

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



RALEIGH, NORTH CAROLINA FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 2017

A DEPARTMENT OF THE STATE OF NORTH CAROLINA



NC  **OSA**
The Taxpayers' Watchdog



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

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Certified Public Accountants
and Consultants

Report of Independent Auditors

To the North Carolina
Office of the State Auditor
Raleigh, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the North Carolina Office of the State Auditor (the “Office”) which comprise the balance sheet as of June 30, 2017, and the related statement of revenues, expenditures, and changes in fund balance for the year then ended, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 entity’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 entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Office as of June 30, 2017, and the results of its operations for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government 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.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Office as a whole. The schedule of revenues, expenditures, and changes in unreserved fund balance - budget and actual (the "budget and actual") is presented for purposes of additional analysis and is not a required part of the financial statements. The budget and actual are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Thomas S. Gibbs CA, PLLC

Durham, North Carolina
November 16, 2017



MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a narrative overview and analysis of the North Carolina Office of the State Auditor's financial performance for the fiscal year ended June 30, 2017. Please read it in conjunction with the financial statements which follow this section.

Discussion of the Basic Financial Statements

The North Carolina Office of the State Auditor (Office) is a part of the State of North Carolina (State) and is not a separate legal or reporting entity. The Office's accounts and transactions are included in the State of North Carolina's *Comprehensive Annual Financial Report* (CAFR) as a part of the State's General Fund.

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 financial statements of the Office. Because the Office is not a separate entity, government-wide financial statements are not prepared.

Governmental fund financial statements are reported using the current financial resources measurement focus and 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 State considers revenues to be available if they are collected within 31 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred.

Cash and Cash Equivalents are not presented on the current year financial statements due to a change in the method in which the cash carryforward process is handled at state agencies. Beginning in fiscal year 2016, state agencies no longer record approved carryforward funds. The agency carryforward is now recorded in a reserve account at the North Carolina Office of State Budget and Management.

Since capital asset and long-term liability accounts relating to governmental funds are reported only in the governmental activities column of the government-wide financial statements, these amounts are not included in the financial statements of the Office. However, amounts are reported in the notes to the financial statements.

Financial Condition

The Office continues to strategically optimize positions geographically and divisionally based on changing workloads and priorities. As a result, personal services expenditures were less than 2016, while contracted audit services were slightly higher. The Office expects to continue to efficiently manage resources to optimize output.

Condensed Data

See the following for comparative condensed financial information.

Condensed Balance Sheets
Governmental Fund

	6/30/2017	6/30/2016
Total Assets and Deferred Outflows of Resources	\$ 1,676,633.01	\$ 1,533,447.49
Liabilities, Deferred Inflows of Resources and Net Position:		
Total Liabilities	\$ 595,978.75	\$ 724,472.65
Total Deferred Inflows of Resources	1,517,086.50	1,466,741.70
Fund Balance:		
Nonspendable:		
Inventories	17,443.51	25,274.29
Unassigned	(453,875.75)	(683,041.15)
Total Fund Balance	(436,432.24)	(657,766.86)
Total Liabilities, Deferred Inflows of Resources and Fund Balance	\$ 1,676,633.01	\$ 1,533,447.49

Condensed Statements of Revenues, Expenditures, and
Changes in Fund Balance
Governmental Fund

	Fiscal Year Ended 6/30/17	Fiscal Year Ended 6/30/16
Revenues:		
Total Revenues	\$ 6,273,312.99	\$ 7,323,484.48
Expenditures:		
Personal Services and Employee Benefits	14,154,387.50	15,321,863.27
Contracted Audits and Services	1,447,117.97	1,167,951.72
Supplies and Materials	23,013.38	50,559.69
Travel	204,101.80	207,259.22
Communications	44,213.70	46,845.40
Utilities	5,230.63	6,097.60
Data Processing Service	61,055.54	70,319.27
Employee Education	147,086.84	140,171.37
Other Services	13,533.19	11,093.20
Rent of Property and Equipment	66,072.98	61,005.80
Service and Maintenance	245,309.85	287,797.47
Other Fixed Charges	50,066.95	50,651.90
Insurance and Bonding	2,539.03	2,644.60
Capital Outlay	586,886.38	78,985.82
Total Expenditures	17,050,615.74	17,503,246.33
Deficiency of Revenues Under Expenditures	(10,777,302.75)	(10,179,761.85)
Other Financing Sources (Uses):		
State Appropriations	10,770,189.61	10,733,890.79
Transfers In	1,235,561.00	0.00
Transfers Out	(1,007,163.24)	(1,645,896.80)
Sale of Surplus Property	50.00	(212.66)
Total Other Financing Sources	10,998,637.37	9,087,781.33
Net Change in Fund Balance	221,334.62	(1,091,980.52)
Fund Balance Beginning of Year	(657,766.86)	434,213.66
Fund Balance End of Year	\$ (436,432.24)	\$ (657,766.86)

