to heightened incentives for high-income taxpayers to maximize federal income tax deductions for state and local taxes prior to new limitations taking effect in tax year 2018. As a result, individual income tax collections were 1.43% above the budgeted amount.

Insurance premium tax collections were $83.7 million above the budgeted amount, which was likely the result of the sunset of tax credits claimed by many large insurance companies in prior tax years. Franchise tax collections were $63.2 million above the budgeted amount. Franchise tax collections increased by more than 40% between fiscal years 2016 and 2017, and the consensus forecast for fiscal year end 2018 franchise tax collections had assumed that most of the fiscal year 2017 increase was of a one-time nature. It appears, however, that previously enacted changes to the franchise tax base may have increased the tax base more than indicated by initial estimates.

Actual total expenditures were $34.3 million less than budgeted expenditures during fiscal year end 2018. Budgeted expenditures exceeded actual expenditures primarily because the Department spent $28.6 million less on contracted services and salaries and benefits. The amount spent on contracted services was $20.7 million less than budgeted primarily due to decreased spending on other information technology services for the Collections Case Management project.

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

Actual total other financing sources (uses) were $359.2 million above budgeted amounts primarily due to an increase in transfers to the State's general fund. Transfers to the State's general fund consist solely of the year-end transfer of net tax revenues to the Office of the State Controller. This increase is attributable to the increase in tax revenues as discussed above.

Future Outlook

General Operations

Session Law 2018-5 of the 2018 Session of the North Carolina General Assembly was enacted in June 2018 to modify the 2017 Appropriations Act. Session Law 2018-5 increased the amount appropriated to the Department of Revenue for general operations for the fiscal year ending June 30, 2019 by $1.4 million. The majority of this increase was because funds were provided for a 2% annual recurring salary increase. The Department was also authorized to spend $12.5 million from the Collections Assistance Fee to support the Portfolio Warehouse, Modernize eFile, and tax systems operations and maintenance upgrades. 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.

North Carolina Economic Conditions

There were continued improvements in the economy during the 2017-2018 fiscal year. The number of payroll jobs in North Carolina has steadily increased, according to data compiled by the Bureau of Labor Statistics. In June 2018, there were 103,600 more jobs than in June 2017 and 180,500 more than in June 2016. The unemployment rate in North Carolina hovered in the range 4.4% to 4.5% throughout most of the fiscal year end 2018, and dropped to 4.2% in June 2018. Finally, as reported by the Bureau of Economic Analysis, North Carolina's personal income increased 3.79% between 2016 and 2017. This trend, along with further tightening of the labor market, may indicate further wage increases in 2018. The improvement in the economy should positively impact major sources of the State's tax revenues, such as personal income taxes and sales & use taxes, that increase when incomes and spending increase.

Tax Changes

Individual Income Tax

Effective January 1, 2018, a taxpayer who is allowed a federal child tax credit for the taxable year is allowed a deduction for each dependent 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 replaced 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.

Effective January 1, 2019, the individual income tax rate decreased from 5.499% to 5.25%. Effective January 1, 2016, withholding tax tables were adjusted such that the tax rate on wages is set at 0.1% higher than the actual individual income tax rate. Therefore, effective January 1, 2019, the withholding rate on wages paid is 5.35%. In addition, the standard deduction amounts increased 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 2018 and 2019 tax years will not be known until final individual income tax payments are remitted by taxpayers in the spring of 2019 and 2020.

Sales and Use Tax

Effective June 12, 2018, *North Carolina General Statute* 105-244.3 was amended by Session Law 2018-5 to add additional provisions to the Sales Tax Base Expansion Protection Act and to extend the time of the grace period for an additional year. Impacted retailers that meet certain conditions as detailed in the statute are provided a grace period under which the North Carolina Department of Revenue will take no action to assess any tax due provided the retailer demonstrates a good faith effort to comply. As a result, the Department shall take no action to assess any tax due for a filing period beginning on or after March 1, 2016, and ending prior to January 1, 2019. Previous legislation stated "prior to January 1, 2018". This change provides relief for additional taxes owed as a result of the expansion of the sales tax base and may result in a reduction of sales and use tax collections in the 2018-2019 fiscal year.

Session Law 2017-204 increased the percentage for determining taxability of repair, maintenance, and installation services in mixed transactions with real property contracts for capital improvements from 10% to 25% of the contract. The change is retroactive to January 1, 2017 and should result in a reduction of future tax collections.

The North Carolina Department of Revenue issued a directive August 7, 2018 requiring certain sellers not physically located in North Carolina to collect and remit sales tax on sales sourced to North Carolina. The directive comes after the U.S. Supreme Court's June 2018 decision in *South Dakota v. Wayfair*, in which the court found that physical presence is not necessary to create a substantial nexus between a remote seller and a taxing state. Accordingly, North Carolina will enforce an existing law [*North Carolina General Statute* 105-164.8(b)] regarding remote sales and require remote sellers to collect and remit the applicable sales and use tax on taxable retail sales sourced to North Carolina. The law will be applied on a prospective basis beginning November 1, 2018. The Department will enforce the North Carolina statute concerning remote sales with regard to remote sellers having gross sales sourced to the state in excess of $100,000 or having 200 or more separate transactions sourced to the state in the previous or current calendar year.

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.

Franchise Tax

Session Law 2017-57 modified the computation of general business franchise tax for S-corporations. Minimum franchise tax of $200 applies to the first one million dollars of value. Any value exceeding one million dollars is taxed at the standard rate of $1.50 per $1,000. The change is effective for taxable years on or after January 1, 2019, and is applicable to the calculation of franchise tax reported on the tax year 2018 and later corporate income tax returns.

Session Law 2015-241 eliminated a deduction for debt incurred for purchase or improvement of real estate in computing the tangible property base. Session Law 2017-204 restores this deduction and is effective for taxable years beginning on or after January 1, 2020, and is applicable to the calculation of franchise tax reported on the 2019 and later corporate income tax returns.

Manufacturing Tax

Session Law 2017-57 repealed the mill machinery tax effective July 1, 2018. Items previously included under this tax were exempt from the higher sales and use tax. After the repeal, the items will continue to be exempt from the sales and use tax.

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 (RFP) was posted in January 2018 with minimal responses received. As a result, the RFP was cancelled, revised for clarity and an enhanced level of detail, and reposted in August 2018. Vendor submissions were received November 19, 2018 and vendor presentations will be completed by January 31, 2019. It is anticipated that a contract will be awarded by April 2019.

FINANCIAL STATEMENTS

North Carolina Department of Revenue
Balance Sheet
Governmental Funds
As of June 30, 2018
(With Comparative Totals for June 30, 2017) ***Exhibit A-1***

	General Fund	Special Revenue	Total 2018	Total 2017
ASSETS				
Cash and Cash Equivalents (Note 2)	$ 95,061,455	$ 2,253,654	$ 97,315,109	$ 97,370,129
Receivables:				
Accounts Receivable	267,232		267,232	695,561
Intergovernmental Receivables (Note 6)	11,064,023		11,064,023	11,471,998
Taxes Receivable, Net (Note 3)	2,011,662,481	3,504,518	2,015,166,999	1,906,855,293
Securities Held in Trust (Sureties)	40,300		40,300	40,300
Due from Other Funds	66,019		66,019	72,800
Inventories	2,236,849		2,236,849	913,905
Total Assets	2,120,398,359	5,758,172	2,126,156,531	2,017,419,986
DEFERRED OUTFLOWS OF RESOURCES				
Total Deferred Outflows of Resources	0	0	0	0
Total Assets and Deferred Outflows of Resources	$ 2,120,398,359	$ 5,758,172	$ 2,126,156,531	$ 2,017,419,986
LIABILITIES				
Accounts Payable and Accrued Liabilities:				
Accounts Payable (Note 5)	$ 2,837,347	$ 0	$ 2,837,347	$ 1,296,001
Accrued Payroll				806
Intergovernmental Payables (Note 6)	148,991,075	1,294,742	150,285,817	144,234,496
Funds Held for Others	40,150		40,150	40,150
Due to Fiduciary Funds	30,744,535		30,744,535	28,924,249
Tax Refunds Payable (Note 3)	997,142,469		997,142,469	957,188,817
Unearned Revenue	351,200,000		351,200,000	336,200,000
Total Liabilities	1,530,955,576	1,294,742	1,532,250,318	1,467,884,519
DEFERRED INFLOWS OF RESOURCES				
Unavailable Revenues (Note 7)	81,882,430	3,041,082	84,923,512	78,029,914
FUND BALANCES (Note 10)				
Nonspendable	2,236,849		2,236,849	913,905
Committed	70,680,305	1,422,348	72,102,653	76,223,244
Unassigned	434,643,199		434,643,199	394,368,404
Total Fund Balances	507,560,353	1,422,348	508,982,701	471,505,553
Total Liabilities, Deferred Inflows, and Fund Balances	$ 2,120,398,359	$ 5,758,172	$ 2,126,156,531	$ 2,017,419,986

