

Financial Statements

**NORTH CAROLINA
OFFICE OF THE STATE AUDITOR
For the Fiscal Year Ended June 30, 2015**

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OFFICE OF THE STATE AUDITOR
Financial Statements
For the Fiscal Year Ended June 30, 2015**

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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, 2015, 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, 2015, 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 6 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
October 1, 2015

**NORTH CAROLINA OFFICE OF THE STATE AUDITOR
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2015**

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, 2015. 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 Boards (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.

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

During the 2015 fiscal year, the Office received a request to perform separate financial statement audits on the six largest state agencies. For the past 20 years State agency financial statements were audited only as necessary to support the State's *Comprehensive Annual Financial Report*. The Office responded to this request by performing a financial statement audit of the Department of Health and Human Services and the Department of Public Instruction, the two largest agencies. The use of resources significantly contributed to the increased Office expenditures of \$1.1 million over the 2014 fiscal year.

**NORTH CAROLINA OFFICE OF THE STATE AUDITOR
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2015**

The Office continues to strategically optimize positions geographically and divisionally based on changing workloads and priorities. As a result, personal services expenditures were slightly less than 2014, while contracted audit services were significantly greater. 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	6/30/2015	6/30/2014
Total Assets and Deferred Outflows of Resources	<u>\$ 1,677,210.06</u>	<u>\$ 940,555.72</u>
Liabilities, Deferred Inflows of Resources and Net Position:		
Total Liabilities	<u>\$ 34,379.40</u>	<u>\$ 32,281.91</u>
Total Deferred Inflows of Resources	<u>1,208,617.00</u>	<u>775,486.00</u>
Fund Balance:		
Nonspendable:		
Inventories	43,607.90	44,277.72
Assigned:		
For Outstanding Purchase Orders	331,686.00	57,582.00
Unassigned	<u>58,919.76</u>	<u>30,928.09</u>
Total Fund Balance	<u>434,213.66</u>	<u>132,787.81</u>
Total Liabilities, Deferred Inflows of Resources and Fund Balance	<u>\$ 1,677,210.06</u>	<u>\$ 940,555.72</u>

**NORTH CAROLINA OFFICE OF THE STATE AUDITOR
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2015**

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

	Fiscal Year Ended 6/30/15	Fiscal Year Ended 6/30/14
Revenues:		
Total Revenues	\$ <u>6,166,590.90</u>	\$ <u>5,277,886.20</u>
Expenditures:		
Personal Services and Employee Benefits	13,107,966.15	13,538,837.38
Contracted Audits and Services	1,911,188.30	275,769.93
Other Services	526,186.62	523,150.73
Travel	191,052.52	190,229.13
Capital Outlay	161,618.17	192,426.71
Supplies and Materials	29,772.65	28,721.21
Total Expenditures	<u>15,927,784.41</u>	<u>14,749,135.09</u>
Deficiency of Revenues Under Expenditures	<u>(9,761,193.51)</u>	<u>(9,471,248.89)</u>
Other Financing Sources (Uses):		
State Appropriations	10,079,189.29	9,603,808.21
Transfers Out	<u>(16,569.93)</u>	<u>(15,855.85)</u>
Total Other Financing Sources (Uses)	<u>10,062,619.36</u>	<u>9,587,952.36</u>
Net Change in Fund Balance	301,425.85	116,703.47
Fund Balance beginning of year	<u>132,787.81</u>	<u>16,084.34</u>
Fund Balance end of year	<u>\$ 434,213.66</u>	<u>\$ 132,787.81</u>

**NORTH CAROLINA OFFICE OF THE STATE AUDITOR
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2015**

Comparative Data and Variances

Total assets and deferred outflows of resources increased approximately 78% or \$736,654 during the current fiscal year due to the increase in billings for all 4 quarters of 2015 when compared to 2014. This increase was materially due to the increase in the hourly billing rate from \$76 for the billings during the 2014 fiscal year to \$94 per hour for billings during the 2015 fiscal year. The billing rate is based on actual historical costs of the Office.

Overall expenditures increased during the 2015 fiscal period by approximately \$1,178,649. This increase was materially due to the Office's performance of a financial statement audit of the Department of Health and Human Services and the Department of Public Instruction with the assistance of contract auditors. Additionally, the Office coordinated a contract audit of the new Core Banking System at the Department of the State Treasurer.

State appropriations increased during 2015, primarily due to the increase in total expenditures discussed above.

Capital Asset Activity

No significant changes were identified.