Comparative Data and Variances

Total assets and deferred outflows of resources increased approximately \$143,186 during the current fiscal year primarily due to the increase in accounts receivable for the second and third quarters of fiscal year 2017. Receivables increased due to a small increase in the billing rate. Work performed during fiscal year 2016 for fiscal year 2015 audits was billed at \$99 per hour. Work performed during fiscal year 2017 for fiscal year 2016 audits was billed at \$103 per hour. The billing rate is based on actual historical costs of the Office.

The variance in the unassigned fund balance is partially due to a decrease in liabilities recorded in the prior year of \$680,341 related to an employment law matter. This large decrease from the prior year is offset by current year increases in total assets and accounts payable. The accounts payable increase is primarily due to a large year-end accrual for an information technology infrastructure upgrade.

Total revenues decreased by approximately \$1,050,171. This decrease is primarily due to the implementation of the United States Office of Management and Budget Uniform Guidance for audits. Under the new standards, the method to select federal programs to audit was slightly changed, which resulted in less federal programs being included in the fiscal year 2017 audit plan.

Personal services and employee benefits decreased during the 2017 fiscal period by approximately \$1,167,476. This decrease is materially due to the agency reorganization that occurred during the last quarter of fiscal year 2016. The Reorganization through Reduction program allowed the Office to restructure or reorganize to gain financial and/or skill set efficiencies and therefore increase agency effectiveness and achieve agency business needs, objectives and goals. Twelve former employees, making relatively higher salaries, voluntarily participated in this program, resulting in a large decrease in personal services and employee benefits during the 2017 fiscal period.

Capital outlay increased due to the costs of the information technology infrastructure upgrade.

Transfers in increased due to the change in the method in which the cash carryforward process is being handled at state agencies, as described in the *Discussion of Basic Financial Statements* section. This amount represents the funds that were distributed from the OSBM reserve account to the Office for authorized encumbrances carried forward from the prior year.

Net change in fund balance increased by approximately \$1,313,315. This increase is primarily due to the decrease in personal services and employee benefits and transfers out. The carryforward from the prior fiscal year to the current fiscal year is included as a transfer out, and this amount significantly decreased from fiscal year 2016 to fiscal year 2017.

Capital Asset Activity

The capital asset note includes a large increase for data processing systems for the information technology infrastructure upgrade. See Note 7 for more information.

Long-Term Liability Activity

The long-term liabilities shown in the notes to the financial statements consist of the outstanding balance in vacation and bonus leave referred to as compensated absences. Each employee may accumulate a maximum of 30 days of vacation which may be carried forward each January 1 or for which an employee may be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at 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 NC General Assembly in prior years. This unused bonus leave on hand could be retained by employees. It was not subject to the limitation on annual leave carried forward described above and was not subject to conversion to sick leave.

Additionally, the long-term liability activity reflects the Office's proportionate share of the collective net pension liability reported in State of North Carolina's *Comprehensive Annual Financial Report* (CAFR).

Economic Outlook

The budget for the 2017-2018 period has been approved, and we anticipate that the Legislative action for the 2017-2018 period for the Office will remain relatively constant.