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, 2018
(With Comparative Totals for June 30, 2017)

Exhibit A-2

	General Fund	Special Revenue	Total 2018	Total 2017
REVENUES				
Tax Revenues	$ 23,463,466,687	$ 8,191,075	23,471,657,762	$ 22,536,712,512
Revenues from Other State Agencies (Note 12)	6,067,216		6,067,216	5,481,901
Services	1,890,043		1,890,043	1,918,930
Fees	2,536,082		2,536,082	2,464,254
Miscellaneous	161,656		161,656	139,437
Total Revenues	23,474,121,684	8,191,075	23,482,312,759	22,546,717,034
EXPENDITURES				
Statutory Tax Distributions	641,879,573	5,597,901	647,477,474	636,773,250
Contracted Services	15,714,370		15,714,370	13,174,923
Salaries and Benefits	99,477,394		99,477,394	96,649,674
Supplies and Materials	1,327,604		1,327,604	842,944
Travel	1,242,008		1,242,008	1,165,950
Communication	2,797,411		2,797,411	2,837,773
Utilities	151,984		151,984	135,232
Data Processing Services	4,930,396		4,930,396	4,651,941
Claims and Benefits	66,642		66,642	59,365
Other Services	3,617,300	21,615	3,638,915	4,618,680
Other Fixed Charges	5,980,740		5,980,740	5,883,473
Expenditures to Other State Agencies (Note 12)	4,000	1,865,364	1,869,364	2,909,370
Capital Outlay	4,927,580		4,927,580	5,736,632
Insurance and Bonding	41,490		41,490	42,012
Other Expenditures	5,297,501		5,297,501	5,004,305
Total Expenditures	787,455,993	7,484,880	794,940,873	780,485,524
Excess of Revenues Over Expenditures	22,686,665,691	706,195	22,687,371,886	21,766,231,510
OTHER FINANCING SOURCES (USES)				
State Appropriations	83,384,770		83,384,770	81,784,574
Sale of Capital Assets	500		500	820
Transfers In (Note 11)	694,180		694,180	588,669
Transfers Out (Note 11)	(22,731,569,316)	(694,180)	(22,732,263,496)	(21,830,706,739)
Transfers from State Reserve Fund	825,629		825,629	798,485
Transfers to State Reserve Fund	(2,536,321)		(2,536,321)	(1,127,629)
Total Other Financing Sources (Uses)	(22,649,200,558)	(694,180)	(22,649,894,738)	(21,748,661,820)
Net Change in Fund Balances	37,465,133	12,015	37,477,148	17,569,690
Fund Balances - July 1	470,095,220	1,410,333	471,505,553	453,935,863
Fund Balances - June 30	$ 507,560,353	$ 1,422,348	$ 508,982,701	$ 471,505,553

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 and other postemployment benefit 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 judgements payable, compensated absences, net pension liability, and net other postemployment benefits (OPEB) 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 2017 *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, deferred outflows of resources, and deferred inflows of resources related to pensions.

Net OPEB Liability – The net OPEB liability represents the Department's proportionate share of the collective net OPEB liability reported in the State of North Carolina's 2017 *Comprehensive Annual Financial Report*. This liability represents the Department's portion of the collective total OPEB liability less the fiduciary net position of the Retiree Health Benefit Fund. See Note 14 for further information regarding the Department's policies for recognizing liabilities, expenses, deferred outflows of resources, and deferred inflows of resources related to OPEB.

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 moneys received 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, authorizes the State Treasurer to invest all deposits in obligations of or fully guaranteed by the United States; obligations of certain federal agencies; specified repurchase agreements; obligations of the State of North Carolina; time deposits with specified financial institutions; prime quality commercial paper with specified ratings; specified bills of exchange or time drafts; asset-backed securities with specified ratings; and corporate bonds and notes with specified ratings.

At June 30, 2018, the governmental funds' Balance Sheet reported cash and cash equivalents of $97,315,109. 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 1.4 years as of June 30, 2018. 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/ 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, 2018. 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, the Department's investments held in the STIF were valued at $97,315,109. 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. Pool investments are measured at fair value in accordance with GASB 72. The Department's position in the pool is measured and reported at fair value and the STIF is not required to be categorized within the fair value hierarchy.

NOTE 3 - TAXES RECEIVABLE AND TAX REFUNDS PAYABLE

Taxes receivable for the General Fund at June 30, 2018, were reported as follows:

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
Taxes Receivable:			
Individual	$ 374,500,000	$ 0	$ 374,500,000
Sales and Use Tax	376,200,000		376,200,000
Corporate	39,300,000		39,300,000
Underwithholding - Individual	495,100,000		495,100,000
Other	121,779,780		121,779,780
Delinquent Receivables			
Individual	1,135,984,147	648,641,722	487,342,425
Sales and Use Tax	186,689,982	96,211,655	90,478,327
Corporate	15,052,714	8,788,281	6,264,433
Tobacco Products	23,219,656	18,939,853	4,279,803
Franchise	16,898,420	3,386,754	13,511,666
Estate	10,366,274	9,817,892	548,382
License and Excise	4,380,232	3,217,823	1,162,409
Alcoholic Beverage	670,392	585,160	85,232
Other	1,504,917	394,893	1,110,024
Total Taxes Receivable	$ 2,801,646,514	$ 789,984,033	$ 2,011,662,481

Within the General Fund, the significant receivables not expected to be collected within one year were $824 million of taxes receivable (gross).

See Exhibit E-1 Schedule of Aging of Taxes Receivable.

Taxes receivable for the Special Revenue Fund at June 30, 2018, were reported as follows:

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
Taxes Receivable:			
Unauthorized Substance Tax	$ 350,451,837	$ 346,947,319	$ 3,504,518
Total Taxes Receivable	$ 350,451,837	$ 346,947,319	$ 3,504,518

Tax refunds payable for the General Fund at June 30, 2018, were reported as follows:

	2018
Tax Refunds Payable:	
Individual	$ 606,300,000
Sales and Use Tax	275,300,000
Corporate	115,000,000
Other	542,469
Total Tax Refunds Payable	$ 997,142,469

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, 2018, is presented as follows:

	Balance July 1, 2017 (As Restated)[1]	Increases	Decreases	Balance June 30, 2018
Capital Assets, Nondepreciable:				
Computer Software in Development	$ 0	$ 0	$ 0	$ 0
Total Capital Assets, Nondepreciable				
Capital Assets, Depreciable:				
Equipment	11,034,385	95,139	749,500	10,380,024
Computer Software	34,153,665	3,646,305		37,799,970
Total Capital Assets, Depreciable	45,188,050	3,741,444	749,500	48,179,994
Less Accumulated Depreciation for:				
Equipment	3,854,676	438,367	358,779	3,934,264
Computer Software	5,564,952	1,552,458		7,117,410
Total Accumulated Depreciation	9,419,628	1,990,825	358,779	11,051,674
Total Capital Assets, Depreciable, Net	35,768,422	1,750,619	390,721	37,128,320
Capital Assets, Net	$ 35,768,422	$ 1,750,619	$ 390,721	$ 37,128,320

[1] Depreciation for Computer Software account have been restated by $6,016,679, $20,830, and $699,599 (respectively) due to a prior year asset adjustment.

