

# 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  
FOR THE YEAR ENDED JUNE 30, 2019

A DEPARTMENT OF THE STATE OF NORTH CAROLINA



**NCOSA**  
The Taxpayers' Watchdog

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



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

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## AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of the North Carolina Department of Revenue for the year ended June 30, 2019, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

A handwritten signature in black ink, reading "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

## AN OVERVIEW OF HOW TO USE THIS REPORT

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This report provides audited financial information on the Department of Revenue (Department) 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 reports financial activities in two governmental funds and one fiduciary fund. The governmental funds are used to report all activity of the Department. The fiduciary fund is an agency fund that reports local sales tax collections.

It is important to note that while the governmental fund financial statements report all the activity of the Department, 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 Department'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. Throughout the report, the term Department is used to refer to the governmental funds and the fiduciary fund combined, unless otherwise specifically stated.

**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. The Management's Discussion and Analysis is prepared by the Department and has not been subjected to the same auditing procedures performed on the financial statements.

**"A" Exhibits** present the Balance Sheet as of June 30, 2019 (with comparative totals as of June 30, 2018) and the Statement of Revenues, Expenditures, and Changes in Fund Balance for fiscal year ended June 30, 2019 (with comparative totals for fiscal year ended June 30, 2018) for the Department's **governmental funds as a whole**.

**"B" Exhibit** presents the Statement of Fiduciary Net Position as of June 30, 2019 (with unaudited comparative totals for June 30, 2018) for the **fiduciary fund as a whole (represented by the Local Sales Tax Collection Fund)**.

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

**"C" 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, 2019). These schedules have not been subjected to the same auditing procedures performed on the financial statements.

**Supplementary Information:**

**“D” Exhibits** present the Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance **by Company** (for fiscal year ended June 30, 2019, with comparative totals for fiscal year ended June 30, 2018).

**“E” Exhibits** present the Statement of Collections (Cash Basis), which details certain tax revenues collected by the Department (for fiscal years ended June 30, 2019 and 2018).

**“F” 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, 2019 and 2018).

**“G” 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, 2019 and 2018).

**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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Chapter 147, Article 5A of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.

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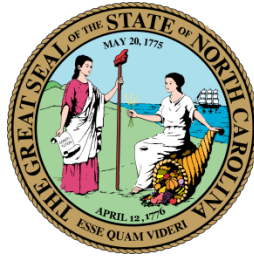
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# **INDEPENDENT AUDITOR'S REPORT**

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



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

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## **INDEPENDENT AUDITOR'S REPORT**

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Secretary Ronald G. Penny  
and Management of the North Carolina Department of Revenue

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental funds and the fiduciary fund of the North Carolina Department of Revenue (Department), as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

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



significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### Opinions

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental funds and the fiduciary fund of the North Carolina Department of Revenue as of June 30, 2019, 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, 2019 or the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### Other Matters

#### *Prior Period Information*

We have previously audited the accompanying financial statements of the governmental funds of the Department as of June 30, 2018, 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 26, 2019. 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 statements of the governmental funds as a whole for the year ended June 30, 2018.

The accompanying Statement of Fiduciary Net Position as of June 30, 2018 was not audited, reviewed, or compiled by us and, accordingly, we do not express an opinion or any other form of assurance on this statement.

#### *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 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 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 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

#### Other Reporting Required by *Government Auditing Standards*

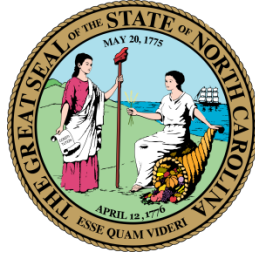
In accordance with *Government Auditing Standards*, we have also issued our report dated April 29, 2020 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.



Beth A. Wood, CPA  
State Auditor

Raleigh, North Carolina

April 29, 2020



# **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, 2019, with comparative information for the fiscal year ended June 30, 2018. 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) and the Fiduciary Fund (Local Sales Tax Collection Fund). The governmental fund's 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 fiduciary fund financial statements consist of a Statement of Fiduciary Net Position.

#### **Governmental Funds:**

- The Balance Sheet presents the governmental fund's assets, deferred outflows, liabilities, and deferred inflows that are considered relevant to an assessment of near-term liquidity. The difference between assets (plus deferred outflows) and liabilities (plus deferred inflows) is reported as fund balance.
- The Statement of Revenues, Expenditures, and Changes in Fund Balances reports the resource flow (revenues and expenditures) of the governmental funds.

#### **Fiduciary Fund:**

- The Statement of Fiduciary Net Position shows the amount of assets and liabilities that the Department holds for the benefit of parties outside of state government.

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 Sheets

The following condensed balance sheet shows the governmental funds' financial position at June 30, 2019 and 2018:

	2019	2018	Increase (Decrease)
Assets	\$ 2,202,941,057	\$ 2,126,156,531	\$ 76,784,526
Deferred Outflows of Resources	0	0	0
Total Assets and Deferred Outflows of Resources	\$ 2,202,941,057	\$ 2,126,156,531	\$ 76,784,526
Liabilities	\$ 1,605,820,151	\$ 1,532,250,318	\$ 73,569,833
Deferred Inflows of Resources	94,303,185	84,923,512	9,379,673
Fund Balance			
Nonspendable	4,051,656	2,236,849	1,814,807
Committed	63,817,251	72,102,653	(8,285,402)
Unassigned	434,948,814	434,643,199	305,615
Total Fund Balances	502,817,721	508,982,701	(6,164,980)
Total Liabilities, Deferred Inflows of Resources, and Fund Balance	\$ 2,202,941,057	\$ 2,126,156,531	\$ 76,784,526

### Assets

Total assets increased by \$76.8 million during fiscal year end 2019 due to a \$96.6 million increase in taxes receivable. Taxes receivable increased \$96.6 million from the prior fiscal year primarily due to the amount estimated for individual income tax underpayments was \$61.9 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 2018 – December 2018) 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 2020 fiscal year are for the 2019 tax year (January 2019 – December 2019). 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 2020 fiscal year would have been earned by June 30, 2019 (in the time period of January 2019 – June 2019). The final payments estimated to be received in the 2020 fiscal year is also adjusted for any delinquent individual income taxes receivables that have also been accrued. As a result of the trend analysis, the final payments estimated to be received in the 2020 fiscal year were \$119.5 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 was closest to actual for the past three fiscal years. One-half of this amount was taken, resulting in estimated final payments that were \$59.7 million more than the prior fiscal year. The amount was also reduced by

delinquent individual income taxes receivable; however, the amount deducted this fiscal year was not significantly different from the amount deducted last fiscal year.

### **Liabilities**

Total liabilities increased by \$73.6 million compared to the prior year. The majority of this increase is due to an increase in tax refunds payable of \$39.2 million and unearned revenue of \$24.6 million.

Tax refunds payable increase is primarily due to the \$27.6 million increase in individual income tax revenues estimated to be refunded in some future period. An estimate is prepared at the end of each fiscal year to determine the amount of individual income taxes that will be refunded for amounts collected by the Department in excess of final tax liability during the time period January to June. Amounts collected during this time period that are included in the calculation of the estimate are withholdings and estimated tax payments. Collections during the first half of the fiscal year (July 2018 – December 2018) are considered to be settled when tax returns are submitted by April 15<sup>th</sup> and are refunded prior to June 30. To estimate the individual income tax refunds payable on collections from January through June 2019, the Department collects data of cash refunds to total collections for several years and uses various trend models to calculate a refund percentage. The refund percentage is applied to the January to June collections to estimate future cash refunds. The refund ratio calculated for the 2019 fiscal year was higher than in the prior fiscal year. The higher refund percentage was based on the trend in the refund ratio since the implementation of individual income tax law changes that took effect in tax year 2014. The increased refund percentage, along with an increased January to June collections of \$105.4 million, caused an increase in individual income tax revenues estimated to be refunded in some future period.

The increase in unearned revenue is due to an increase in corporate income tax collections for January to June 2019. Corporate income taxpayers can elect different income years and are generally required to make installment payments four times a year with the due date depending on the income year elected. Final payment of expected net tax liability is due when the tax return is due, even though corporate taxpayers often take a 6-month extension to file the return. In addition, corporate taxpayers will frequently elect to apply any overpayment to a future tax period. These amounts are considered unearned revenue. Estimated unearned revenue related to corporate income tax increased \$39.3 million from the prior fiscal year. An estimate is prepared at the end of each fiscal year to determine the amount of corporate income tax unearned revenue. The Department assumes that corporate income tax collections during the time period July to December and any refund requests associated with these collections have been applied or paid out by June 30. Collections for January to June that are not considered final are used as a base for the corporate income tax unearned revenue calculation. Corporate income tax collections for January to June 2019 increased \$105.7 million from the same time period in the prior fiscal year. The increase in the base for the corporate income tax unearned revenue calculation is the primary reason for the increase in corporate income tax unearned revenue. The increase in corporate income tax collections for January to June 2019 is attributable the federal tax law changes in the Tax Cuts and Jobs Act (TCJA) that increased corporate profits in the short-term, such as the deemed repatriation of the earnings of foreign subsidiaries of U.S. companies.

### **Deferred Inflows of Resources**

Deferred inflows of resources increased \$9.4 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 decreased by \$6.2 million during fiscal year end 2019. The decrease is attributable to a decrease of \$8.3 million in the committed fund balance. The decrease in the committed fund balance is due to the amount committed for Project Collect Tax, a collection assistance fee imposed by the General Assembly under General Statute 105-243.1. The fee is imposed on an overdue tax debt that remains unpaid 30 days or more after the fee notice is mailed to the taxpayer. 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 unless appropriated by the General Assembly. During the 2019 fiscal year the Department collected \$43.6 million in collection assistance fees and expended \$51 million from the Project Collect fund. Therefore, \$7.4 million more was expended than collected during the 2019 fiscal year; hence, reducing fund balance. Expenditures exceeded revenues because Session Law 2018-5 of the 2018 Session of the North Carolina General Assembly authorized the Department to spend \$12.5 million from the collection assistance fee to support the Portfolio Warehouse, Modernize eFile, and tax systems operations and maintenance upgrades.

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 statements show the governmental funds' resource flows at June 30, 2019 and 2018.

	2019	2018	Increase (Decrease)
Revenues:			
Tax Revenues	\$ 24,664,018,355	\$ 23,471,657,762	\$ 1,192,360,593
Revenues from Other State Agencies	6,472,955	6,067,216	405,739
Fees	3,005,301	2,536,082	469,219
Other Revenues	3,358,336	2,051,699	1,306,637
Total Revenues	24,676,854,947	23,482,312,759	1,194,542,188
Expenditures:			
Statutory Tax Distributions	679,551,831	647,477,474	32,074,357
Salaries and Benefits	100,254,017	99,477,394	776,623
Expenditures to Other State Agencies	1,861,668	1,869,364	(7,696)
Other Expenditures	50,975,555	46,116,641	4,858,914
Total Expenditures	832,643,071	794,940,873	37,702,198
Excess of Revenues Over Expenditures	23,844,211,876	22,687,371,886	1,156,839,990
Other Financing Sources (Uses)			
State Appropriation	84,093,147	83,384,770	708,377
Sale of Capital Assets	2,009	500	1,509
Transfers In	3,217,545	1,519,809	1,697,736
Transfers Out	(23,937,689,557)	(22,734,799,817)	(1,202,889,740)
Total Other Financing Sources (Uses)	(23,850,376,856)	(22,649,894,738)	(1,200,482,118)
Net Change in Fund Balance	(6,164,980)	37,477,148	(43,642,128)
Fund Balance - July 1	508,982,701	471,505,553	37,477,148
Fund Balance - June 30	\$ 502,817,721	\$ 508,982,701	\$ (6,164,980)

### Tax Revenues

Total tax revenues were \$24.7 billion at June 30, 2019, an increase of \$1.2 billion from the prior fiscal year. This increase is primarily due to an increase in net individual income tax revenues of \$635.2 million, net sales and use tax revenues of \$487.8 million, and net franchise tax revenues of \$81.1 million.