FINANCIAL STATEMENTS

**North Carolina Office of the State Auditor
Balance Sheet
Governmental Fund - General Fund
June 30, 2017**

Exhibit A-1

ASSETS

Due from Other Funds	\$ 888,065.50
Due from Component Units	771,124.00
Inventories	<u>17,443.51</u>
Total Assets	<u>1,676,633.01</u>

DEFERRED OUTFLOWS OF RESOURCES

	<u>0.00</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 1,676,633.01</u>

LIABILITIES

Due to Employees	\$ 6,097.83
Due to Other Funds	14,949.56
Accounts Payable	<u>574,931.36</u>
Total Liabilities	<u>595,978.75</u>

DEFERRED INFLOWS OF RESOURCES

Unavailable Revenue	<u>1,517,086.50</u>
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FUND BALANCE

Nonexpendable:	
Inventories	17,443.51
Unassigned	<u>(453,875.75)</u>
Total Fund Balance	<u>(436,432.24)</u>
Total Liabilities, Deferred Inflows of Resources, and Fund Balance	<u>\$ 1,676,633.01</u>

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

North Carolina Office of the State Auditor
Statement of Revenues, Expenditures, and Changes in Fund Balance
Governmental Fund - General Fund
For the Fiscal Year Ended June 30, 2017

Exhibit A-2

REVENUES

Audit Fees	\$ 6,271,739.24
Miscellaneous Income	1,573.75
	<hr/>
Total Revenues	6,273,312.99

EXPENDITURES

Personal Services and Employee Benefits	14,154,387.50
Contracted Audits and Services	1,447,117.97
Supplies and Materials	23,013.38
Travel	204,101.80
Communications	44,213.70
Utilities	5,230.63
Data Processing Service	61,055.54
Employee Education	147,086.84
Other Services	13,533.19
Rent of Property and Equipment	66,072.98
Service and Maintenance	245,309.85
Other Fixed Charges	50,066.95
Insurance and Bonding	2,539.03
Capital Outlay	586,886.38
	<hr/>
Total Expenditures	17,050,615.74
	<hr/>
Deficiency of Revenues Under Expenditures	(10,777,302.75)

OTHER FINANCING SOURCES (USES):

State Appropriations	10,770,189.61
Transfers In - Carryforward	1,235,561.00
Transfers Out:	
Office of State Budget and Management - Carryforward	(689,418.00)
Office of State Budget and Management - Operating Transfer	(300,000.00)
Office of the State Controller - DCAP	(17,745.24)
Sale of Surplus Property	50.00
	<hr/>
Total Other Financing Sources (Uses)	10,998,637.37

Net Change in Fund Balance	221,334.62
Fund Balance, July 1, 2016	(657,766.86)
	<hr/>
Fund Balance, June 30, 2017	\$ (436,432.24)

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 Office of the State Auditor (Office) is a part of the State of North Carolina and is not a separate legal or reporting entity. The Office performs an array of work, including financial statement audits, financial-related audits, performance audits, information technology audits, and special investigations.
- 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 Office 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 Office. The Office's accounts and transactions are included in the State's *Comprehensive Annual Financial Report* as part of the State's governmental funds.

- C. Basis of Presentation** - The Office's records are maintained on a cash basis throughout the year, but adjustments are made at fiscal year end 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 financial statements of the Office. Because the Office is not a separate entity, government-wide financial statements are not prepared.

- D. Measurement Focus and Basis of Accounting** - Governmental fund financial statements are reported using the current financial resources measurement focus and 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 Office considers revenues to be available if they are collected within 31 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, except for compensated absences which are recognized as expenditures when payment is due. Pension contributions

to cost-sharing plans are recognized as expenditures in the period to which the payment relates, even if payment is not due until the subsequent period.

Since capital asset and long-term liability accounts relating to governmental funds are reported only in the governmental activities column of the government-wide financial statements, these amounts are not included in the financial statements of the Office. However, amounts are reported in the Notes to the Financial Statements.