NOTE 5 - ACCOUNTS PAYABLE

Accounts payable at June 30, 2018, were reported as follows:

Accounts Payable	2018
Accounts Payable	$ 2,770,119
Due to Employees	67,228
Total Accounts Payable	$ 2,837,347

NOTE 6 - INTERGOVERNMENTAL RECEIVABLES AND PAYABLES

Intergovernmental receivables and payables at June 30, 2018, were reported as follows:

	2018	
	General Fund	Special Revenue
Intergovernmental Receivables:		
Local Governments - Medicaid Hold Harmless:		
Distribution Returned	$ 384,275	$ 0
State Agencies - Payroll Taxes	10,679,748	
Total Intergovernmental Receivables	$ 11,064,023	$ 0
Intergovernmental Payables:		
Local Government Tax Distributions:		
Medicaid Hold Harmless	$ 11,274,699	$ 0
Alcoholic Beverage	9,629,559	
Real Estate Conveyance, White Goods Disposal, Scrap Tire Disposal, and Solid Waste Disposal	3,717,048	
Electricity	69,137,410	
Video Program	18,576,843	
Telecom	11,397,681	
Piped Natural Gas	4,752,954	
Unauthorized Substance		983,592
Total to Local Governments	128,486,194	983,592
Statutory Tax Distribution to the General Fund:		
White Goods Disposal	771,548	
Scrap Tire Disposal	3,649,171	
Solid Waste Disposal	1,582,950	
Unauthorized Substance		311,150
Total to General Fund	6,003,669	311,150
State Agencies:		
Department of Transportation - Aviation Fuel Taxes	7,434,303	
Department of Environmental Quality - Solid Waste Taxes	4,676,074	
Department of Information Technology - 911 Service Charges	2,390,835	
Total to State Agencies	14,501,212	
Total Intergovernmental Payables	$ 148,991,075	$ 1,294,742

NOTE 7 - DEFERRED INFLOWS OF RESOURCES

The various components of deferred inflows of resources at June 30, 2018, were reported as follows:

	Unavailable at June 30, 2017	Current Year Unavailable Increase	Prior Year Unavailable Earned in Current Year	Unavailable at June 30, 2018
General Fund:				
Estate Taxes	$ 104,994	$ 548,382	$ (104,994)	$ 548,382
Gift Taxes	2,428	1,235	(2,428)	1,235
License Taxes	935,993	1,105,654	(935,993)	1,105,654
Tobacco Taxes	475,510	4,255,702	(475,510)	4,255,702
Beverage Taxes	169,929	80,432	(169,929)	80,432
Franchise Taxes	6,157,121	12,867,946	(6,157,121)	12,867,946
Sales & Use Taxes	53,338,296	56,153,683	(53,338,296)	56,153,683
Corporate Taxes	4,936,601	5,829,820	(4,936,601)	5,829,820
White Goods Taxes	734	9,280	(734)	9,280
Scrap Tire Taxes	415,272	429,646	(415,272)	429,646
Manufacturing Taxes	103,879	444,025	(103,879)	444,025
Solid Waste Taxes	1,752	2,299	(1,752)	2,299
Insurance Taxes	1,019,349	154,326	(1,019,349)	154,326
	$ 67,661,858	$ 81,882,430	$ (67,661,858)	$ 81,882,430
Special Revenue Fund:				
Unauthorized Substance Taxes	$ 10,368,056	$ 3,041,082	$ (10,368,056)	$ 3,041,082
	$ 10,368,056	$ 3,041,082	$ (10,368,056)	$ 3,041,082

NOTE 8 - LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2018, is presented as follows:

General Fund	Balance July 1, 2017 (as Restated)[1]	Additions	Reductions	Balance June 30, 2018	Due Within One Year
Claims and Judgments Payable	$ 583,340,162	$ 0	$ 0	$ 583,340,162	$ 0
Compensated Absences	8,829,488	5,998,458	5,865,116	8,962,830	667,731
Net Pension Liability[2]	40,123,455		4,924,688	35,198,767	
Net Other Postemployment Benefits Liability[3]	153,806,267		25,609,366	128,196,901	
Total Long-Term Liabilities	$ 786,099,372	$ 5,998,458	$ 36,399,170	$ 755,698,660	$ 667,731

[1] The July 1, 2017 Net Other Postemployment benefit liability was restated in accordance with the implementation of GASB Statement No.75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions.*

[2] Additional information regarding the net pension liability is included in Note 13.

[3] Additional information regarding the net other postemployment benefits liability is included in Note 14.

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, 2018:

Fiscal Year	General Fund
2019	$ 3,002,752
2020	2,763,433
2021	2,207,059
2022	2,313,845
2023	2,077,316
2024-2028	5,949,098
Total Minimum Lease Payments	$ 18,313,503

Rental expense for all operating leases during the year ended June 30, 2018 was $2,965,656.

NOTE 10 - FUND BALANCE

The details of the fund balance classifications for the governmental funds at June 30, 2018, are as follows:

	2018		
	General Fund	Special Revenue	Total
Fund Balance:			
Nonspendable:			
Inventory of Supplies	$ 2,236,849	$ 0	$ 2,236,849
Committed to:			
General Government			
Project Collect Tax	65,130,887		65,130,887
Transaction Fees	4,846,185		4,846,185
Operations and Maintenance for Tax Systems	115,607		115,607
Other Committed	587,626		587,626
Unauthorized Substance Tax		1,422,348	1,422,348
Unassigned	434,643,199		434,643,199
Total Fund Balance	$ 507,560,353	$ 1,422,348	$ 508,982,701

NOTE 11 - INTERFUND TRANSFERS

Transfers in/out of other funds for the fiscal year ended June 30, 2018, consisted of the following:

	Transfers In			
	General Fund	State General Fund	Other State Funds	Total
Transfers Out				
General Fund	$ 0	$ 22,635,911,103	$ 95,658,213	$ 22,731,569,316
Special Revenue	694,180			694,180
Total	$ 694,180	$ 22,635,911,103	$ 95,658,213	$ 22,732,263,496

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) $68,698,497 to the Department of Public Instruction for the State Public School Fund per General Statute 105-164.44H, (2) $22,784,926 to the Department of Insurance for Workers' Compensation and Volunteer Fire Department Funds per General Statute 105-228.5, and (3) $4,174,790 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, 2018, in the amount of $48,808,277, 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, 2018, are as follows:

General Fund:	Purpose	Amount
Revenues from Other State Agencies:		
Department of Transportation	Motor Fuels Reimbursement	$ 3,885,849
Department of Transportation	Fuel Tax Compliance Reimbursement	1,322,201
Department of Transportation	International Registration Plan Reimbursement	206,142
Department of Transportation	Project Collect Tax	49,473
Department of Information Technology	Information Technology Security Positions	370,922
Department of Insurance	Insurance Reimbursement	108,725
Department of Agriculture and Consumer Services	Forestry Reimbursement	103,460
Department of Commerce	Job Development Investment Grants	20,444
Total Revenues from Other State Agencies		$ 6,067,216

	Purpose	Amount
Expenditures to Other State Agencies:		
Statewide General Fund	William S. Lee Fees	4,000
Total Expenditures to Other State Agencies		$ 4,000

Special Revenue Fund:	Purpose	Amount
Expenditures to Other State Agencies:		
Statewide General Fund	25% Transfer to General Fund	$ 1,865,364
Total Expenditures to Other State Agencies		$ 1,865,364

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, 2018 was 10.78% of covered payroll. Employee contributions to the pension plan were $4,215,675, and the Department's contributions were $7,574,162 for the year ended June 30, 2018.