### Individual Income Tax

Individual income tax revenues on a modified accrual basis increased \$635.2 million or 5.0% from the 2017-2018 fiscal year. This increase is primarily due to an increase in gross revenues on a cash basis, which increased by \$688.1 million or 5.0%. This increase is due primarily to a significant increase in final tax payments. Final individual income tax payments increased \$485.0 million or 24.0% from the 2017-2018 fiscal year. The large increase is attributable to the increase in capital gains for the 2018 tax year. This increase is considered mostly one-time in nature.



A net increase in combined withholding and estimated tax payments also contributed to the increase in gross revenues on a cash basis and can be attributed to an improved economy. Recent national data for personal income and wage and salary income indicate growth for the 2018-2019 fiscal year in the range of 4.9% to 5.1%. Growth in personal income and wage and salary income is generally correlated with individual income tax revenue growth. This is supported by an increase in withholding tax payments by \$416.1 million or 4.0% from the 2017-2018 fiscal year even though there were state tax cuts that became effective mid fiscal year. Effective January 1, 2019, the individual income tax rate decreased from 5.499% to 5.25% and 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.

Estimated tax payments decreased from the 2017-2018 fiscal year by \$213.0 million or 14.21%. Decrease in estimated tax payments is attributed to 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 year. As a result, the estimated payments in December 2018 and January 2019 were lower as expected.

### **Sales and Use Tax**

Sales and use tax revenues on a modified accrual basis increased by \$487.8 million or 6.1% from the 2017-2018 fiscal year. This increase is due to an increase in net revenues (net of refunds and tax distributions) on a cash basis, which increased by \$449.4 million or 5.7%. This increase can be attributed to an improved economy as well as the United States Supreme Court's ruling in *South Dakota v. Wayfair, et al. (Wayfair)* in June 2018. 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 the Economic Conditions section below, have increased the disposable incomes of consumers. Recent national data for personal consumption expenditures indicate growth for the 2018-2019 fiscal year in the range of 4.6%. Growth in this area is generally correlated with sales and use tax revenue growth.

The North Carolina Department of Revenue issued a directive dated August 7, 2018, requiring remote sellers not physically located in North Carolina to collect and remit sales tax on sales sourced to North Carolina on a prospective basis. The directive was issued after the United States Supreme Court's June 2018 decision in *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 began enforcing an existing law [*North Carolina General Statute* §105-164.8(b)] regarding remote sales and required remote sellers having sales in excess of \$100,000 or 200 or more separate transactions sourced to North Carolina in the previous or current calendar year (threshold) to register, collect, and remit sales and use tax effective November 1, 2018 or 60 days after the seller met the sales threshold, whichever was later.

### **Franchise Tax**

Franchise tax revenues increased by \$81.1 million or 12.1% on a modified accrual basis in the 2018-2019 fiscal year as compared to the 2017-2018 fiscal year. This increase is due to an increase in gross revenues on a cash basis during the 2018-2019 fiscal year. Gross franchise tax revenues on a cash basis increased by \$82.8 million or 11.9% from the 2017-2018 fiscal year and is mainly due to an improved economy and federal tax law changes from the Tax

Cuts and Jobs Act (TCJA). The major tax base for franchise tax is “net worth” and the TCJA caused an increase in corporate values in 2017 and 2018 tax years, due mainly to the large tax rate cut and the treatment of repatriated foreign earnings.

### **Expenditures**

Total expenditures increased \$37.7 million from the prior year due primarily to an increase in statutory tax distributions. Statutory tax distributions increased \$32.1 million from the prior fiscal year because Medicaid hold harmless distributions to local governments per General Statute 105-523 increased significantly in the 2019 fiscal year. Local governments' sales and use tax revenue was reduced when General Statutes 105-515 through 105-520 under Article 44 of the North Carolina Revenue Laws were repealed effective October 1, 2009. In addition, the local governments' cost of administering the Medicaid program was reduced as the State assumed responsibility for the administration of Medicaid. The intent of General Statute 105-523 is that each county be held harmless from the exchange of a portion of the local sales and use taxes for the State's agreement to assume the responsibility for the non-administrative costs of Medicaid. The Department is charged with comparing the lost sales and use tax revenue to the lost cost of administering the Medicaid program for each county. If the lost revenue is higher than the lost cost, then a distribution is made to the county. The increase in Medicaid hold harmless distributions can be attributed to continued growth in sales and use tax revenues while the administrative costs of Medicaid growth is relatively slow in comparison.

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

Total other financing uses increased \$1.2 billion 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 \$22.6 billion to \$23.8 billion during fiscal year end 2019. This increase is attributable to the increase in tax revenues as discussed above.

### **Budget Variations**

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

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

The final budgeted revenues were \$2.2 million more than the original budget. The increase is primarily due an increase in the final budgets for services and fees as well as a decrease in the final budget for revenues from other state agencies. The increase in services of \$2.3 million and the decrease in revenues from other state agencies of \$1.4 million was mostly due to a budget revision to correct the account for receipts received from the Department of Transportation for the Tax and Tag program from revenues from other state agencies to services.

The increase of \$1 million for fees is primarily due to increases in the budgeted revenues for credit card and debit card transaction fees. The increase in the final budgeted revenues for credit card and debit card transactions fees relates directly to an increase in credit card transactions. Tax payments can be made online by bank draft, credit card or debit card. There is a convenience fee to remit payments by credit card or debit card. The incremental fee is

calculated as \$2 for every \$100 of payment. Actual credit or debit card transaction fees collected were significantly higher than the original certified budget of \$1.8 million. Therefore, the final budget was increased by \$760 thousand.

The final budgeted expenditures increased \$26.4 million from the original budget. The increase is primarily due to increases in the final budgets for contracted personal services, other services, and capital outlay as well as decreases in the final budgets for salaries and benefits, data processing services, and other fixed charges.

The final budgeted expenditures for contracted personal services were \$34.9 million more than the original budget. The increase is primarily due to an increase in the final budget for other information technology services, administrative services, and temporary agency services. Other information technology services' original budget increased \$23.1 million and was mostly due to a revision for the Collections Case Management project.

Other services' final budgeted expenditures were \$3.8 million more than the original budget. This is due to an increase in the final budget for postage and delivery services.

The combined final budgets for temporary agency services and postage and delivery services increased \$7.2 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 were moved to temporary agency services and postage and delivery services accounts.

The Department was authorized to use \$12.5 million from the Collection Assistance Fee 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 (other fixed charges) and data processing services. A significant amount of these budgets were later moved to other technology services (\$3.9 million) and capital outlay (\$2.9 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 the 2019 fiscal year for identity theft and tax fraud analysis. 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.

The final amount budgeted for other financing sources (uses) was \$1.6 million less than the original budget due to transfers to/from the State Reserve Fund not having an original budget. See Note 1(O) for additional information regarding transfers to/from the State Reserve Fund.

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

Actual total revenue collected was \$862.2 million above budgeted revenue amounts. The majority of this increase is due to greater than anticipated individual income tax, sales and use tax, and corporate income tax collections. Individual income taxes, which account for more than half of total general fund tax revenue collections, were \$461.3 million above the \$12.7 billion forecast due primarily to higher-than-anticipated final and extension payments in April 2019. Withholding payments from wage earnings were also higher than anticipated. Quarterly payments from business owners came in lower than expected in December and

January due to the newly implemented \$10,000 cap on the itemized deduction for state and local taxes taking effect in tax year 2018.

Sales and use tax collections account for over 30% of total general fund revenue collections in fiscal year 2019 and were \$126.4 million above the certified amount. An unexpected boost from implementation of economic nexus for out-of-state sellers without a physical presence in North Carolina and strong growth in construction-industry purchases accounted for much of the extra revenue collections.

Corporate income tax collections, though comprising only 3.5% of total general fund revenue collections, were \$120.9 million above the original budgeted amount of \$709.6 million. The growth in corporate income tax has been attributed to effects from the federal Tax Cuts and Jobs Act.

Actual total expenditures were \$36.8 million less than budgeted expenditures during fiscal year end 2019. Budgeted expenditures exceeded actual expenditures primarily because the Department spent \$32.6 million less on contracted personal services and salaries and benefits. The amount spent on contracted personal services was \$23.4 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 \$821.6 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**

As of the date of this report, North Carolina has not enacted a comprehensive budget for fiscal year 2020. However, Session Law 2016-94 has allowed the State to continue operating under the prior fiscal year level of recurring expenditures. Additionally, the General Assembly has enacted several mini appropriation budgets to provide new spending levels for fiscal year 2020. Session Law 2019-242 provided appropriations from the general fund for the budget of the Department for each year of the 2019-2021 fiscal biennium; the total net appropriations for fiscal year 2020's base budget for the Department is \$87 million. Session Law 2019-209 provided salary increases for the Department's employees for each year of the 2019-2021 fiscal biennium; the amount appropriated from the general fund for the 2020 fiscal year for the Department was \$2.4 million. Session Law 2019-237 authorized the Department to spend \$12.5 million from the Collections Assistance Fee in the 2020 fiscal year for costs associated with tax systems operations and maintenance upgrades. Session Law 2019-237 also authorized the Department to spend \$4.4 million from the Collections Assistance Fee in each year of the 2019-2021 fiscal biennium to contract with a vendor to perform identity theft and tax fraud analysis using the Government Data Analytics Center (GDAC).

### **North Carolina Economic Conditions**

There were continued improvements in the economy during the 2018-2019 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 2019, there were 63,600 more jobs than in June 2018 and 156,400 more than in June 2017. The unemployment rate in North Carolina was below 4% throughout most of the 2018-2019 fiscal year; however, it has increased back to 4.2% in June 2019 as more job seekers enter the labor market. Finally, as reported by the Bureau of Economic Analysis, North Carolina's personal income increased 5.5% between 2017 and 2018. This trend, along with the healthy labor market, may indicate further wage increases in 2019. 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.<sup>1</sup>

### **Tax Changes**

#### **Individual Income Tax**

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.

Effective January 1, 2020, the standard deduction amounts will increase to \$21,500 for married couples filing jointly, \$10,750 for single taxpayers, and \$16,125 for head of household.

The total impact of these tax law changes for the 2019 and 2020 tax years will not be known until final individual income tax payments are remitted by taxpayers in the spring of 2020 and 2021.