- E. Due From Other Funds and Component Units** - These classifications are composed of amounts due from other funds or component units of the State of North Carolina for audit fees. All amounts are considered collectible and therefore, no allowance for doubtful accounts is recorded.
- F. Inventories** - Inventories, consisting of general supplies and materials, are recorded as expenditures when consumed rather than when purchased. In the fund financial statements, inventories are offset in a nonspendable fund balance account to indicate that they are not available for appropriation and are not expendable available financial resources.
- G. Unavailable Revenue** – Revenue is not recognized until it is considered available.
- H. Vacation and Sick Leave** - Employees earn vacation leave ranging from 1.17 to 2.17 days per month depending upon years of service. There is no requirement that vacation leave be taken; however, the maximum permissible accumulation of unused vacation leave which can be carried forward each January 1 or for which an employee can be paid upon termination of employment with the State is 30 days. Under this policy, the accumulated vacation leave for each employee at each June 30 would equal the leave carried forward at the previous December 31 plus the leave earned and less the leave taken between January 1 and June 30. Also, any accumulated vacation leave in excess of 30 days at December 31 is converted to sick leave.

There is a category of special “annual bonus leave” that was awarded by the General Assembly in prior years. These unused bonus leave balances could be retained by employees and transferred into the next calendar year. It was not subject to the limitation on annual leave carried forward described above and was not subject to conversion to sick leave.

Employees earn sick leave at the rate of one day per month with an unlimited accumulation. Employees are not paid for accumulated sick leave upon termination; however, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement. The State has no obligation to pay sick leave upon termination or retirement.

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

The nonspendable fund balance classification includes amounts that cannot be spent because they represent inventories that are not available for appropriation and are not expendable available resources.

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

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

NOTE 2 - PENSIONS PLANS

A. Teachers' and State Employees' Retirement System

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

Benefits Provided: TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of general members who die while in active service or within 180 days of their last day of service and who also have either

completed 20 years of creditable service regardless of age, or have completed five years of service and have reached age 60. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

Contributions: Contribution provisions are established by General Statute 135-8 and may be amended only by the North Carolina General Assembly. Employees are required to contribute 6% of their annual pay. The contribution rate for employers is set each year by the North Carolina General Assembly in the Appropriations Act based on the actuarially-determined rate recommended by the actuary. The Office's contractually-required contribution rate for the year ended June 30, 2017 was 9.98% of covered payroll. The Office's contributions to the pension plan were \$1,063,975.10, and employee contributions were \$639,664.39 for the year ended June 30, 2017.

The TSERS plan's financial information, including all information about the plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, is included in the State of North Carolina's fiscal year 2016 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

B. Deferred Compensation and Supplemental Retirement Income Plans

IRC Section 457 Plan - All permanent employees are eligible to participate in the deferred compensation plan offered by the State of North Carolina in accordance with Internal Revenue Code Section 457. The plan permits each participant to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation of service, death, disability, retirement or due to financial hardships if approved by the Board of Trustees of the plan. All costs of administering the plan are the responsibility of the plan's participants. Voluntary contributions by employees amounted to \$207,731.00 during the year ended June 30, 2017.

IRC Section 401(k) Plan - Effective January 1, 1985, Chapter 135, Article 5 of the North Carolina General Statutes authorized the creation of the Supplemental Retirement Income Plan of North Carolina in accordance with Internal Revenue Code Section 401(k). All employees who are members of the Teachers' and State Employees' Retirement System of North Carolina are eligible for enrollment in this plan. Members of the plan may receive their benefits upon retirement, disability, termination, hardship, or death. All costs of administering the plan are the responsibility of the plan's participants. Voluntary contributions by employees amounted to \$183,208.00 during the year ended June 30, 2017.

NOTE 3 - OTHER POSTEMPLOYMENT BENEFITS

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

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

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

For the current fiscal year, the Office contributed an average of 5.81% of covered payroll under TSERS to the Fund. Required contribution rates for the years ended June 30, 2016, and 2015, were 5.60% and 5.49%, respectively. The Office made 100% of its annual required contributions to the Plan for the years ended June, 30 2017, 2016, and 2015, which were \$619,450.99, \$649,446.46, and \$545,639.77, respectively. The Office assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