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 2017 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at https://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 also determined using the accrual basis of accounting.

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 External Investment Pool. TSERS and other pension plans of the State of North Carolina are the sole participants in the Long-Term Investment, Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Opportunistic Fixed Income Investment, and Inflation Sensitive Investment Portfolios. The Fixed Income Asset Class includes the Long-Term Investment and 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 External Investment Pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2017 *Comprehensive Annual Financial Report*.

Net Pension Liability: At June 30, 2018, the Department reported a liability of $35,198,767 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2017. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2016, and update procedures were used to roll forward the total pension liability to June 30, 2017. 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, 2017, the Department's proportion was 0.44362%, which was an increase of 0.00707 from its proportion measured as of June 30, 2016, which was 0.43655%.

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	12/31/2016
Inflation	3%
Salary Increases*	3.50% - 8.10%
Investment Rate of Return**	7.20%

* Salary increases include 3.5% inflation and productivity factor.

** Investment rate of return includes inflation assumption and is net of pension plan investment expense.

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 mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2016 valuations were based on the results of an actuarial experience review for the period January 1, 2010 through December 31, 2014.

Future ad hoc Cost of Living Adjustment 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, 2017 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Opportunistic Fixed Income	6.0%
Inflation Sensitive	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. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2017 is 1.3%.

Discount Rate: The discount rate used to measure the total pension liability was lowered from 7.25% to 7.20% for the December 31, 2016 valuation. This discount rate is in line with the long-term nominal expected return on pension plan investments. The calculation of the net pension liability is a present value calculation of the future net pension payments. These net pension payments assume that contributions from plan members will be made at the current statutory contribution rate and that contributions from employers will be made at the contractually 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, 2017 calculated using the discount rate of 7.20%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.20%) or 1-percentage point higher (8.20%) than the current rate:

Net Pension Liability		
1% Decrease (6.20%)	Current Discount Rate (7.20%)	1% Increase (8.20%)
$ 72,453,633	$ 35,198,767	$ 3,983,938

Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: For the year ended June 30, 2018, the Department recognized pension expense of $10,090,390. At June 30, 2018, 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	$ 763,044	$ 1,151,535
Changes of Assumptions	5,560,874	
Net Difference Between Projected and Actual Earnings on Plan Investments	4,763,587	
Change in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions	1,480,174	
Contributions Subsequent to the Measurement Date	7,798,971	
Total	$ 20,366,650	$ 1,151,535

The amount of $7,798,971 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be included as a reduction of the net pension liability in the fiscal year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as 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
2019	$ 2,532,098
2020	7,216,250
2021	3,574,235
2022	(1,906,439)
2023	
Total	$ 11,416,144

NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS

The Department participates in two postemployment benefit plans, the Retiree Health Benefit Fund and the Disability Income Plan of North Carolina, that are administered by the State of North Carolina as pension and other employee benefit trust funds. Each plan's financial information, including all information about the plans' 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 2017 *Comprehensive Annual Financial Report.* An electronic version of this report is available on the North Carolina Office of the State Controller's website at https://www.osc.nc.gov/ or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

A. Summary of Significant Accounting Policies and Plan Asset Matters

Basis of Accounting: The financial statements of these postemployment benefit (OPEB) plans were prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the terms of each plan. The fiduciary net position of each OPEB plan was also determined using the accrual basis of accounting.

Methods Used to Value Plan Investments: Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the other postemployment benefits funds. The State Treasurer maintains various investment portfolios in its External Investment Pool. The Retiree Health Benefit Fund participates in the External Investment Pool. The Disability Income Plan of North Carolina is invested in the Short-Term Investment Portfolio of the External Investment Pool and the Bond Index External Investment Pool. The investment balance of each other employee benefit 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 2017 *Comprehensive Annual Financial Report.*

B. Plan Descriptions

1. Health Benefits

Plan Administration: The State of North Carolina administers the North Carolina State Health Plan for Teachers and State Employees, referred to as the State Health Plan (the Plan), a healthcare plan exclusively for the benefit of employees of the State, the University of North Carolina System, community colleges, and certain other component units. In addition, Local Education Agencies (LEAs), charter schools, and some select local governments that are not part of the State's financial reporting entity also participate. Health benefit programs and premium rates are determined by the State Treasurer upon approval of the Plan Board of Trustees.

The Retiree Health Benefit Fund (RHBF) has been established as a fund to provide health benefits to retired and disabled employees and their applicable beneficiaries. RHBF is established by General Statute 135-7, Article 1. RHBF is a cost-sharing, multiple-employer, defined benefit healthcare plan, exclusively for the benefit of eligible former employees of the State, the University of North Carolina System, and community colleges. In addition, LEAs, charter schools, and some select local governments that are not part of the State's financial reporting entity also participate.

By statute, RHBF is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System (TSERS). RHBF is supported by a percent of payroll contribution from participating employing units. Each year the percentage is set in legislation, as are the maximum per retiree contributions from RHBF to the Plan. The State Treasurer, with the approval of the Plan Board of Trustees, then sets the employer contributions (subject to the legislative cap) and the premiums to be paid by retirees, as well as the health benefits to be provided through the Plan.

Benefits Provided: Plan benefits received by retired employees and disabled employees from RHBF are OPEB. The healthcare benefits for retired and disabled employees who are not eligible for Medicare are the same as for active employees as described in Note 15. The plan options change when former employees become eligible for Medicare. Medicare retirees have the option of selecting one of two fully-insured Medicare Advantage/Prescription Drug Plan options or the self-funded Traditional 70/30 Preferred Provider Organization plan option that is also offered to non-Medicare members. If the Traditional 70/30 Plan is selected by a Medicare retiree, the self-funded State Health Plan coverage is secondary to Medicare.

Those former employees who are eligible to receive medical benefits from RHBF are long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of TSERS with five or more years of contributory membership service in their retirement system prior to disability or retirement, with the following exceptions: for employees first hired on or after October 1, 2006, and members of the General Assembly first taking office on or after February 1, 2007, future coverage as retired employees and retired members of the General Assembly is subject to the requirement that the future retiree have 20 or more years of retirement service credit in order to receive coverage on a noncontributory basis. Employees first hired on or after October 1, 2006 and members of the General Assembly first taking office on or after February 1, 2007 with 10 but less than 20 years of retirement service credit are eligible for coverage on a partially contributory basis. For such future retirees, the State will pay 50% of the State Health Plan's total noncontributory premium.

The Plan's and RHBF's benefit and contribution provisions are established by Chapter 135-7, Article 1, and Chapter 135, Article 3B of the General Statutes and may be amended only by the North Carolina General Assembly. RHBF does not provide for automatic post-retirement benefit increases.

Contributions: Contribution rates to RHBF, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill. The Department's contractually-required contribution rate for the year ended June 30, 2018 was 6.05% of covered payroll. The Department's contributions to the RHBF were $4,250,805 for the year ended June 30, 2018.

2. Disability Income

Plan Administration: As discussed in Note 15, short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer, defined benefit plan, to the eligible members of TSERS. By statute, DIPNC is administered by the Department of State Treasurer and the Board of Trustees of TSERS.

Benefits Provided: Long-term disability benefits are payable as an OPEB from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in TSERS earned within 96 months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from TSERS; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from TSERS after (1) reaching the age of 65 and completing five years of membership service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

For employees who had five or more years of membership service as of July 31, 2007, during the first 36 months of the long-term disability period, the monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one-twelfth of the annual longevity payment and local supplements to which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of $3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than $10 a month. After the first 36 months of the long-term disability, the long-term benefit is calculated in the same manner as described above except the monthly benefit is reduced by an amount equal to a monthly primary Social Security disability benefit to which the participant or beneficiary might be entitled had Social Security disability benefits been awarded. When an employee qualifies for an unreduced service retirement allowance from TSERS, the benefits payable from DIPNC will cease, and the employee will commence retirement under TSERS.