Session Law 2019-187 exempts certain nonresident businesses and individuals who temporarily come to North Carolina at the request of a critical infrastructure company solely to perform disaster-related work during a disaster response period from registration and tax laws. The impact of this disaster relief legislation is an unknown decrease in individual income, corporate, and franchise revenues.

On June 21, 2019, the United States Supreme Court issued an opinion in *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust (Kaestner)*. The Court determined that, under the facts of *Kaestner*, North Carolina may not, consistent with the federal due process clause, impose a tax on the income of the Kaestner trust based solely on the trust's beneficiary's residence in the State. Currently, the Department is reviewing the decision and has issued guidance to taxpayers who believe the facts of *Kaestner* apply to their individual facts and circumstances on how to file a request for a refund. The total impact of the decision in *Kaestner* will not be known until all information from taxpayers has been received and reviewed.

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<sup>1</sup> Governor Cooper issued a state of emergency for North Carolina to respond to the COVID-19 crisis on March 10, 2020. See Note 17 Subsequent Events for the impact of COVID-19 on the State's revenues beginning in the last quarter of the 2020 fiscal year.



## Sales and Use Tax

Session Law 2019-246 requires marketplace facilitators to collect and remit sales tax under certain circumstances. This tax law change is effective February 1, 2020 and is expected to increase sales and use tax revenues by \$65 million, \$135.2 million, and 140.6 million in the 2020, 2021, and 2022 fiscal years, respectively.

Session Law 2019-169 made the following clarifying and administrative changes to the Revenue Laws that will result in a reduction in sales and use tax collections. All are effective as of October 1, 2019.

- *North Carolina General Statute* §105-164.13(5p) was added and provides an exemption from sales and use tax for “sales of equipment, or an attachment or repair part for equipment, which is used in cutting, shaping, polishing, and finishing rough cut slabs and blocks of natural and engineered stone and stone-like products and sold to a company primarily engaged in the business of providing made-to-order countertops, walls, or tubs.” This allows taxpayers who purchase equipment, attachments, and repair parts for the equipment used in cutting, shaping, polishing, and finishing granite, marble, Corian®, and similar stone-like countertops, walls, and tubs an exemption from sales and use tax for such purchases made on or after October 1, 2019.
- *North Carolina General Statute* §105-164.13(13d) was added and provides an exemption from sales and use tax for “sales of diapers or incontinence underpads on prescription by an enrolled State Medicaid/Health Choice provider for use by beneficiaries of the State Medicaid program when the provider is reimbursed by the State Medicaid program or a Medicaid managed care organization.”
- *North Carolina General Statute* §105-164.13(61a) was amended to include “limited-service vehicle wash” in the list of repair, maintenance, or installation service and service contracts exempt from sales and use tax. The supplies used in providing the limited-service vehicle wash are not included in the exemption.

Session Law 2019-69 reduces the alternate highway use tax on vehicle subscriptions by making various amendments to *North Carolina General Statute* §105-187.1. Changes include revised definitions for long-term and short-term lease or rentals as well as adding definitions for a limited possession commitment, vehicle sharing service, and vehicle subscription. A limited possession commitment is defined as “long-term lease or rental, short-term lease or rental, and vehicle subscriptions.” The applicable tax rates on the gross receipts from a limited possession commitment are (1) short-term lease or rental – 8%, (2) vehicle subscription – 5%, and (3) long-term lease or rental – 3%. Prior to amendments, vehicle subscriptions were considered short-term leases or rentals and were taxed at the 8% tax rate. This law was effective as of October 1, 2019, and applies to vehicle subscription agreements entered into on or after that date.

## Corporate Income Tax

The corporate income tax rate for tax years beginning on or after January 1, 2019 was reduced from 3% to 2.5%.

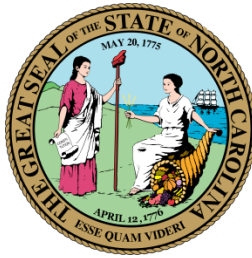
Session Law 2019-246 implemented market-based sourcing for multistate tax apportionment, effective for taxable years beginning on or after January 1, 2020. Market-based sourcing requires a multistate corporation to calculate its sales factor, for apportionment purposes,

based on the percentage of income attributed to the consumption of products and services in the North Carolina marketplace. While this tax law change is expected to decrease corporate income tax revenues by \$1 million in the 2020 fiscal year, increases of \$3.5 million and \$3.9 million are expected in the 2021 and 2022 fiscal years, respectively.

### **Franchise Tax**

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.

The franchise tax on a holding company has a cap of \$150,000 to prevent the taxation of assets that are included in the net worth of the subsidiary, and indirectly in the net worth of the parent company by virtue of its investment in the holding company. Session Law 2019-246 expanded the franchise tax definition of a holding company to include additional taxpayers that meet certain required criteria. This becomes effective for taxable years beginning on or after January 1, 2020.



# **FINANCIAL STATEMENTS**



**North Carolina Department of Revenue**  
**Balance Sheet**  
**Governmental Funds**  
**As of June 30, 2019 (With Comparative Totals for June 30, 2018)**

**Exhibit A-1**

	General Fund <sup>1</sup>	Special Revenue	Total Governmental Funds 2019	Total Governmental Funds 2018
<b>ASSETS</b>				
Cash and Cash Equivalents (Note 2)	\$ 73,612,509	\$ 1,790,059	\$ 75,402,568	\$ 97,315,109
Receivables:				
Taxes Receivable, Net (Note 4)	2,108,793,622	2,956,963	2,111,750,585	2,015,166,999
Accounts Receivable, Net (Note 4)	1,138,225		1,138,225	267,232
Intergovernmental Receivables (Note 4)	10,513,462		10,513,462	11,064,023
Due from Other Funds (Note 13)	59,561		59,561	66,019
Inventories (Note 5)	4,051,656		4,051,656	2,236,849
Securities Held in Trust (Sureties)	25,000		25,000	40,300
Total Assets	2,198,194,035	4,747,022	2,202,941,057	2,126,156,531
<b>DEFERRED OUTFLOWS OF RESOURCES</b>				
Total Deferred Outflows of Resources	0	0	0	0
Total Assets and Deferred Outflows of Resources	\$ 2,198,194,035	\$ 4,747,022	\$ 2,202,941,057	\$ 2,126,156,531
<b>LIABILITIES</b>				
Accounts Payable and Accrued Liabilities:				
Accounts Payable (Note 7)	\$ 2,239,012	\$ 0	\$ 2,239,012	\$ 2,837,347
Accrued Payroll	14,351		14,351	
Intergovernmental Payables (Note 7)	152,578,242	1,029,348	153,607,590	150,219,798
Tax Refunds Payable (Note 7)	1,036,316,810		1,036,316,810	997,142,469
Due to Other Funds (Note 13)	37,757,977	59,561	37,817,538	30,810,554
Unearned Revenue	375,800,000		375,800,000	351,200,000
Funds Held for Others	24,850		24,850	40,150
Total Liabilities	1,604,731,242	1,088,909	1,605,820,151	1,532,250,318
<b>DEFERRED INFLOWS OF RESOURCES</b>				
Unavailable Revenue (Note 8)	91,713,386	2,589,799	94,303,185	84,923,512
Total Deferred Inflows of Resources	91,713,386	2,589,799	94,303,185	84,923,512
<b>FUND BALANCES (Note 11)</b>				
Nonspendable	4,051,656		4,051,656	2,236,849
Committed	62,748,937	1,068,314	63,817,251	72,102,653
Unassigned	434,948,814		434,948,814	434,643,199
Total Fund Balances	501,749,407	1,068,314	502,817,721	508,982,701
Total Liabilities, Deferred Inflows of Resources, and Fund Balances	\$ 2,198,194,035	\$ 4,747,022	\$ 2,202,941,057	\$ 2,126,156,531

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

<sup>1</sup>See supplementary Schedules D-1 and D-5 for detailed information of each company within the General Fund.

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balances**  
**Governmental Funds**  
**For the Fiscal Year Ended June 30, 2019**  
**(With Comparative Totals for the Fiscal Year Ended June 30, 2018)**

**Exhibit A-2**

	General Fund <sup>1</sup>	Special Revenue	Total Governmental Funds 2019	Total Governmental Funds 2018
<b>REVENUES</b>				
Tax Revenues	\$ 24,657,031,615	\$ 6,986,740	\$ 24,664,018,355	\$ 23,471,657,762
Services	2,609,895		2,609,895	1,890,043
Fees	3,005,301		3,005,301	2,536,082
Revenues from Other State Agencies (Note 12)	6,472,955		6,472,955	6,067,216
Miscellaneous Revenues	748,441		748,441	161,656
Total Revenues	24,669,868,207	6,986,740	24,676,854,947	23,482,312,759
<b>EXPENDITURES</b>				
Salaries and Benefits	100,254,017		100,254,017	99,477,394
Contracted Personal Services	16,717,990		16,717,990	15,714,370
Supplies and Materials	826,303		826,303	1,327,604
Travel	1,202,694		1,202,694	1,242,008
Communication	2,686,224		2,686,224	2,797,411
Utilities	154,298		154,298	151,984
Data Processing Services	4,053,634		4,053,634	4,930,396
Other Services	5,713,021	29,391	5,742,412	3,638,915
Claims and Benefits	122,283		122,283	66,642
Other Fixed Charges	6,019,641		6,019,641	5,980,740
Capital Outlay	7,305,410		7,305,410	4,927,580
Insurance and Bonding	72,971		72,971	41,490
Statutory Tax Distributions	674,576,521	4,975,310	679,551,831	647,477,474
Expenditures to Other State Agencies (Note 12)	206,819	1,654,849	1,861,668	1,869,364
Other Expenditures	6,071,695		6,071,695	5,297,501
Total Expenditures	825,983,521	6,659,550	832,643,071	794,940,873
Excess of Revenues Over Expenditures	23,843,884,686	327,190	23,844,211,876	22,687,371,886
<b>OTHER FINANCING SOURCES (USES)</b>				
Sale of Capital Assets	2,009		2,009	500
Transfers to State Reserve Fund	(759,802)		(759,802)	(2,536,321)
Transfers from State Reserve Fund	2,536,321		2,536,321	825,629
Transfers In (Note 13)	681,224		681,224	694,180
Transfers Out (Note 13)	(23,936,248,531)	(681,224)	(23,936,929,755)	(22,732,263,496)
State Appropriations	84,093,147		84,093,147	83,384,770
Total Other Financing Sources (Uses)	(23,849,695,632)	(681,224)	(23,850,376,856)	(22,649,894,738)
Net Change in Fund Balances	(5,810,946)	(354,034)	(6,164,980)	37,477,148
Fund Balances - July 1	507,560,353	1,422,348	508,982,701	471,505,553
Fund Balances - June 30	\$ 501,749,407	\$ 1,068,314	\$ 502,817,721	\$ 508,982,701

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

<sup>1</sup>See supplementary Schedules D-2 and D-6 for detailed information of each company within the General Fund.