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

- B. Disability Income** - The Office participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of TSERS. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may

be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2017, the Office made a statutory contribution of .38% of covered payroll under TSERS to the DIPNC. Required contribution rates for the years ended June 30, 2016, and 2015, were .41% in both years. The Office made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2017, 2016, and 2015, which were \$40,512.08, \$47,548.76, and \$40,749.05, respectively. The Office assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 4 - OPERATING LEASES

The Office entered into operating leases for office space and equipment. Future minimum lease payments under non-cancelable operating leases consist of the following at June 30, 2017:

<u>Fiscal Year</u>	<u>Amount</u>
2018	\$ 54,582.54
2019	24,593.67
2020	8,711.28
Total Minimum Lease Payments	<u>\$ 87,887.49</u>

Rental expense for all operating leases during the year was \$65,301.54.

NOTE 5 - AUDIT FEES

The Office performs federal compliance audits as specified in Uniform Guidance. State agencies, universities, and community colleges are billed for the federal compliance audit work performed on a cost reimbursement basis. Additionally, the Office bills colleges and universities for the cost of their financial statement audits as required by law. The Office performs certain other audits on a cost reimbursement basis as required by law.

NOTE 6 - RISK MANAGEMENT

The Office 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**

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

2. Death Benefit Plan of North Carolina

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

3. Disability Benefit Plan

Short-term and long-term disability benefits are provided to eligible members of the Teachers' and State Employees' Retirement System. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability. Long-term disability benefits are payable as another postemployment benefit from the Disability Income Plan of North Carolina 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. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly. The NC Department of State Treasurer administers the plan.

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

The State Property Fire Insurance Fund insures all State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses for all operations supported by the State's General Fund is provided at no cost to this Office. Losses

covered by the Fund are subject to a \$5,000 per occurrence deductible.

The State is required by Chapter 58, Article 31, and Part 50 of the General Statutes to provide liability insurance on every state-owned motor vehicle. The State is self-insured for the first \$1,000,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than \$1,000,000 up to \$10,000,000 per occurrence.

2. Public Officers' and Employees' Liability Insurance

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

3. Employee Dishonesty and Computer Fraud

The Office is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from state funds. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. 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 are included in the program. When an employee is injured, the Office's primary responsibility is to arrange for and provide the necessary treatment for work related injuries. The Office is responsible to pay medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act.

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. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NOTE 7 - CAPITAL ASSETS

Purchases of capital assets are reported as expenditures in governmental funds. Consequently, capital asset balances are not reported on the face of the financial statements. In accordance with Office of the State Controller policy, assets that have a value of \$5,000 or more when acquired and a useful life of more than one year are recorded in the accounting system for statewide reporting purposes.

Depreciation is recorded at the statewide level. A summary of changes in the Office's capital asset balances is presented as follows:

	Balance July 1, 2016	Increases	Decreases	Balance June 30, 2017
Capital Assets:				
Furniture	\$ 380,076.22	\$ 0.00	\$ 0.00	\$ 380,076.22
Data Processing Systems	762,708.07	499,090.40	0.00	1,261,798.47
Total Capital Assets	<u>\$ 1,142,784.29</u>	<u>\$ 499,090.40</u>	<u>\$ 0.00</u>	<u>\$ 1,641,874.69</u>

NOTE 8 - CHANGES IN LONG-TERM LIABILITIES

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

The general long-term liability is composed of unused vacation and bonus leave and matching benefits for retirement and social security as well as the net pension liability representing the Office's proportionate share of the collective net pension liability reported in the State of North Carolina's 2016 *Comprehensive Annual Financial Report*. The net pension liability represents the Office's portion of the collective total pension liability less the fiduciary net position of the Teachers' and State Employees' Retirement System. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015, and update procedures were used to roll forward the total pension liability to June 30, 2016. The Office's proportion of the net pension liability was based on the present value of future salaries for the Office relative to the present value of future salaries for all participating employers, actuarially-determined.