For employees who had less than five years of membership service as of July 31, 2007, and meet the requirements for long-term disability on or after August 1, 2007, during the first 36 months of the long-term disability period, the monthly long-term benefit shall be reduced by an amount equal to the monthly primary Social Security retirement benefit to which the employee might be entitled should the employee become age 62 during the first 36 months. This reduction becomes effective as of the first day of the month following the month of initial entitlement to Social Security benefits. After the first 36 months of the long-term disability, no further benefits are payable under the terms of this section unless the employee has been approved and is in receipt of primary Social Security disability benefits.

Contributions: Although DIPNC operates on a calendar year, disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly and coincide with the State's fiscal year. The Department's contractually-required contribution rate for the year ended June 30, 2018 was 0.14% of covered payroll. The Department's contributions to DIPNC were $98,366 for the year ended June 30, 2018.

C. Net OPEB Liability (Asset)

Net OPEB Liability: At June 30, 2018, the Department reported a liability of $128,196,901 for its proportionate share of the collective net OPEB liability for RHBF. The net OPEB liability was measured as of June 30, 2017. The total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of December 31, 2016, and update procedures were used to roll forward the total OPEB liability to June 30, 2017. The Department's proportion of the net OPEB 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, 2017, the Department's proportion was 0.39100%, which was an increase of 0.03745 from its proportion measured as of June 30, 2016, which was 0.35355%.

Net OPEB Asset: At June 30, 2018, the Department reported an asset of $237,256 for its proportionate share of the collective net OPEB asset for DIPNC. The net OPEB asset was measured as of June 30, 2017. The total OPEB asset used to calculate the net OPEB asset was determined by an actuarial valuation as of December 31, 2016, and update procedures were used to roll forward the total OPEB asset to June 30, 2017. The Department's proportion of the net OPEB asset 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, 2017, the Department's proportion was 0.38818%, which was an increase of 0.00346 from its proportion measured as of June 30, 2016, which was 0.38472%.

Actuarial Assumptions: The total OPEB liabilities (assets) for RHBF and DIPNC were determined by actuarial valuations as of December 31, 2016, using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified. The total OPEB liabilities (assets) were then rolled forward to June 30, 2017 utilizing update procedures incorporating the actuarial assumptions.

	Retiree Health Benefit Fund	Disability Income Plan of N. C.
Valuation Date	12/31/2016	12/31/2016
Inflation	2.75%	3.00%
Salary Increases*	3.50% - 8.10%	3.50% - 8.10%
Investment Rate of Return**	7.20%	3.75%
Healthcare Cost Trend Rate - Medical	5.00% - 6.50%	N/A
Healthcare Cost Trend Rate - Prescription Drug	5.00% - 7.25%	N/A
Healthcare Cost Trend Rate - Medicare Advantage	4.00% - 5.00%	N/A
Healthcare Cost Trend Rate - Administrative	3.00%	N/A

* Salary increases include 3.5% inflation and productivity factor.

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

N/A - Not Applicable

The OPEB plans currently use 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 studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The projected long-term investment returns and inflation assumptions are developed through a 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 projects 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. DIPNC is primarily invested in the Bond Index Investment Pool as of June 30, 2017.

Best estimates of real rates of return for each major asset class included in RHBF's target asset allocation as of June 30, 2017 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Opportunistic Fixed Income	6.0%
Inflation Sensitive	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. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2017 is 1.3%.

Actuarial valuations of the plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The actuarial assumptions used for RHBF are consistent with those used to value the pension benefits of TSERS where appropriate. These assumptions are based on the most recent pension valuations available. The discount rate used for RHBF reflects a pay-as-you-go approach.

Projections of benefits for financial reporting purposes of the plans are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and historical pattern of sharing of benefit costs between the employer and plan members to that point. Historically, the benefits funded solely by employer contributions applied equally to all retirees. Currently, as described earlier in the note, benefits are dependent on membership requirements.

The actuarial methods and assumptions used for DIPNC include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The actuarial assumptions used in the December 31, 2016 valuations were based on the results of an actuarial experience study prepared as of December 31, 2014.

Discount Rate: The discount rate used to measure the total OPEB liability for RHBF was 3.58%. The projection of cash flows used to determine the discount rate assumed that contributions from employers will be made at the current statutorily determined contribution rate. Based on the above assumptions, the plan's fiduciary net position was not projected to be available to make projected future benefit payments of current plan members. As a result, a municipal bond rate of 3.58% was used as the discount rate used to measure the total OPEB liability. The 3.58% rate is based on the Bond Buyer 20-year General Obligation Index as of June 30, 2017.

The discount rate used to measure the total OPEB asset for DIPNC was 3.75%. 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 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 plan investments was applied to all periods of projected benefit payments to determine the total OPEB asset.

Sensitivity of the Net OPEB Liability (Asset) to Changes in the Discount Rate: The following presents the Department's proportionate share of the net OPEB liability (asset) of the plans, as well as what the plans' net OPEB liability (asset) would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current discount rate:

	Net OPEB Liability (Asset)		
	1% Decrease (2.58%)	Current Discount Rate (3.58%)	1% Increase (4.58%)
RHBF	$ 152,930,110	$ 128,196,901	$ 108,577,807
	1% Decrease (2.75%)	Current Discount Rate (3.75%)	1% Increase (4.75%)
DIPNC	$ (201,702)	$ (237,256)	$ (272,891)

Sensitivity of the Net OPEB Liability (Asset) to Changes in the Healthcare Cost Trend Rates: The following presents the net OPEB liability (asset) of the plans, as well as what the plans' net OPEB liability (asset) would be if it were calculated using healthcare cost trend rates that are 1-percentage point lower or 1-percentage point higher than the current healthcare cost trend rates:

	1% Decrease (Medical - 4.00 - 5.50%, Pharmacy - 4.00 - 6.25%, Med. Advantage - 3.00 - 4.00%, Administrative - 2.00%)	Current Healthcare Cost Trend Rates (Medical - 5.00 - 6.50%, Pharmacy - 5.00 - 7.25%, Med. Advantage - 4.00 - 5.00%, Administrative - 3.00%)	1% Increase (Medical - 6.00 - 7.50%, Pharmacy - 6.00 - 8.25%, Med. Advantage - 5.00 - 6.00%, Administrative - 4.00%)
RHBF Net OPEB Liability	$ 104,724,083	$ 128,196,901	$ 159,392,483
DIPNC Net OPEB Asset	N/A	N/A	N/A

Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB: For the year ended June 30, 2018, the Department recognized OPEB expense of $9,127,576 for RHBF and $131,947 for DIPNC. At June 30, 2018, the Department reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

Employer Balances of Deferred Outflows of Resources
Related to OPEB by Classification:

	RHBF	DIPNC	Total
Differences Between Actual and Expected Experience	$ 0	$ 65,051	$ 65,051
Changes of Assumptions			
Net Difference Between Projected and Actual Earnings on Plan Investments		52,004	52,004
Changes in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions	13,858,905	17,679	13,876,584
Contributions Subsequent to the Measurement Date	4,376,973	101,285	4,478,258
Total	$ 18,235,878	$ 236,019	$ 18,471,897

Employer Balances of Deferred Inflows of Resources
Related to OPEB by Classification:

	RHBF		DIPNC		Total	
Differences Between Actual and Expected Experience	$	9,191,954	$	0	$	9,191,954
Changes of Assumptions		35,304,841				35,304,841
Net Difference Between Projected and Actual Earnings on Plan Investments		47,644				47,644
Changes in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions						
Total	$	44,544,439	$	0	$	44,544,439

Amounts reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability related to RHBF and an increase of the net OPEB asset related to DIPNC in the fiscal year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB 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 OPEB Expense:

Year Ended June 30:	RHBF		DIPNC	
2019	$	(6,139,489)	$	40,585
2020		(6,139,489)		40,585
2021		(6,139,489)		40,573
2022		(6,139,489)		12,991
2023		(6,127,578)		
Total	$	(30,685,534)	$	134,734

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 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 contributions. Certain plans also require contributions from employees. The Plan has contracted with third parties to process claims. See Note 14, Other Postemployment Benefits, for additional information regarding retiree health benefits

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 0.16% for the current fiscal year.