**North Carolina Department of Revenue**  
**Statement of Fiduciary Net Position**  
**Fiduciary Fund - Local Sales Tax Collection Fund**  
**Agency Fund**  
**June 30, 2019**

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

**Exhibit B-1**

	<b>2019</b>	<b>2018 (Unaudited)</b>
<b>ASSETS</b>		
Cash and Cash Equivalents (Note 2)	\$ 643,053,749	\$ 582,297,303
Taxes Receivable	193,000,000	192,857,000
Due from Other Funds (Note 13)	37,757,977	30,744,535
Total Assets	873,811,726	805,898,838
<b>LIABILITIES</b>		
Intergovernmental Payables	873,811,726	805,898,838
Total Liabilities	873,811,726	805,898,838
<b>NET POSITION</b>		
Unrestricted	\$ 0	\$ 0

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 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 and fiduciary 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 fund and fiduciary fund financial statements 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 governmental funds and fiduciary funds, each displayed in separate exhibits. Throughout the report, the term Department is used to refer to the governmental funds and fiduciary fund combined, unless otherwise specifically stated.

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.

The Department's financial statements consist of the following fiduciary fund:

**Local Sales Tax Collection Fund** – This fiduciary fund accounts for sales and use tax collections held on behalf of local governments in a pure custodial capacity. These assets belong to those local governments and are not considered to be assets or liabilities of the Department.

### D. Measurement Focus and Basis of Accounting

**Governmental Funds** – Governmental fund financial statements have been 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 (OPEB) 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.

**Fiduciary Fund** – The fiduciary fund is considered an agency fund and is custodial in nature, therefore, their financial statements do not have a measurement focus.

**Nonexchange Transactions** – 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.

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

- E. **Cash and Cash Equivalents** – This classification includes undeposited receipts and deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty. The Department's equity position in the STIF is recorded at fair value. Additional information regarding the fair value measurement of deposits held by the State Treasurer in the STIF is disclosed in Note 3.
- F. **Receivables** – Receivables consist of amounts that have arisen in the ordinary course of business.

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.

Accounts receivable primarily include amounts due from individuals and companies in connection with the Department's general business operations. Receivables are recorded net of estimated uncollectible amounts.

Intergovernmental receivables include amounts due from state and local governments in connection with the Department's general business operations. Receivables are considered fully collectible; accordingly, no allowance for doubtful accounts has been recorded.

**G. Due from/to Other Funds** – Activities between the Department's funds are composed of amounts due from or due to other funds of the Department. All amounts are considered collectible; accordingly, no allowance for doubtful accounts has been recorded.

**H. Inventories** – Inventories, consisting of general supplies and materials, are valued at cost using the first-in, first-out (FIFO) method. Inventories of the governmental funds are recorded as expenditures when consumed rather than when purchased.

**I. Payables** – Accounts payable primarily include amounts due to individuals and companies in connection with the Department's general business operations.

Intergovernmental payables include amounts due to local governments and law enforcement agencies primarily in connection with tax distributions.

Tax refunds payable 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.

**J. Unearned Revenue** – Unearned revenue represents the cumulative excess of cash received for various taxes that is to be applied in a future year.

**K. Deferred Inflows of Resources** – In addition to liabilities, the Department reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of fund balance that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until then. 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.

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



*Nonspendable Fund Balance* – These amounts cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

*Committed Fund Balance* – These amounts 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.

*Unassigned Fund Balance* – This 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 committed to those purposes.

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

- M. Revenues and Expenditures From/To Other State Agencies** – Revenues and expenditures from/to other state agencies 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*.
- N. 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.
- O. Transfers From/To State Reserve Fund** – These transfers are for funds obligated in the current year, but not spent at year-end, that will be carried forward to the next fiscal year. The Department must obtain authorization from the Office of State Budget and Management (OSBM) to carryforward funds. At year-end, these funds are transferred to the State Reserve Fund and held by the North Carolina Office of the State Controller until approval is granted from OSBM to return the funds to the Department in the next fiscal year.

**NOTE 2 - DEPOSITS**

Unless specifically exempt, every agency of the State and certain component units are 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 Statutes 147-69.1 and 147-69.2 authorizes the State Treasurer to invest all deposits in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; specified repurchase agreements; obligations of the State of North Carolina; 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, 2019, the governmental funds' Balance Sheet reported cash and cash equivalents of \$75,402,568. The Local Sales Tax Collection Fund Statement of Fiduciary Net Position reported cash and cash equivalents of \$643,053,749 for the same date. These amounts represent 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) had a weighted average maturity of 1.3 years as of June 30, 2019. 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.

### NOTE 3 - FAIR VALUE MEASUREMENTS

To the extent available, the Department's investments are recorded at fair value as of June 30, 2019. 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.

At June 30, 2019, the Department has the following investments:

**Short-Term Investment Fund** – At year-end, the Department's cash and cash equivalents, valued at \$718,456,317, were held in the STIF. Ownership interests of the STIF are 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 4 - RECEIVABLES

##### A. Taxes Receivable

Taxes receivable for the governmental funds at June 30, 2019, were as follows:

	Gross Taxes Receivable	Less Allowance for Uncollectible Taxes	Net Taxes Receivable
<b>General Fund:</b>			
Individual	\$ 382,100,000	\$ 0	\$ 382,100,000
Sales and Use Tax	394,900,000		394,900,000
Corporate	24,400,000		24,400,000
Underwithholding - Individual	557,000,000		557,000,000
Other	116,250,973		116,250,973
<b>Delinquent Receivables:</b>			
Individual	1,144,191,672	659,049,084	485,142,588
Sales and Use Tax	221,198,130	110,112,585	111,085,545
Corporate	32,641,360	20,393,907	12,247,453
Tobacco Products	11,915,724	6,065,181	5,850,543
Franchise	22,115,634	4,574,906	17,540,728
Estate	10,260,792	10,195,078	65,714
License and Excise	3,246,628	2,196,921	1,049,707
Alcoholic Beverage	788,486	550,643	237,843
Other	1,294,300	371,772	922,528
<b>Total Delinquent Receivables</b>	<b>1,447,652,726</b>	<b>813,510,077</b>	<b>634,142,649</b>
<b>Total</b>	<b>2,922,303,699</b>	<b>813,510,077</b>	<b>2,108,793,622</b>
<b>Special Revenue Fund:</b>			
Unauthorized Substance Tax	295,696,320	292,739,357	2,956,963
<b>Total Taxes Receivable</b>	<b>\$ 3,218,000,019</b>	<b>\$ 1,106,249,434</b>	<b>\$ 2,111,750,585</b>

Within the General Fund, the significant receivables not expected to be collected within one year were \$901,765,197 of taxes receivable (gross).

See Exhibit F-1 for the Schedule of Aging of the Taxes Receivable.

**B. Accounts Receivable**

Accounts receivable for the governmental funds at June 30, 2019, were as follows:

	<u>General Fund</u>
Accounts Receivable:	
Gross Accounts Receivable	\$ 1,148,306
Less Allowance for Doubtful Accounts	<u>10,081</u>
Total Accounts Receivable, Net	<u>\$ 1,138,225</u>

**C. Intergovernmental Receivable**

Intergovernmental receivables for governmental funds at June 30, 2019, were as follows:

	<u>Gross Receivables</u>
General Fund:	
Local Governments - Medicaid Hold Harmless Distribution Returned	\$ 142,912
State Agencies - Payroll Taxes	<u>10,370,550</u>
Total Intergovernmental Receivables	<u>\$ 10,513,462</u>

**NOTE 5 - INVENTORIES**

Inventories at June 30, 2019, were as follows:

	<u>General Fund</u>
Inventories:	
Postage	\$ 3,907,188
Other Office Materials/Supplies	<u>144,468</u>
Total Inventories	<u>\$ 4,051,656</u>

**NOTE 6 - 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 governmental funds' financial statements, but are reported in the Department's notes to the 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 acquisition value at the date of the donation except that capital assets donated prior to July 1, 2015 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 \$1,000,000 or \$100,000, respectively.

Depreciation is recorded at the statewide level for governmental funds. Depreciation is computed using the straight-line method over the estimated useful lives of the assets in the following manner:

<u>Asset Class</u>	<u>Estimated Useful Life</u>
Equipment	2-30 years
Computer Software	2-30 years

A summary of changes in the Department's capital assets for the year ended June 30, 2019, is presented as follows:

	Balance July 1, 2018 (As Restated) <sup>1</sup>	Increases	Decreases	Balance June 30, 2019
Capital Assets, Depreciable:				
Equipment	\$ 10,380,024	\$ 1,023,640	\$ 98,404	\$ 11,305,260
Computer Software	28,303,731			28,303,731
<b>Total Capital Assets, Depreciable</b>	<b>38,683,755</b>	<b>1,023,640</b>	<b>98,404</b>	<b>39,608,991</b>
Less Accumulated Depreciation for:				
Equipment	3,934,264	428,829	22,810	4,340,283
Computer Software	6,330,822	1,406,849		7,737,671
<b>Total Accumulated Depreciation</b>	<b>10,265,086</b>	<b>1,835,678</b>	<b>22,810</b>	<b>12,077,954</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>28,418,669</b>	<b>(812,038)</b>	<b>75,594</b>	<b>27,531,037</b>
<b>Capital Assets, Net</b>	<b>\$ 28,418,669</b>	<b>\$ (812,038)</b>	<b>\$ 75,594</b>	<b>\$ 27,531,037</b>

<sup>1</sup> The Computer Software account and related depreciation have been restated by \$9,496,239 and \$786,588 (respectively) due to a prior year asset adjustment.

**NOTE 7 - PAYABLES****A. Accounts Payable**

Accounts payable for the governmental funds at June 30, 2019, were as follows:

	<u>General Fund</u>
Accounts Payable:	
Accounts Payable	\$ 2,178,518
Due to Employees	<u>60,494</u>
<b>Total Accounts Payable</b>	<b><u>\$ 2,239,012</u></b>

**B. Intergovernmental Payables**

Intergovernmental payables for the governmental funds at June 30, 2019, were as follows:

	<u>General Fund</u>	<u>Special Revenue</u>
Intergovernmental Payables:		
Local Government Tax Distributions:		
Medicaid Hold Harmless	\$ 16,967,861	\$ 0
Alcoholic Beverage	6,716,422	
Real Estate Conveyance, White Goods Disposal, Scrap Tire Disposal, and Solid Waste Disposal	3,684,616	
Electricity	72,429,779	
Video Program	16,153,892	
Telecom	9,956,935	
Piped Natural Gas	4,536,771	
Unauthorized Substance		<u>798,255</u>
<b>Total to Local Governments</b>	<u>130,446,276</u>	<u>798,255</u>
Statutory Tax Distribution to the General Fund:		
White Goods Disposal	678,670	
Scrap Tire Disposal	3,733,245	
Solid Waste Disposal	2,089,537	
Unauthorized Substance		<u>231,093</u>
<b>Total to General Fund</b>	<u>6,501,452</u>	<u>231,093</u>
State Agencies:		
Department of Transportation - Aviation Fuel Taxes	7,878,565	
Department of Environmental Quality - Solid Waste Taxes	5,232,504	
Department of Information Technology - 911 Service Charges	<u>2,519,445</u>	
<b>Total to State Agencies</b>	<u>15,630,514</u>	
<b>Total Intergovernmental Payables</b>	<b><u>\$ 152,578,242</u></b>	<b><u>\$ 1,029,348</u></b>

### C. Tax Refunds Payable

Tax refunds payable for the governmental funds at June 30, 2019, were as follows:

	<u>General Fund</u>
Tax Refunds Payable:	
Individual	\$ 635,900,000
Sales and use Tax	281,200,000
Corporate	118,000,000
Other	<u>1,216,810</u>
<b>Total Tax Refunds Payable</b>	<b><u>\$ 1,036,316,810</u></b>

### NOTE 8 - DEFERRED INFLOWS OF RESOURCES

The various components of deferred inflows of resources at June 30, 2019, were as follows:

	<u>Unavailable at June 30, 2018</u>	<u>Current Year Unavailable Increase</u>	<u>Prior Year Unavailable Earned in Current Year</u>	<u>Unavailable at June 30, 2019</u>
<b>General Fund:</b>				
Estate Taxes	\$ 548,382	\$ 65,714	\$ (548,382)	\$ 65,714
Gift Taxes	1,235	1,212	(1,235)	1,212
License Taxes	1,105,654	1,002,006	(1,105,654)	1,002,006
Tobacco Taxes	4,255,702	5,672,257	(4,255,702)	5,672,257
Beverage Taxes	80,432	223,459	(80,432)	223,459
Franchise Taxes	12,867,946	17,129,762	(12,867,946)	17,129,762
Sales & Use Taxes	56,153,683	55,168,533	(56,153,683)	55,168,533
Corporate Taxes	5,829,820	11,594,961	(5,829,820)	11,594,961
White Goods Taxes	9,280	39,475	(9,280)	39,475
Scrap Tire Taxes	429,646	446,915	(429,646)	446,915
Manufacturing Taxes	444,025	291,257	(444,025)	291,257
Solid Waste Taxes	2,299	210	(2,299)	210
Insurance Taxes	<u>154,326</u>	<u>77,625</u>	<u>(154,326)</u>	<u>77,625</u>
<b>Total</b>	<u>81,882,430</u>	<u>91,713,386</u>	<u>(81,882,430)</u>	<u>91,713,386</u>
<b>Special Revenue Fund:</b>				
Unauthorized Substance Taxes	<u>3,041,082</u>	<u>2,589,799</u>	<u>(3,041,082)</u>	<u>2,589,799</u>
<b>Total Deferred Inflows of Resources</b>	<b><u>\$ 84,923,512</u></b>	<b><u>\$ 94,303,185</u></b>	<b><u>\$ (84,923,512)</u></b>	<b><u>\$ 94,303,185</u></b>

### NOTE 9 - LONG-TERM LIABILITIES

General long-term liabilities for the governmental funds are not recognized in the governmental funds until they become due. Consequently, the general long-term liabilities not yet due are not reported on the face of the governmental



funds' financial statements, but are disclosed in the Department's notes to the financial statements.

Noncurrent long-term liabilities include other long-term liabilities that will not be paid within the next fiscal year. Other long-term liabilities include: claims and judgments payable, compensated absences, net pension liability, net other postemployment benefits (OPEB) liability, and workers' compensation.

**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.

**Compensated Absences** – Employees of the Department are permitted to accumulate earned but unused vacation pay benefits. In the governmental funds, 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. When classifying the compensated absences into current and noncurrent for the long-term liabilities disclosure, leave is considered taken using a last-in, first-out (LIFO) method.

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 subject to the limitation on annual leave carried forward described above 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.

**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 2018 *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 14 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 2018 *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 15 for further information regarding the Department's policies for recognizing liabilities, expenses, deferred outflows of resources, and deferred inflows of resources related to OPEB.

**Changes in Long-Term Liabilities** - A summary of changes in the long-term liabilities for the year ended June 30, 2019 is presented as follows:

	Balance July 1, 2018 (as Restated) <sup>1</sup>	Additions	Reductions	Balance June 30, 2019	Current Portion
Governmental Funds					
Other Long-Term Liabilities					
Claims and Judgments Payable	\$ 583,340,162	\$ 0	\$ 0	\$ 583,340,162	\$ 0
Employee Benefits:					
Compensated Absences	8,962,830	7,788,340	6,511,773	10,239,397	729,045
Net Pension Liability <sup>2</sup>	35,198,767	9,926,211		45,124,978	
Net Other Postemployment Benefits Liability <sup>3</sup>	128,196,901		17,333,235	110,863,666	
Workers' Compensation Liability <sup>4</sup>	1,093	7,905	3,167	5,831	5,831
<b>Total Other Long-Term Liabilities</b>	<b>\$ 755,699,753</b>	<b>\$ 17,722,456</b>	<b>\$ 23,848,175</b>	<b>\$ 749,574,034</b>	<b>\$ 734,876</b>

<sup>1</sup> The July 1, 2018 workers' compensation liability was restated for the amounts payable as of June 30, 2018.

<sup>2</sup> Additional information regarding the net pension liability is included in Note 14.

<sup>3</sup> Additional information regarding the net other postemployment benefits liability is included in Note 15.

<sup>4</sup> Additional information regarding the workers' compensation liability is included in Note 16.

**NOTE 10 - OPERATING LEASE OBLIGATIONS**

The Department entered into operating leases for facilities. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2019:

<u>Fiscal Year</u>	<u>General Fund</u>
2020	\$ 3,264,761
2021	3,083,465
2022	2,568,061
2023	2,060,921
2024	1,612,791
2025-2029	<u>3,716,468</u>
Total Minimum Lease Payments	<u>\$ 16,306,467</u>

Rental expense for all operating leases during the year was \$3,242,425.

**NOTE 11 - FUND BALANCE**

The details of the fund balance classifications for the governmental funds at June 30, 2019 were as follows:

	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total</u>
Fund Balance:			
Nonspendable:			
Inventories	\$ 4,051,656	\$ 0	\$ 4,051,656
Committed to:			
General Government			
Project Collect Tax	57,096,340		57,096,340
Transaction Fees	5,011,156		5,011,156
Operations and Maintenance for Tax Systems	115,607		115,607
Other Committed	525,834		525,834
Unauthorized Substance Tax		1,068,314	1,068,314
Unassigned	<u>434,948,814</u>		<u>434,948,814</u>
Total Fund Balance	<u>\$ 501,749,407</u>	<u>\$ 1,068,314</u>	<u>\$ 502,817,721</u>

**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 for the fiscal year ended June 30, 2019, were as follows:

Revenues from Other State Agencies:

	Purpose	Amount
<b>General Fund:</b>		
Department of Transportation	Motor Fuels Reimbursement	\$ 4,006,203
Department of Transportation	Fuel Tax Compliance Reimbursement	1,429,116
Department of Transportation	International Registration Plan Reimbursement	202,128
Department of Transportation	Project Collect Tax	162,838
Department of Information Technology	Information Technology Security Positions	401,999
Department of Insurance	Insurance Reimbursement	150,661
Department of Agriculture and Consumer Services	Forestry Reimbursement	119,460
Department of Agriculture and Consumer Services	Project Collect Tax	550
<b>Total Revenues from Other State Agencies</b>		<b>\$ 6,472,955</b>

Expenditures to Other State Agencies:

	Purpose	Amount
<b>General Fund:</b>		
Department of Commerce	Job Development Investment Grants	\$ 201,819
Statewide General Fund	William S. Lee Fees	5,000
<b>Total</b>		<b>206,819</b>
<b>Special Revenue Fund:</b>		
Statewide General Fund	25% Transfer to General Fund	1,654,849
<b>Total</b>		<b>1,654,849</b>
<b>Total Expenditures to Other State Agencies</b>		<b>\$ 1,861,668</b>

**NOTE 13 - INTERFUND BALANCES AND TRANSFERS**

**A. Interfund Balances**

Amounts due to/from other funds at June 30, 2019 were as follows:

	Due From Other Funds	
	General Fund	Fiduciary Fund - Local Governments
<b>Due To Other Funds</b>		
General Fund	\$ 0	\$ 37,757,977
Special Revenue	59,561	
<b>Total</b>	<b>\$ 59,561</b>	<b>\$ 37,757,977</b>

**B. Interfund Transfers**

Transfers in/out of other funds for the fiscal year ended June 30, 2019 consisted of the following:

	Transfers In			Total
	General Fund	State General Fund	Other State Funds	
<b>Transfers Out</b>				
General Fund	\$ 0	\$ 23,836,749,444	\$ 99,499,087	\$ 23,936,248,531
Special Revenue	681,224			681,224
<b>Total</b>	<u>\$ 681,224</u>	<u>\$ 23,836,749,444</u>	<u>\$ 99,499,087</u>	<u>\$ 23,936,929,755</u>

Transfers are primarily used to (1) transfer revenues and proceeds 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) \$71,218,740 to the Department of Public Instruction for the State Public School Fund per General Statute 105-164.44H, (2) \$23,820,211 to the Department of Insurance for Workers' Compensation and Volunteer Fire Department Funds per General Statute 105-228.5, and (3) \$4,460,136 to the Department of the State Treasurer to reimburse costs of Local Government Commission collections per General Statute 105-501.

The Department also had intrafund transfers from Company 99 to Company 45 for fiscal year ended June 30, 2019, in the amount of \$47,419,782, 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 14 - PENSION PLANS****A. Cost-Sharing, Multiple-Employer, 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.

TSERS plan members who are LEOs are eligible to retire with full retirement benefits at age 55 with five years of creditable service as an officer, or at any age with 30 years of creditable service. LEO plan members are eligible to retire with partial retirement benefits at age 50 with 15 years of creditable service as an officer. Survivor benefits are available to eligible beneficiaries of LEO 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 (not including sick leave) regardless of age, or have completed 15 years of creditable service as an LEO and have reached age 50, or have completed five years of creditable service as an LEO and have reached age 55, or have completed 15 years of creditable service as an LEO if killed in the line of duty. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions.

*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, 2019 was 12.29% of covered payroll. Employee contributions to

the pension plan were \$4,328,084, and the Department's contributions were \$8,865,358 for the year ended June 30, 2019.

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 2018 *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. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the TSERS plan, and additions to/deductions from the TSERS plan's fiduciary net position have been determined on the same basis as they are reported by TSERS.

*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 2018 *Comprehensive Annual Financial Report*.

*Net Pension Liability:* At June 30, 2019, the Department reported a liability of \$45,124,978 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2018. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2017, and update procedures were used to roll forward the total pension liability to June 30, 2018. 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, 2018, the Department's proportion

was 0.45324%, which was an increase of 0.00962 from its proportion measured as of June 30, 2017, which was 0.44362%.

*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	12/31/2017
Inflation	3.0%
Salary Increases*	3.5% - 8.1%
Investment Rate of Return**	7.0%

\* 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, 2017 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, 2018 (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 rate of return for the Bond Index Investment Pool as of June 30, 2018 is 1.5%.