A summary of changes in long-term liabilities is presented as follows:

	Balance July 1, 2016	Additions	Reductions	Balance June 30, 2017	Due Within One Year
Compensated Absences	\$ 1,368,502.00	\$ 891,575.00	\$ 817,578.00	\$ 1,442,499.00	\$ 82,078.15
Net Pension Liability	2,686,878.00	4,017,061.00	0.00	6,703,939.00	0.00
Total Long-Term Liabilities	<u>\$ 4,055,380.00</u>	<u>\$ 4,908,636.00</u>	<u>\$ 817,578.00</u>	<u>\$ 8,146,438.00</u>	<u>\$ 82,078.15</u>



REQUIRED SUPPLEMENTARY INFORMATION

North Carolina Office of the State Auditor
Required Supplementary Information
Schedule of Revenues, Expenditures, and Changes in
Unreserved Fund Balance-Budget and Actual (Budgetary Basis-Non-GAAP)
Governmental Fund
For the Fiscal Year Ended June 30, 2017

Schedule C-1

	General Fund			
	Budgeted Amounts		Actual (Cash Basis)	Under (Over) Final Budget
	Original	Final		
Revenues:				
Reimbursement from Primary Government	\$ 3,171,162.00	\$ 3,171,162.00	\$ 3,201,949.80	\$ (30,787.80)
Reimbursement from Component Units	2,535,543.00	2,774,505.00	2,967,736.50	(193,231.50)
Refund of Prior Year Expenditures	0.00	0.00	1,381.44	(1,381.44)
Procurement Card Rebates	0.00	355.00	373.75	(18.75)
Other Miscellaneous Revenues	0.00	0.00	1,200.00	(1,200.00)
Total Revenues	5,706,705.00	5,946,022.00	6,172,641.49	(226,619.49)
Expenditures:				
Personal Services	12,800,820.00	13,056,181.00	11,176,454.95	1,879,726.05
Employee Benefits	4,511,712.00	4,669,369.00	3,676,434.77	992,934.23
Contracted Audits and Services	1,102,795.00	1,429,255.00	1,407,307.97	21,947.03
Utility/Energy Service	8,053.00	6,053.00	4,113.60	1,939.40
Repair Service	2,326.00	2,326.00	751.00	1,575.00
Maintenance Agreements	70,000.00	241,605.00	238,909.76	2,695.24
Rental/Leases	29,585.00	68,414.00	66,072.98	2,341.02
Travel /Other Employee Expense	292,038.00	267,510.00	200,107.51	67,402.49
Communication/Data Processing	172,181.00	127,093.00	120,212.08	6,880.92
Other Services	136,958.00	154,263.00	151,923.33	2,339.67
General Administrative Supplies	41,182.00	27,785.00	13,971.76	13,813.24
Equipment and Intangible Assets	135,221.00	111,079.00	83,763.15	27,315.85
Other Expenditures	35,285.00	56,298.00	49,001.24	7,296.76
Reserves	0.00	989,418.00	989,418.00	0.00
Total Expenditures	19,338,156.00	21,206,649.00	18,178,442.10	3,028,206.90
Deficiency of Revenues Under Expenditures	(13,631,451.00)	(15,260,627.00)	(12,005,800.61)	(3,254,826.39)
Other Financing Sources:				
State Appropriations	13,631,401.00	13,631,401.00	10,770,189.61	2,861,211.39
Encumbrance Carryforward	0.00	1,629,176.00	1,235,561.00	393,615.00
Sale of Surplus Property	50.00	50.00	50.00	0.00
Total Other Financing Sources	13,631,451.00	15,260,627.00	12,005,800.61	3,254,826.39
Net Change in Fund Balance	0.00	0.00	0.00	0.00
Fund Balance July 1, 2016	0.00	0.00	0.00	0.00
Fund Balance June 30, 2017	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

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.

BUDGETARY (CASH) BASIS VS. GAAP (MODIFIED ACCRUAL)

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

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

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

	General Fund
Fund Balance (Budgetary Basis) June 30, 2017	\$ 0.00
Reconciling Adjustments:	
<i>Basis Differences:</i>	
Accrued Revenues	142,103.00
Accrued Expenditures	(595,978.75)
<i>Other Adjustment:</i>	
Inventories	17,443.51
Fund Balance (GAAP Basis) June 30, 2017	\$ (436,432.24)

OTHER INFORMATION

This audit required 85.25 audit hours at an approximate cost of \$8,100