3. Disability Income Plan

Short-term and long-term disability benefits are provided to Department employees through the Disability Income Plan of North Carolina (DIPNC), part of the State's Pension and Other Employee Benefit Trust Funds. Short-Term benefits are paid by the Department up to the first six months of benefits and reimbursed by DIPNC for any additional short-term benefits. As discussed in Note 14, long-term disability benefits are payable as other postemployment benefits from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled.

B. Other Risk Management and Insurance Activities

1. Automobile, Fire, and Other Property Losses

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

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

2. Public Officers' and Employees' Liability Insurance

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

3. Employee Dishonesty and Computer Fraud

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

4. Statewide Workers' Compensation Program

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

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

NOTE 16 CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2018, the Department implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*
- GASB Statement No. 85, *Omnibus 2017*

GASB Statement No. 75 improves accounting and financial reporting requirements by state and local governments for postemployment benefits other than pensions (OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB.

GASB Statement No. 85 addresses practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and OPEB).

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, 2018 ***Exhibit B-1***

	Budgeted Amounts			Favorable
	Original	**Final**	**Actual**	**(Unfavorable)**
REVENUES				
Tax Revenues[1]	$ 22,286,800,000	$ 22,278,300,000	$ 22,683,369,993	$ 405,069,993
Revenues from Other State Agencies	7,834,550	7,866,895	6,066,079	(1,800,816)
Services	2,488,274	2,525,814	1,890,043	(635,771)
Fees	2,182,242	2,484,574	2,536,082	51,508
Miscellaneous	591,541	1,021,749	158,651	(863,098)
Total Revenues	22,299,896,607	22,292,199,032	22,694,020,848	401,821,816
EXPENDITURES				
Contracted Services	25,180,980	36,299,301	15,620,581	20,678,720
Salaries and Benefits	113,659,935	107,414,056	99,523,605	7,890,451
Supplies and Materials	831,604	923,020	751,259	171,761
Travel	1,528,078	1,559,102	1,226,588	332,514
Communication	3,529,870	3,916,066	2,791,479	1,124,587
Utilities	186,195	195,942	149,288	46,654
Data Processing Services	10,473,580	6,060,084	4,902,780	1,157,304
Claims and Benefits	14,323	66,870	66,642	228
Other Services	4,338,147	5,943,049	5,494,709	448,340
Other Fixed Charges	8,851,928	6,228,610	5,912,687	315,923
Expenditures to Other State Agencies	299,500	299,500	4,000	295,500
Capital Outlay	5,826,908	5,748,311	4,344,654	1,403,657
Insurance and Bonding	43,955	48,573	41,490	7,083
Other Expenditures	6,007,843	5,766,677	5,296,750	469,927
Total Expenditures	180,772,846	180,469,161	146,126,512	34,342,649
Excess of Revenues Over Expenditures	22,119,123,761	22,111,729,871	22,547,894,336	436,164,465
OTHER FINANCING SOURCES (USES)				
State Appropriations	84,662,631	84,662,631	83,384,770	(1,277,861)
Sale of Capital Assets	1,000	1,000	1,000	
Transfers from Other Departments or Funds	2,248,146	2,248,146	2,235,002	(13,144)
Transfers from the State Reserve Fund		1,127,629	825,629	(302,000)
Transfers to the State Reserve Fund		(2,536,321)	(2,536,321)	
Transfers to the State General Fund[1]	(22,286,800,000)	(22,278,300,000)	(22,635,911,103)	(357,611,103)
Total Other Financing Sources (Uses)	(22,199,888,223)	(22,192,796,915)	(22,552,001,023)	(359,204,108)
Net Change in Fund Balance	(80,764,462)	(81,067,044)	(4,106,687)	76,960,357
Fund Balance - July 1	71,538,313	71,538,313	71,538,313	
Fund Balance - June 30	$ (9,226,149)	$ (9,528,731)	$ 67,431,626	$ 76,960,357

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

1 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.

The following table presents a reconciliation of resulting basis differences in the fund balance (budgetary basis) at June 30, 2018 to the fund balance on a modified accrual basis (GAAP).

	General Fund
Fund Balance (Budgetary Basis) June 30, 2018	$ 67,431,626
Reconciling Adjustments:	
Basis Differences:	
Accrued Revenues:	
Accounts Receivable	267,232
Intergovernmental Receivable	11,064,023
Due from Other Funds	66,019
Taxes Receivable	2,011,662,481
Other Receivables	
Less:	
Unearned Revenue	(351,200,000)
Total Accrued Revenues	1,671,859,755
Accrued Expenditures:	
Accounts Payable	(2,837,347)
Tax Refund Payable	(997,142,469)
Accrued Payroll	
Intergovernmental Payables	(148,991,075)
Total Accrued Expenditures	(1,148,970,891)
Other Adjustments:	
Inventories	2,236,849
Securities Held in Trust (Sureties)	40,300
Due to Fiduciary Funds	(30,744,535)
Funds Held for Others	(40,150)
Unavailable Revenue	(81,882,430)
Undistributed E-911 Funds	2,391,327
Undeposited Receipts	17,124,232
General Fund Tax Reserves	8,114,270
Fund Balance (GAAP Basis) June 30, 2018	$ 507,560,353

SUPPLEMENTARY INFORMATION

North Carolina Department of Revenue
Balance Sheet
General Fund - Company 45
As of June 30, 2018
(With Comparative Totals for June 30, 2017) ***Exhibit C-1***

		2018		2017
ASSETS				
Cash and Cash Equivalents	$	69,826,356	$	74,125,371
Accounts Receivable		194,797		418,931
Securities Held in Trust (Sureties)		40,300		40,300
Due from Company 99[1]		3,304,567		3,486,665
Due from Other Funds		66,019		72,800
Inventories		2,236,849		913,905
Total Assets		75,668,888		79,057,972
DEFERRED OUTFLOWS OF RESOURCES				
Total Deferred Outflows of Resources		0		0
Total Assets and Deferred Outflows of Resources	$	75,668,888	$	79,057,972
LIABILITIES				
Accounts Payable and Accrued Liabilities:				
Accounts Payable	$	2,308,499	$	1,177,762
Accrued Payroll				806
Intergovernmental Payables		2,390,835		3,165,462
Funds Held for Others		40,150		40,150
Total Liabilities		4,739,484		4,384,180
DEFERRED INFLOWS OF RESOURCES				
Total Deferred Inflows of Resources		0		0
FUND BALANCE				
Nonspendable		2,236,849		913,905
Committed		70,680,305		74,812,911
Unassigned		(1,987,750)		(1,053,024)
Total Fund Balance		70,929,404		74,673,792
Total Liabilities, Deferred Inflows, and Fund Balance	$	75,668,888	$	79,057,972

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.

[1]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, 2018
(With Comparative Totals for June 30, 2017) ***Exhibit C-2***

	2018	2017
REVENUES		
Revenues from Other State Agencies	$ 6,067,216	$ 5,481,901
Revenues from Company 99[1]	48,808,277	41,543,613
Services	1,890,043	1,918,930
Fees	2,536,082	2,464,254
Miscellaneous	161,656	139,437
Total Revenues	59,463,274	51,548,135
EXPENDITURES		
Contracted Services	15,714,370	13,174,923
Salaries and Benefits	99,477,394	96,649,674
Supplies and Materials	1,327,604	842,944
Travel	1,242,008	1,165,950
Communication	2,797,411	2,837,773
Utilities	151,984	135,232
Data Processing Services	4,930,396	4,651,941
Claims and Benefits	66,642	59,365
Other Services	3,617,300	4,561,765
Other Fixed Charges	5,980,740	5,883,473
Expenditures to Other State Agencies	4,000	1,318,260
Capital Outlay	4,927,580	5,736,632
Insurance and Bonding	41,490	42,012
Other Expenditures	5,297,501	4,998,852
Total Expenditures	145,576,420	142,058,796
Deficit of Revenues Under Expenditures	(86,113,146)	(90,510,661)
OTHER FINANCING SOURCES (USES)		
State Appropriations	83,384,770	81,784,574
Sale of Capital Assets	500	820
Transfers In	694,180	588,669
Transfers from State Reserve Fund	825,629	798,485
Transfers to State Reserve Fund	(2,536,321)	(1,127,629)
Total Other Financing Sources (Uses)	82,368,758	82,044,919
Net Change in Fund Balance	(3,744,388)	(8,465,742)
Fund Balance - July 1	74,673,792	83,139,534
Fund Balance - June 30	$ 70,929,404	$ 74,673,792

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.