*Discount Rate:* The discount rate used to measure the total pension liability was lowered from 7.2% to 7.0% for the December 31, 2017 valuation. The 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, 2018 calculated using the discount rate of 7.0%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.0%) or 1-percentage point higher (8.0%) than the current rate:

Net Pension Liability		
1% Decrease (6.0%)	Current Discount Rate (7.0%)	1% Increase (8.0%)
\$ 86,060,980	\$ 45,124,978	\$ 10,775,618

*Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions:* For the year ended June 30, 2019, the Department's proportionate share of the collective pension expense was \$11,205,567. At June 30, 2019, the Department's proportionate share of deferred outflows of resources and deferred inflows of resources related to pensions were 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	\$ 3,293,251	\$ 452,859
Changes of Assumptions	9,055,422	
Net Difference Between Projected and Actual Earnings on Plan Investments	4,300,418	
Change in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions	1,713,545	
Contributions Subsequent to the Measurement Date	8,865,358	
<b>Total</b>	<b>\$ 27,227,994</b>	<b>\$ 452,859</b>

The amount of \$8,865,358 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, 2020. 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
2020	\$ 10,338,370
2021	6,621,072
2022	1,029,302
2023	(78,967)
2024	
<b>Total</b>	<b>\$ 17,909,777</b>

## B. Defined Contribution Plan

Internal Revenue Code Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No

costs are incurred by the Department except for a 5% employer contribution for the Department's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of Department law enforcement officers for the year ended June 30, 2019, were \$86,766.

#### **NOTE 15 - 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 2018 *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 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. For purposes of measuring the net other postemployment benefits (OPEB) liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of each plan, and additions to/deductions from each plans' fiduciary net position have been determined on the same basis as they are reported by the plans.

*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 2018 *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 contributions 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 16. 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, the Consolidated Judicial Retirement System, the Legislative Retirement

System, the University Employees' Optional Retirement Program (ORP), and a small number of local governments, 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 North Carolina General Assembly first taking office on or after February 1, 2007, future coverage as retired employees and retired members of the North Carolina 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 North Carolina 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, 2019 was 6.27% of covered payroll. The Department's contributions to the RHBF were \$4,522,848 for the year ended June 30, 2019.

## 2. Disability Income

*Plan Administration:* As discussed in Note 16, 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 which includes employees of the State, the University of North Carolina system, community colleges, certain participating component units, LEAs which are not part of the reporting entity, and the University Employees' ORP. 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 or the University Employees' ORP, 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 or the University Employees' ORP.

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 North Carolina General Assembly and coincide with the State's fiscal year. The Department's contractually-required contribution rate for the year ended June 30, 2019 was 0.14% of covered payroll. The Department's contributions to DIPNC were \$100,989 for the year ended June 30, 2019.

### **C. Net OPEB Liability (Asset)**

*Net OPEB Liability:* At June 30, 2019, the Department reported a liability of \$110,863,666 for its proportionate share of the collective net OPEB liability for RHBF. The net OPEB liability was measured as of June 30, 2018. The total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of December 31, 2017, and update procedures were used to roll forward the total OPEB liability to June 30, 2018. 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, 2018, the Department's proportion was 0.38916%, which was a decrease of 0.00184 from its proportion measured as of June 30, 2017, which was 0.39100%.

*Net OPEB Asset:* At June 30, 2019, the Department reported an asset of \$119,077 for its proportionate share of the collective net OPEB asset for DIPNC. The net OPEB asset was measured as of June 30, 2018. The total OPEB asset used to calculate the net OPEB asset was determined by an actuarial valuation as of December 31, 2017, and update procedures were used to roll forward the total OPEB asset to June 30, 2018. 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, 2018, the Department's proportion was 0.39201%, which was an increase of 0.00383 from its proportion measured as of June 30, 2017, which was 0.38818%.



*Actuarial Assumptions:* The total OPEB liabilities for RHBF and DIPNC were determined by actuarial valuations as of December 31, 2017, using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified. The total OPEB liabilities were then rolled forward to June 30, 2018 utilizing update procedures incorporating the actuarial assumptions.

	Retiree Health Benefit Fund	Disability Income Plan of N.C.
Valuation Date	12/31/2017	12/31/2017
Inflation	3.00%	3.00%
Salary Increases*	8.10% grading down to 3.50% depending on employee class	3.50% - 8.10%
Investment Rate of Return**	7.00%	3.75%
Healthcare Cost Trend Rate - Medical	6.50% grading down to 5.00% by 2024	6.50% grading down to 5.00% by 2024
Healthcare Cost Trend Rate - Prescription Drug	7.25% grading down to 5.00% by 2027	N/A
Healthcare Cost Trend Rate - Medicare Advantage	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, 2018.



Best estimates of real rates of return for each major asset class included in RHBF's target asset allocation as of June 30, 2018 (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, 2018 is 1.5%.

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, 2017 valuations were generally based on the results of an actuarial experience study prepared as of December 31, 2014, as amended for updates to certain assumptions (such as the long-term investment return, medical claims, and medical trend rate assumptions) implemented based on annual reviews that have occurred since that experience study.

*Discount Rate:* The discount rate used to measure the total OPEB liability for RHBF was 3.87%. 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 3.87% was used as the discount rate used to measure the total OPEB liability. The 3.87% rate is based on the Bond Buyer 20-year General Obligation Index as of June 30, 2018.

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 (2.87%)	Current Discount Rate (3.87%)	1% Increase (4.87%)	
RHBF Net OPEB Liability	\$ 130,987,672	\$ 110,863,666	\$ 94,733,841	
	1% Decrease (2.75%)	Current Discount Rate (3.75%)	1% Increase (4.75%)	
DIPNC Net OPEB Asset	\$ (91,240)	\$ (119,077)	\$ (145,781)	

*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 - 4.00%, Administrative - 2.00%)	Current Healthcare Cost Trend Rates (Medical - 5.00 - 6.50%, Pharmacy - 5.00 - 7.25%, Med. Advantage - 5.00%, Administrative - 3.00%)	1% Increase (Medical - 6.00 - 7.50%, Pharmacy - 6.00 - 8.25%, Med. Advantage - 6.00%, Administrative - 4.00%)
RHBF Net OPEB Liability	\$ 91,460,426	\$ 110,863,666	\$ 136,338,528
	1% Decrease (5.50% grading down to 4.00% in 2024)	Current Healthcare Cost Trend Rates (6.50% grading down to 5.00% in 2024)	1% Increase (7.50% grading down to 6.00% in 2024)
DIPNC Net OPEB Asset	\$ (119,422)	\$ (119,077)	\$ (118,752)

*Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB:* For the year ended June 30, 2019, the Department's proportionate share of the collective OPEB expense was \$1,203,198 for RHBF and \$14,185 for DIPNC. At June 30, 2019, the Department's proportionate share of deferred outflows of resources and deferred inflows of resources related to OPEB were 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	\$ 207,718	\$ 207,718
Changes of Assumptions		22,486	22,486
Net Difference Between Projected and Actual Earnings on Plan Investments	11,923	92,738	104,661
Changes in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions	11,087,124	16,828	11,103,952
Contributions Subsequent to the Measurement Date	4,522,848	100,989	4,623,837
<b>Total</b>	<b>\$ 15,621,895</b>	<b>\$ 440,759</b>	<b>\$ 16,062,654</b>

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

	RHBF	DIPNC	Total
Differences Between Actual and Expected Experience	\$ 7,581,346	\$ 0	\$ 7,581,346
Changes of Assumptions	48,028,699		48,028,699
Changes in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions	344,530		344,530
Total	\$ 55,954,575	\$ 0	\$ 55,954,575

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, 2020. 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
2020	\$ (10,190,581)	\$ 86,175
2021	(10,190,581)	86,163
2022	(10,190,581)	58,368
2023	(10,178,727)	45,255
2024	(4,105,058)	31,911
Thereafter		31,898
Total	\$ (44,855,528)	\$ 339,770

**NOTE 16 - 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 15, 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 15, 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 \$2,000,000 per claim and \$10,000,000 in the aggregate per fiscal year 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.

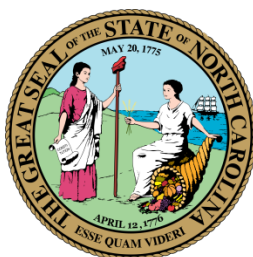
## 4. Statewide Workers' Compensation Program

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 17 - SUBSEQUENT EVENT

Governor Cooper issued a state of emergency for North Carolina to respond to the COVID-19 crisis on March 10, 2020. It is anticipated that the COVID-19 outbreak will have a negative impact on general fund tax revenues. Individual income tax and sales and use tax revenues generally account for 88% of total general fund tax revenues. It is expected that these taxes, as well as others, will begin to be negatively impacted in the last quarter of the 2020 fiscal year due to governmental and private actions in response to the crisis. The extent of how large of an impact and how long tax revenues will be negatively impacted is currently unknown.



# **REQUIRED SUPPLEMENTARY INFORMATION**

**North Carolina Department of Revenue**  
**Required Supplementary Information**  
**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, 2019**

**Exhibit C-1**

	Budgeted Amounts			
	Original	Final	Actual (Cash Basis)	Favorable (Unfavorable)
REVENUES				
Tax Revenues <sup>1</sup>	\$ 23,017,900,000	\$ 23,017,900,000	\$ 23,883,233,097	\$ 865,333,097
Services	510,997	2,812,702	2,609,895	(202,807)
Fees	2,182,242	3,166,491	3,005,301	(161,190)
Revenues from Other State Agencies	9,980,727	8,580,981	6,463,531	(2,117,450)
Miscellaneous Revenues	591,541	866,172	173,056	(693,116)
Total Revenues	23,031,165,507	23,033,326,346	23,895,484,880	862,158,534
EXPENDITURES				
Salaries and Benefits	117,391,459	109,477,539	100,224,293	9,253,246
Contracted Personal Services	5,181,196	40,130,405	16,742,607	23,387,798
Supplies and Materials	825,127	796,575	643,655	152,920
Travel	1,528,078	1,530,797	1,241,770	289,027
Communication	3,523,947	3,541,674	2,685,137	856,537
Utilities	186,195	190,708	148,615	42,093
Data Processing Services	10,473,580	5,041,137	4,159,661	881,476
Other Services	4,336,636	8,102,637	7,735,296	367,341
Claims and Benefits	14,323	122,995	122,283	712
Other Fixed Charges	8,885,262	6,157,536	6,088,437	69,099
Capital Outlay	5,808,105	9,002,990	8,049,190	953,800
Insurance and Bonding	43,955	48,621	44,307	4,314
Expenditures to Other State Agencies	299,500	501,319	206,819	294,500
Other Expenditures	6,007,843	6,305,644	6,080,041	225,603
Total Expenditures	164,505,206	190,950,577	154,172,111	36,778,466
Excess of Revenues Over Expenditures	22,866,660,301	22,842,375,769	23,741,312,769	898,937,000
OTHER FINANCING SOURCES (USES)				
Sale of Capital Assets	1,000	1,000	1,000	
Transfers to the State Reserve Fund		(759,802)	(759,802)	
Transfers from the State Reserve Fund		2,536,322	2,536,321	(1)
Transfers from Other Departments or Funds	2,263,942	2,105,111	2,276,114	171,003
Transfers to the State General Fund <sup>1</sup>	(23,017,900,000)	(23,017,900,000)	(23,836,749,444)	(818,849,444)
State Appropriations	87,046,713	87,046,713	84,093,147	(2,953,566)
Total Other Financing Sources (Uses)	(22,928,588,345)	(22,926,970,656)	(23,748,602,664)	(821,632,008)
Net Change in Fund Balance	(61,928,044)	(84,594,887)	(7,289,895)	77,304,992
Fund Balance - July 1	67,431,626	67,431,626	67,431,626	
Fund Balance - June 30	\$ 5,503,582	\$ (17,163,261)	\$ 60,141,731	\$ 77,304,992

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

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



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

**A. Budgetary Process**

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

**B. Reconciliation of Budget/GAAP Reporting Differences**

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

**Basis differences:** Budgetary funds are accounted for on the cash basis of accounting, while under GAAP the governmental funds use the modified accrual basis of accounting. Accrued revenues and expenditures are recognized in the GAAP financial statements.

## NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION

The following table presents a reconciliation of resulting basis differences in the fund balance (budgetary basis) at June 30, 2019 to the fund balance on a modified accrual basis (GAAP).

	General Fund
Fund Balance (Budgetary Basis) June 30, 2019	\$ 60,141,731
<u>Reconciling Adjustments:</u>	
<b>Basis Differences:</b>	
<b>Accrued Revenues:</b>	
Taxes Receivable	2,108,793,622
Less: Unearned Revenue	(375,800,000)
Accounts Receivable	1,138,225
Intergovernmental Receivable	10,513,462
Due from Other Funds	59,561
Total Accrued Revenues	<u>1,744,704,870</u>
<b>Accrued Expenditures:</b>	
Accounts Payable	(2,239,012)
Accrued Payroll	(14,351)
Intergovernmental Payables	(152,578,242)
Tax Refund Payable	<u>(1,036,316,810)</u>
Total Accrued Expenditures	<u>(1,191,148,415)</u>
Total Basis Differences	<u>553,556,455</u>
<b>Other Adjustments:</b>	
Undeposited Receipts	1,663,392
General Fund Tax Reserves	9,287,500
Undistributed E-911 Funds	2,519,886
Inventories	4,051,656
Securities Held in Trust (Sureties)	25,000
Due to Other Funds	(37,757,977)
Funds Held for Others	(24,850)
Unavailable Revenue	<u>(91,713,386)</u>
Total Other Adjustments	<u>(111,948,779)</u>
Fund Balance (GAAP Basis) June 30, 2019	<u><u>\$ 501,749,407</u></u>



# **SUPPLEMENTARY INFORMATION**

**North Carolina Department of Revenue**  
**Balance Sheet**

**General Fund - Company 45**

**As of June 30, 2019**

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

**Exhibit D-1**

	<b>2019</b>	<b>2018</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 62,878,465	\$ 69,826,356
Accounts Receivable, Net	499,839	194,797
Due from Company 99 <sup>1</sup>	2,661,471	3,304,567
Due from Other Funds	59,561	66,019
Inventories	4,051,656	2,236,849
Securities Held in Trust (Sureties)	25,000	40,300
Total Assets	<u>70,175,992</u>	<u>75,668,888</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Total Deferred Outflows of Resources	<u>0</u>	<u>0</u>
Total Assets and Deferred Outflows of Resources	<u><u>\$ 70,175,992</u></u>	<u><u>\$ 75,668,888</u></u>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 1,851,618	\$ 2,308,499
Accrued Payroll	14,351	
Intergovernmental Payables	2,519,446	2,390,835
Funds Held for Others	24,850	40,150
Total Liabilities	<u>4,410,265</u>	<u>4,739,484</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Total Deferred Inflows of Resources	<u>0</u>	<u>0</u>
<b>FUND BALANCE</b>		
Nonspendable	4,051,656	2,236,849
Committed	62,748,937	70,680,305
Unassigned	(1,034,866)	(1,987,750)
Total Fund Balance	<u>65,765,727</u>	<u>70,929,404</u>
Total Liabilities, Deferred Inflows, and Fund Balance	<u><u>\$ 70,175,992</u></u>	<u><u>\$ 75,668,888</u></u>

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

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

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

**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balance**  
**General Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2019**  
**(With Comparative Totals for June 30, 2018)**

**Exhibit D-2**

	<b>2019</b>	<b>2018</b>
<b>REVENUES</b>		
Services	\$ 2,609,895	\$ 1,890,043
Fees	3,005,301	2,536,082
Revenues from Company 99 <sup>1</sup>	47,419,782	48,808,277
Revenues from Other State Agencies	6,472,955	6,067,216
Miscellaneous Revenues	182,491	161,656
Total Revenues	59,690,424	59,463,274
<b>EXPENDITURES</b>		
Salaries and Benefits	100,254,017	99,477,394
Contracted Personal Services	16,717,990	15,714,370
Supplies and Materials	826,303	1,327,604
Travel	1,202,694	1,242,008
Communication	2,686,224	2,797,411
Utilities	154,298	151,984
Data Processing Services	4,053,634	4,930,396
Other Services	5,713,021	3,617,300
Claims and Benefits	122,283	66,642
Other Fixed Charges	6,019,641	5,980,740
Capital Outlay	7,305,410	4,927,580
Insurance and Bonding	72,971	41,490
Expenditures to Other State Agencies	206,819	4,000
Other Expenditures	6,071,695	5,297,501
Total Expenditures	151,407,000	145,576,420
Deficit of Revenues Under Expenditures	(91,716,576)	(86,113,146)
<b>OTHER FINANCING SOURCES (USES)</b>		
Sale of Capital Assets	2,009	500
Transfers to State Reserve Fund	(759,802)	(2,536,321)
Transfers from State Reserve Fund	2,536,321	825,629
Transfers In	681,224	694,180
State Appropriations	84,093,147	83,384,770
Total Other Financing Sources (Uses)	86,552,899	82,368,758
Net Change in Fund Balance	(5,163,677)	(3,744,388)
Fund Balance - July 1	70,929,404	74,673,792
Fund Balance - June 30	\$ 65,765,727	\$ 70,929,404

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

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

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

**North Carolina Department of Revenue**  
**Balance Sheet**

**Special Revenue Fund - Company 45**

**As of June 30, 2019**

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

**Exhibit D-3**

	<b>2019</b>	<b>2018</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 1,790,059	\$ 2,253,654
Taxes Receivable, Net	2,956,963	3,504,518
Total Assets	4,747,022	5,758,172
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Total Deferred Outflows of Resources	0	0
Total Assets and Deferred Outflows of Resources	\$ 4,747,022	\$ 5,758,172
<b>LIABILITIES</b>		
Intergovernmental Payables	\$ 1,029,348	\$ 1,228,723
Due to Other Funds	59,561	66,019
Total Liabilities	1,088,909	1,294,742
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable Revenue	2,589,799	3,041,082
Total Deferred Inflows of Resources	2,589,799	3,041,082
<b>FUND BALANCE</b>		
Committed	1,068,314	1,422,348
Total Fund Balance	1,068,314	1,422,348
Total Liabilities, Deferred Inflows, and Fund Balance	\$ 4,747,022	\$ 5,758,172

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, 2019**  
**(With Comparative Totals for June 30, 2018)**

**Exhibit D-4**

	<b>2019</b>	<b>2018</b>
<b>REVENUES</b>		
Tax Revenues	\$ 6,986,740	\$ 8,191,075
Total Revenues	6,986,740	8,191,075
<b>EXPENDITURES</b>		
Other Services	29,391	21,615
Statutory Tax Distributions	4,975,310	5,597,901
Expenditures to Other State Agencies	1,654,849	1,865,364
Total Expenditures	6,659,550	7,484,880
Excess of Revenues Over Expenditures	327,190	706,195
<b>OTHER FINANCING USES</b>		
Transfers Out	(681,224)	(694,180)
Total Other Financing Uses	(681,224)	(694,180)
Net Change in Fund Balance	(354,034)	12,015
Fund Balance - July 1	1,422,348	1,410,333
Fund Balance - June 30	\$ 1,068,314	\$ 1,422,348

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, 2019**

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

**Exhibit D-5**

	<b>2019</b>	<b>2018</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 10,734,044	\$ 25,235,099
Receivables:		
Taxes Receivable, Net	2,108,793,622	2,011,662,481
Accounts Receivable, Net	638,386	72,435
Intergovernmental Receivables	10,513,462	11,064,023
<b>Total Assets</b>	<b>2,130,679,514</b>	<b>2,048,034,038</b>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Total Deferred Outflows of Resources	0	0
<b>Total Assets and Deferred Outflows of Resources</b>	<b>\$ 2,130,679,514</b>	<b>\$ 2,048,034,038</b>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 387,394	\$ 528,848
Intergovernmental Payables	150,058,796	146,600,240
Tax Refunds Payable	1,036,316,810	997,142,469
Due to Company 45 <sup>1</sup>	2,661,471	3,304,567
Due to Other Funds	37,757,977	30,744,535
Unearned Revenue	375,800,000	351,200,000
<b>Total Liabilities</b>	<b>1,602,982,448</b>	<b>1,529,520,659</b>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable Revenue	91,713,386	81,882,430
<b>Total Deferred Inflows of Resources</b>	<b>91,713,386</b>	<b>81,882,430</b>
<b>FUND BALANCE</b>		
Unassigned	435,983,680	436,630,949
<b>Total Fund Balance</b>	<b>435,983,680</b>	<b>436,630,949</b>
<b>Total Liabilities, Deferred Inflows, and Fund Balance</b>	<b>\$ 2,130,679,514</b>	<b>\$ 2,048,034,038</b>

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

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

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



**North Carolina Department of Revenue**  
**Statement of Revenues, Expenditures, and Changes in Fund Balance**  
**General Fund - Company 99**  
**For the Fiscal Year Ended June 30, 2019**  
**(With Comparative Totals for June 30, 2018)**

**Exhibit D-6**

	<u>2019</u>	<u>2018</u>
<b>REVENUES</b>		
Tax Revenues	\$ 24,657,031,615	\$ 23,463,466,687
Miscellaneous Revenues	565,950	
Total Revenues	<u>24,657,597,565</u>	<u>23,463,466,687</u>
<b>EXPENDITURES</b>		
Statutory Tax Distributions	674,576,521	641,879,573
Expenditures to Company 45 <sup>1</sup>	<u>47,419,782</u>	<u>48,808,277</u>
Total Expenditures	<u>721,996,303</u>	<u>690,687,850</u>
Excess of Revenues Over Expenditures	<u>23,935,601,262</u>	<u>22,772,778,837</u>
<b>OTHER FINANCING USES</b>		
Transfers Out	<u>(23,936,248,531)</u>	<u>(22,731,569,316)</u>
Total Other Financing Uses	<u>(23,936,248,531)</u>	<u>(22,731,569,316)</u>
Net Change in Fund Balance	(647,269)	41,209,521
Fund Balance - July 1	<u>436,630,949</u>	<u>395,421,428</u>
Fund Balance - June 30	<u>\$ 435,983,680</u>	<u>\$ 436,630,949</u>

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

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

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

**North Carolina Department of Revenue**  
**Statement of Collections (Cash Basis)**  
**General Fund - Company 99 and Special Revenue Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2019**