[1]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, 2018
(With Comparative Totals for June 30, 2017) ***Exhibit C-3***

	2018	2017
ASSETS		
Cash and Cash Equivalents	$ 2,253,654	$ 2,795,705
Receivables:		
Intergovernmental Receivables		
Taxes Receivable, Net	3,504,518	10,739,322
Total Assets	5,758,172	13,535,027
DEFERRED OUTFLOWS OF RESOURCES		
Total Deferred Outflows of Resources	0	0
Total Assets and Deferred Outflows of Resources	$ 5,758,172	$ 13,535,027
LIABILITIES		
Intergovernmental Payables	$ 1,294,742	$ 1,756,638
Total Liabilities	1,294,742	1,756,638
DEFERRED INFLOWS OF RESOURCES		
Unavailable Revenues	3,041,082	10,368,056
FUND BALANCE		
Committed	1,422,348	1,410,333
Total Fund Balance	1,422,348	1,410,333
Total Liabilities, Deferred Inflows, and Fund Balance	$ 5,758,172	$ 13,535,027

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, 2018
(With Comparative Totals for June 30, 2017) — *Exhibit C-4*

	2018	2017
REVENUES		
Tax Revenues	$ 8,191,075	$ 7,097,588
Total Revenues	8,191,075	7,097,588
EXPENDITURES		
Other Services	21,615	56,915
Expenditures to Other Agencies	1,865,364	1,591,110
Statutory Tax Distributions	5,597,901	4,794,821
Other Expenditures		5,453
Total Expenditures	7,484,880	6,448,299
Excess of Revenues Over Expenditures	706,195	649,289
OTHER FINANCING (USES)		
Transfers Out	(694,180)	(588,669)
Total Other Financing (Uses)	(694,180)	(588,669)
Net Change in Fund Balance	12,015	60,620
Fund Balance - July 1	1,410,333	1,349,713
Fund Balance - June 30	$ 1,422,348	$ 1,410,333

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, 2018
(With Comparative Totals for June 30, 2017) ***Exhibit C-5***

	2018	2017
ASSETS		
Cash and Cash Equivalents	$ 25,235,099	$ 20,449,053
Receivables:		
Accounts Receivable	72,435	276,630
Intergovernmental Receivables	11,064,023	11,471,998
Taxes Receivable, Net	2,011,662,481	1,896,115,971
Total Assets	2,048,034,038	1,928,313,652
DEFERRED OUTFLOWS OF RESOURCES		
Total Deferred Outflows of Resources	0	0
Total Assets and Deferred Outflows of Resources	$ 2,048,034,038	$ 1,928,313,652
LIABILITIES		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	$ 528,848	$ 118,239
Intergovernmental Payables	146,600,240	139,312,396
Due to Fiduciary Funds	30,744,535	28,924,249
Due to Company 45[1]	3,304,567	3,486,665
Tax Refunds Payable	997,142,469	957,188,817
Unearned Revenue	351,200,000	336,200,000
Total Liabilities	1,529,520,659	1,465,230,366
DEFERRED INFLOWS OF RESOURCES		
Unavailable Revenues	81,882,430	67,661,858
FUND BALANCE		
Unassigned	436,630,949	395,421,428
Total Fund Balance	436,630,949	395,421,428
Total Liabilities, Deferred Inflows, and Fund Balance	$ 2,048,034,038	$ 1,928,313,652

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.

[1]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, 2018
(With Comparative Totals for June 30, 2017) ***Exhibit C-6***

	2018	2017
REVENUES		
Tax Revenues	$ 23,463,466,687	$ 22,529,614,924
Miscellaneous		
Total Revenues	23,463,466,687	22,529,614,924
EXPENDITURES		
Statutory Tax Distributions	641,879,573	631,978,429
Expenditures to Company 45[1]	48,808,277	41,543,613
Total Expenditures	690,687,850	673,522,042
Excess of Revenues Over Expenditures	22,772,778,837	21,856,092,882
OTHER FINANCING (USES)		
Transfers Out	(22,731,569,316)	(21,830,118,070)
Total Other Financing (Uses)	(22,731,569,316)	(21,830,118,070)
Net Change in Fund Balance	41,209,521	25,974,812
Fund Balance - July 1	395,421,428	369,446,616
Fund Balance - June 30	$ 436,630,949	$ 395,421,428

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.

[1]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, 2018 — *Exhibit D-1*

Source of Revenue	Gross Revenue	Refunds	Reserves for Local Government	Other Transfers	Net Revenue
Estate Tax	$ 10,715,395	$ 24,007	$ 0	$ 67,211	$ 10,624,177
Privilege License Tax	33,209,781	183,408		594,465	32,431,908
Tobacco Products Tax	293,066,231	808,385		31,966,270	260,291,576
Franchise Tax	696,618,395	22,155,614		5,416,541	669,046,240
Individual Income Tax	13,831,315,228	1,182,416,054		131,358,257	12,517,540,917
Sales and Use Tax	12,004,272,251	634,602,259	3,364,526,155	667,696,537	7,337,447,300
Alcoholic Beverage Tax	410,373,215	189,115	38,859,777	204,011	371,120,312
Gift Tax	43,506			353	43,153
Freight Car Lines Tax	306,605				306,605
Insurance Tax	655,845,743	20,127,779		69,612,640	566,105,324
Corporate Income Tax	920,343,033	177,527,048		3,770,772	739,045,213
Real Estate Conveyance Tax	72,945,222	17,728			72,927,494
White Goods Disposal Tax	9,361,617	21,927	5,081,805	309,483	3,948,402
Scrap Tire Disposal Tax	19,837,432	49,889	13,564,822	418,103	5,804,618
Manufacturing Tax	48,039,063	954,622		370,197	46,714,244
Solid Waste Disposal Tax	20,476,020	608,128	7,400,368	10,003,942	2,463,582
Miscellaneous Tax Receipts	5,501,331	935,000		4,516,292	50,039
Total General Fund Revenue	$ 29,032,270,068	$ 2,040,620,963	$ 3,429,432,927	$ 926,305,074	$ 22,635,911,104
Special Revenue Fund - Unauthorized Substances Tax	$ 8,847,947	$ 175,138	$ 0	$ 9,348,036	$ (675,227)

The following table presents a reconciliation of the fund balances (cash basis) to the fund balances on a modified accrual basis (GAAP) at June 30, 2018.

	General Fund	Special Revenue
Tax Revenues (Cash Basis) June 30, 2018	$ 22,635,911,104	$ (675,227)
Reconciling Adjustements and Accruals:		
Reserve for Local Government	64,906,772	
Other Transfers	715,148,262	9,348,036
Accural Entries	47,500,549	223,471
Year-End Reclassification		(705,205)
Tax Revenues (GAAP Basis) June 30, 2018 (See Exhibit A-2)	$ 23,463,466,687	$ 8,191,075

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-2

Source of Revenue	Gross Revenue	Refunds	Reserves for Local Government	Other Transfers	Net Revenue
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
Total General Fund Revenue	$ 28,081,986,509	$ 2,215,627,666	$ 3,194,732,248	$ 934,461,979	$ 21,737,164,616
Special Revenue Fund - Unauthorized Substances Tax	$ 7,991,868	$ 364,364	$ 0	$ 6,838,080	$ 789,424

The following table presents a reconciliation of the fund balances (cash basis) to the fund balances on a modified accrual basis (GAAP) at June 30, 2017.