**Exhibit E-1**

Source of Revenue	Gross Revenue	Refunds	Reserves for Local Government	Other Transfers	Net Revenue
<b>General Fund:</b>					
Estate Tax	\$ 388,896	\$ 0	\$ 0	\$ 0	\$ 388,896
Privilege License Tax	36,310,065	412,814		517,008	35,380,243
Tobacco Products Tax	293,387,550	443,785		35,780,015	257,163,750
Franchise Tax	779,412,760	18,940,950		10,848,240	749,623,570
Individual Income Tax	14,519,423,746	1,224,215,418		129,255,133	13,165,953,195
Sales and Use Tax	12,822,204,502	759,193,239	3,605,207,664	706,507,782	7,751,295,817
Alcoholic Beverage Tax	436,831,388	1,209,414	39,594,186	166,912	395,860,876
Gift Tax	93,674			908	92,766
Freight Car Lines Tax	261,415			2,770	258,645
Insurance Tax	635,015,295	10,201,922		71,134,440	553,678,933
Corporate Income Tax	1,030,465,016	192,872,957		7,137,536	830,454,523
Real Estate Conveyance Tax	80,378,786	20,763			80,358,023
White Goods Disposal Tax	6,210,735	17,285	2,978,777	328,668	2,886,005
Scrap Tire Disposal Tax	20,874,719	32,215	14,306,965	395,106	6,140,433
Manufacturing Tax	5,990,375	1,425,028		224,135	4,341,212
Solid Waste Disposal Tax	22,466,071	549	8,388,405	11,277,774	2,799,343
Miscellaneous Tax Receipts	377,734			304,520	73,214
Total	<u>\$ 30,690,092,727</u>	<u>\$ 2,208,986,339</u>	<u>\$ 3,670,475,997</u>	<u>\$ 973,880,947</u>	<u>\$ 23,836,749,444</u>
<b>Special Revenue Fund:</b>					
Unauthorized Substances Tax	<u>\$ 8,072,108</u>	<u>\$ 151,358</u>	<u>\$ 0</u>	<u>\$ 8,251,169</u>	<u>\$ (330,419)</u>

The following table presents a reconciliation of tax revenues (cash basis) to tax revenues on a modified accrual basis (GAAP) at June 30, 2019.

	General Fund	Special Revenue
Tax Revenues (Cash Basis)		
June 30, 2019	\$ 23,836,749,444	\$ (330,419)
<b>Reconciling Adjustments and Accruals:</b>		
Reserve for Local Government	65,268,333	
Other Transfers	729,236,841	8,251,169
Accrual Entries	377,897	(231,322)
Year-End Reclassification	25,399,100	(702,688)
<b>Tax Revenues (GAAP Basis)</b>		
June 30, 2019 (See Exhibit A-2)	<u>\$ 24,657,031,615</u>	<u>\$ 6,986,740</u>

**North Carolina Department of Revenue**  
**Statement of Collections (Cash Basis)**  
**General Fund - Company 99 and Special Revenue Fund - Company 45**  
**For the Fiscal Year Ended June 30, 2018**

**Exhibit E-2**

Source of Revenue	Gross Revenue	Refunds	Reserves for Local Government	Other Transfers	Net Revenue
<b>General Fund:</b>					
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	<u>\$ 29,032,270,068</u>	<u>\$ 2,040,620,963</u>	<u>\$ 3,429,432,927</u>	<u>\$ 926,305,074</u>	<u>\$ 22,635,911,104</u>
<b>Special Revenue Fund:</b>					
Unauthorized Substances Tax	<u>\$ 8,847,947</u>	<u>\$ 175,138</u>	<u>\$ 0</u>	<u>\$ 9,348,036</u>	<u>\$ (675,227)</u>

The following table presents a reconciliation of tax revenues (cash basis) to tax revenues 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)
<b>Reconciling Adjustments and Accruals:</b>		
Reserve for Local Government	64,906,772	
Other Transfers	691,036,071	9,348,036
Accrual Entries	47,500,549	223,471
Year-End Reclassification	24,112,191	(705,205)
<b>Tax Revenues (GAAP Basis)</b>		
June 30, 2018 (See Exhibit A-2)	<u>\$ 23,463,466,687</u>	<u>\$ 8,191,075</u>

**North Carolina Department of Revenue**  
**Schedule of Aging of Taxes Receivable**  
**General Fund - Company 99**  
**As of June 30, 2019**

**Exhibit F-1**

Tax Type	Delinquent Receivables (in years)				Total
	Less than 1	1 to 5	5 to 10	More than 10	
Individual	\$ 370,464,100	\$ 544,992,621	\$ 172,350,029	\$ 32,647,987	\$ 1,120,454,737
Corporate	23,193,950	8,555,065	348,464	131,698	32,229,177
Sales and Use	79,352,837	70,024,442	57,327,290	7,252,039	213,956,608
Franchise	15,620,400	5,419,317	576,678	110,692	21,727,087
Scrap Tire	103,515	195,348	200,209	8,442	507,514
White Goods	45,211	434	74		45,719
Manufacturing	37,044	299,830	3,411	375	340,660
Solid Waste	16,198				16,198
License and Excise	689,694	967,631	325,010	28,111	2,010,446
	<u>\$ 489,522,949</u>	<u>\$ 630,454,688</u>	<u>\$ 231,131,165</u>	<u>\$ 40,179,344</u>	<u>1,391,288,146</u>

**Reconciling Adjustments:**

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

Tobacco Products	\$ 11,915,724	
Estate	10,260,792	
License and Excise	1,242,732	
Alcoholic Beverage	788,486	
Gift	236,455	
Insurance	105,673	
Total PSRM Receivables Balance		24,549,862

**Other Adjustments:**

Unposted Accrued Interest for June 30, 2019	39,104,314
July Adjustments	(7,289,596)

**Delinquent Receivables (Gross) - General Fund** \$ 1,447,652,726

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

**Exhibit F-2**

Tax Type	Delinquent Receivables (in years)				Total
	Less than 1	1 to 5	5 to 10	More than 10	
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	0	11,364
Manufacturing	509,548	77,548	1,591	298	588,985
Solid Waste	3,070	0	0	0	3,070
License and Excise	692,044	787,259	228,795	11,220	1,719,318
	<u>\$ 513,196,495</u>	<u>\$ 550,542,317</u>	<u>\$ 245,029,626</u>	<u>\$ 28,557,176</u>	<u>1,337,325,614</u>

**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 Operating Expenditures by Purpose**  
**General Fund - Company 99 and Company 45**  
**For the Fiscal Year Ended June 30, 2019**  
**(With Comparative Totals for June 30, 2018)**

**Exhibit G-1**  
**Page 1 of 2**

	2019	2018
<b>Expenditures Paid for Department Operations and Administration:</b>		
Salaries and Benefits:		
Employee Salaries	\$ 69,781,669	\$ 69,743,703
Law Enforcement Salaries	1,723,041	1,874,029
Temporary Wages	535,948	644,881
Overtime Wages	85,880	88,015
Board Member Compensation	92,400	80,750
Other Salary Expenses	25,036	27,917
Regular Retirement Contributions	13,314,005	12,093,331
Law Enforcement Retirement Contributions	423,373	461,505
Medical Insurance Contributions	7,498,855	7,482,385
Social Security Contributions	5,334,216	5,376,071
Longevity Pay	1,192,852	1,203,500
Employee Educational Expense	132,276	78,437
Unemployment Compensation Payments	29,374	59,894
Workers Compensation Medical Payments	18,529	22,968
Flexible Spending Savings	131,166	122,714
Short Term Disability Payments, Net of Refunds	(88,674)	98,971
Other Employee Benefits	24,071	18,323
Total Salaries and Benefits	100,254,017	99,477,394
Contracted Personal Services:		
Other Information Technology Services	4,787,725	4,472,055
Temporary Agency and Administrative Services	8,539,303	9,051,472
IT Project Management and Analysis Services	12,448	
Legal Services	1,090,172	192,259
Financial and Audit Services	244,749	243,125
Security Services	700,935	669,645
Janitorial and Waste Services	116,343	98,434
Miscellaneous Contractual Services	1,226,315	987,380
Total Contracted Personal Services	16,717,990	15,714,370
Supplies and Materials:		
General Office Supplies	381,466	436,062
Data Processing Supplies	144,449	242,745
Other Supplies and Materials	300,388	648,797
Total Supplies and Materials	826,303	1,327,604
Travel:		
Ground Transportation	701,800	796,028
Air Transportation	82,426	67,494
Lodging	286,762	252,782
Meals	103,958	109,658
Other Travel	27,748	16,046
Total Travel	1,202,694	1,242,008
Communication:		
Telephone Service	1,096,926	1,226,990
Telecommunication Data Charges	1,130,311	1,292,800
Cellular Phone Services	410,480	231,490
Other Telephone Charges	48,507	46,131
Total Communication	2,686,224	2,797,411

**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, 2019**  
**(With Comparative Totals for June 30, 2018)**

**Exhibit G-1**  
**Page 2 of 2**

	2019	2018
<b>Expenditures Paid for Department Operations and Administration (Continued):</b>		
Utilities:		
Energy Services-Electrical	142,086	140,538
Other Utilities	12,212	11,446
Total Utilities	154,298	151,984
Data Processing Services	4,053,634	4,930,396
Other Services:		
Postage and Delivery	4,880,770	2,828,255
Printing and Binding	445,434	523,935
Other Services	386,817	265,110
Total Other Services	5,713,021	3,617,300
Claims and Benefits:		
Law Enforcement Separation Allowance	122,283	66,642
Other Fixed Charges:		
Computer Software Maintenance Agreements	4,743,714	4,706,276
Computer Hardware Maintenance Agreements	219,954	473,947
Other Equipment Maintenance Agreements	358,369	343,582
Membership Dues and Subscriptions	619,962	389,110
Other Fixed Charges	77,642	67,825
Total Other Fixed Charges	6,019,641	5,980,740
Capital Outlay:		
Computer Software	3,198,363	2,793,097
Computer Hardware	2,579,865	640,155
Office Furniture	737,453	1,190,169
Office Equipment	427,265	156,063
Other Capital Outlays	362,464	148,096
Total Capital Outlay	7,305,410	4,927,580
Insurance and Bonding	72,971	41,490
Expenditures to Other State Agencies	206,819	4,000
Other Expenditures:		
Office Building Rent	3,242,425	2,965,656
Office and Communication Equipment Rents and Leases	97,543	124,818
Other Rents and Leases	148,328	73,598
Electronic Payment Processing Fees	2,583,399	2,133,414
Other Operating Expenses		15
Total Other Expenditures	6,071,695	5,297,501
Total Expenditures Paid for Department Operations and Administration	151,407,000	145,576,420
<b>Expenditures Paid by the Department Pursuant to Statutory Tax Allocations:</b>		
Expenditures Paid to Local Governments Pursuant to Statutory Tax Allocations	674,576,521	641,879,573
Total General Fund Expenditures	\$ 825,983,521	\$ 787,455,993



# **INDEPENDENT AUDITOR'S REPORT**



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



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

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

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Secretary Ronald G. Penny  
and Management of the North Carolina Department of Revenue

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental funds and the fiduciary fund of the North Carolina Department of Revenue (Department), a department of the State of North Carolina, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated April 29, 2020.

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, 2019, 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, CPA  
State Auditor

Raleigh, North Carolina

April 29, 2020

# ORDERING INFORMATION

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For additional information, contact the  
North Carolina Office of the State Auditor at 919-807-7666



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This audit required 2,513.5 hours at an approximate cost of \$261,404, including costs associated with the report on the Department's statewide financial statement audit procedures.