	General Fund	Special Revenue
Tax Revenues (Cash Basis) June 30, 2017	$ 21,737,164,616	$ 789,424
Reconciling Adjustements and Accruals:		
Reserve for Local Government	63,383,377	
Other Transfers	706,054,145	6,838,080
Accural Entries	23,012,785	86,853
Year-End Reclassification		(616,769)
Tax Revenues (GAAP Basis) June 30, 2017 (See Exhibit A-2)	$ 22,529,614,924	$ 7,097,588

North Carolina Department of Revenue
Schedule of Aging of Taxes Receivable
General Fund - Company 99
As of June 30, 2018 *Exhibit E-1*

		Delinquent Receivables (in years)			
Tax Type	**Less than 1**	**1 to 5**	**5 to 10**	**More than 10**	**Total**
Individual	$ 440,744,118	$ 465,680,663	$ 190,904,438	$ 23,992,069	$ 1,121,321,288
Corporate	6,713,208	7,490,749	450,147	48,519	14,702,623
Sales and Use	50,711,856	73,570,676	52,849,507	4,276,240	181,408,279
Franchise	13,676,733	2,758,745	423,520	225,536	17,084,534
Scrap Tire	135,125	176,243	171,491	3,294	486,153
White Goods	10,793	434	137		11,364
Manufacturing	509,548	77,548	1,591	298	588,985
Solid Waste	3,070				3,070
License and Excise	692,044	787,259	228,795	11,220	1,719,318
	$ 513,196,495	$ 550,542,317	$ 245,029,626	$ 28,557,176	1,337,325,614

Reconciling Adjustments:

Non-Aged Tax Receivable Balances in Public Sector Revenue Management (PSRM):

Tobacco Products	$ 23,219,656	
Estate	10,366,275	
License and Excise	2,666,133	
Alcoholic Beverage	670,393	
Gift	241,015	
Insurance	162,860	
Total PSRM Receivables Balance		37,326,332
Other Adjustments:		
Unposted Accrued Interest for June 30, 2018		29,123,088
July Adjustments		(9,008,300)
Delinquent Receivables (Gross) - General Fund		$ 1,394,766,734

North Carolina Department of Revenue
Schedule of Aging of Taxes Receivable
General Fund - Company 99
As of June 30, 2017 *Exhibit E-2*

		Delinquent Receivables (in years)			
Tax Type	**Less than 1**	**1 to 5**	**5 to 10**	**More than 10**	**Total**
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
	$ 599,547,304	$ 647,173,816	$ 308,825,470	$ 32,190,989	1,587,737,579

Reconciling Adjustments:

Non-Aged Tax Receivable Balances in Public Sector Revenue Management (PSRM):

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	
Total PSRM Receivables Balance		40,154,926
Other Adjustments:		
Unposted Accrued Interest for June 30, 2017		29,123,088
July Adjustments		(16,366,048)
Delinquent Receivables (Gross) - General Fund		$ 1,640,649,545

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, 2018 — ***Exhibit F-1***
(With Comparative Totals for June 30, 2017) — ***Page 1 of 2***

	2018	2017
Expenditures Paid for Department Operations and Administration:		
Contracted Services:		
Other Information Technology Services	$ 4,472,055	$ 6,827,108
Temporary Agency and Administrative Services	9,051,472	4,099,959
IT Project Management and Analysis Services		33,354
Legal Services	185,359	205,428
Financial and Audit Services	243,125	222,470
Security Services	669,645	620,073
Janitorial and Waste Services	98,434	97,345
Miscellaneous Contractual Services	994,280	1,069,186
Total Contracted Services	15,714,370	13,174,923
Salaries and Benefits		
Employee Salaries	69,743,703	67,270,430
Law Enforcement Salaries	1,874,029	1,848,559
Temporary Wages	644,881	536,459
Overtime Wages	88,015	96,570
Board Member Compensation	80,750	97,450
Other Salary Expenses	27,917	23,448
Regular Retirement Contributions	12,093,331	11,118,203
Law Enforcement Retirement Contributions	461,505	370,675
Medical Insurance Contributions	7,482,385	7,188,787
Social Security Contributions	5,376,071	5,267,684
Longevity Pay	1,203,500	1,175,410
Legislative Bonus		894,057
Employee Educational Expense	78,437	178,203
Unemployment Compensation Payments	59,894	60,237
Workers Compensation Medical Payments	22,968	323,879
Flexible Spending Savings	122,714	112,765
Short Term Disability Payments	98,971	66,327
Other Employee Benefits	18,323	20,531
Total Salaries and Benefits	99,477,394	96,649,674
Supplies and Materials:		
General Office Supplies	436,062	442,757
Data Processing Supplies	242,745	292,983
Other Supplies and Materials	648,797	107,204
Total Supplies and Materials	1,327,604	842,944
Travel:		
Ground Transportation	796,028	778,014
Air Transportation	67,494	68,239
Lodging	252,782	198,361
Meals	109,658	102,631
Other Travel	16,046	18,705
Total Travel	1,242,008	1,165,950
Communication:		
Telephone Service	1,226,990	1,435,421
Telecommunication Data Charges	1,292,800	1,085,866
Cellular Phone Services	231,490	274,524
Other Telephone Charges	46,131	41,962
Total Communication	2,797,411	2,837,773

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, 2018 ***Exhibit F-1***
(With Comparative Totals for June 30, 2017) ***Page 2 of 2***

	2018	2017
Utilities:		
Energy Services-Electrical	140,538	125,850
Other Utilities	11,446	9,382
Total Utilities	151,984	135,232
Data Processing Services	4,930,396	4,651,941
Claims and Benefits:		
Law Enforcement Separation Allowance	66,642	59,365
Other Services:		
Postage and Delivery	2,828,255	3,862,842
Printing and Binding	523,935	416,207
Other Services	265,110	282,716
Total Other Services	3,617,300	4,561,765
Other Fixed Charges:		
Computer Software Maintenance Agreements	4,706,276	4,370,613
Computer Hardware Maintenance Agreements	473,947	621,141
Other Equipment Maintenance Agreements	343,582	486,300
Membership Dues and Subscriptions	389,110	355,544
Other Fixed Charges	67,825	49,875
Total Other Fixed Charges	5,980,740	5,883,473
Expenditures to Other State Agencies (Note 12)	4,000	1,318,260
Capital Outlay:		
Computer Software	2,793,097	3,146,831
Computer Hardware	640,155	1,978,749
Office Furniture	1,190,169	467,712
Voice Communication Equipment		164
Office Equipment	156,063	55,724
Other Capital Outlays	148,096	87,452
Total Capital Outlay	4,927,580	5,736,632
Insurance and Bonding	41,490	42,012
Other Expenditures:		
Office Building Rent	2,965,656	2,642,116
Office and Communication Equipment Rents and Leases	124,818	141,114
Other Rents and Leases	73,598	36,694
Electronic Payment Processing Fees	2,133,414	2,178,777
Other Operating Expenses	15	151
Total Other Expenditures	5,297,501	4,998,852
Total Expenditures Paid for Department Operations and Administration	145,576,420	142,058,796
Expenditures Paid by the Department Pursuant to Statutory Tax Allocations:		
Expenditures Paid to Local Governments Pursuant to Statutory Tax Allocations	641,879,573	631,978,429
Total General Fund Expenditures	$ 787,455,993	$ 774,037,225

Independent Auditor's Report

STATE OF NORTH CAROLINA
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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*

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, 2018, 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 26, 2019.

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 only 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, 2018, 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.

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

Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 26, 2019

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

NC OSA
The Taxpayers' Watchdog

This audit required 2,437 hours at an approximate cost of $251,011, including costs associated with the report on the Department's statewide financial statement audit procedures.