Long-Term Debt Activity

The long-term debt shown in the notes to the financial statements consists 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 (2002, 2003 and 2005). 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 debt 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 2015-2016 has not yet been approved. However, we anticipate that the Legislative action for the 2015-2016 period for the Office will remain relatively constant.

**North Carolina Office of the State Auditor
Balance Sheet
Governmental Fund
June 30, 2015**

Exhibit A

ASSETS	General
Cash and Cash Equivalents	\$ 331,686.00
Due from Other Funds	644,302.66
Due from Component Units	657,613.50
Inventories	43,607.90
	<hr/>
Total Assets	1,677,210.06
	<hr/>
DEFERRED OUTFLOWS OF RESOURCES	
Deferred Outflows of Resources	0.00
	<hr/>
Total Assets and Deferred Outflows of Resources	\$ 1,677,210.06
	<hr/> <hr/>
LIABILITIES	
Due to Employees	\$ 3,986.59
Due to Other Funds	11,704.94
Accounts Payable	18,687.87
	<hr/>
Total Liabilities	34,379.40
	<hr/>
DEFERRED INFLOWS OF RESOURCES	
Deferred Inflows of Resources	
Unavailable Revenue	1,208,617.00
	<hr/>
Total Deferred Inflows of Resources	1,208,617.00
	<hr/>
FUND BALANCE	
Nonspendable:	
Inventories	43,607.90
Assigned	331,686.00
Unassigned	58,919.76
	<hr/>
Total Fund Balance	434,213.66
	<hr/>
Total Liabilities, Deferred Inflows of Resources and Fund Balance	\$ 1,677,210.06
	<hr/> <hr/>

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
For the Fiscal Year Ended June 30, 2015***

Exhibit B

	<u>General</u>
Revenues:	
Audit Fees	\$ 6,165,158.00
Miscellaneous Income	1,432.90
	<hr/>
Total Revenues	6,166,590.90
	<hr/>
Expenditures:	
Personal Services and Employee Benefits	12,987,033.19
Contracted Audits and Services	1,911,188.30
Supplies and Materials	29,772.65
Travel	191,052.52
Communications	45,236.93
Utilities	4,549.92
Data Processing Service	95,999.09
Employee Education	120,932.96
Other Services	8,661.33
Rent of Property and Equipment	45,185.02
Service and Maintenance	233,965.40
Other Fixed Charges	89,829.03
Insurance and Bonding	2,759.90
Capital Outlay	161,618.17
	<hr/>
Total Expenditures	15,927,784.41
	<hr/>
Deficiency of Revenues Under Expenditures	(9,761,193.51)
	<hr/>
Other Financing Sources (Uses):	
State Appropriations	10,079,189.29
Transfer Out:	
Office of the State Controller - DCAP	(16,569.93)
	<hr/>
Total Other Financing Sources (Uses)	10,062,619.36
	<hr/>
Net Change in Fund Balance	301,425.85
Fund Balance July 1, 2014	132,787.81
	<hr/>
Fund Balance June 30, 2015	\$ 434,213.66
	<hr/> <hr/>

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

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. Reporting Entity** - 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'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.
- B. 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 generally accepted accounting principles (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 Boards (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.

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.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- C. Cash and Cash Equivalents** - This classification includes the amount on deposit with the State Treasurer that is available for expenditures in the next fiscal year.
- D. 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.
- E. Inventories** – Inventories 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.
- F. Unavailable Revenue** – Revenue is not recognized until it is considered available.
- G. 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 1st 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 30th 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 year end is converted to sick leave.

There is a category of special “annual bonus leave” that was awarded by the General Assembly in prior years (2002, 2003 and 2005). 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.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

H. 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 are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

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

Committed fund balances can only be used for specific purposes pursuant to constraints imposed by formal action of the N.C. General Assembly, the State's highest level of decision-making authority. The N.C. 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.

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

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.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 2 - PENSION PLANS

A. Teachers' and State Employees' Retirement System

Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System. The Teachers' and State Employees' Retirement System (System) is a cost sharing multiple-employer defined benefit pension plan administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by North Carolina General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2015, these rates were set at 9.15% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the Office had a total payroll of \$9,938,793.58 of which \$9,938,793.58 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$909,399.61 and \$596,327.61, respectively.

Required employer contribution rates for the years ended June 30, 2015 and 2014, were 9.15% and 8.69%, respectively, while employee contributions were 6% each year. The Office made 100% of its annual required contributions for the years ended June 30, 2015, 2014, and 2013, which were \$909,399.61, \$898,284.43, and \$895,846.60, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 2 - PENSION PLANS (CONCLUDED)

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 \$175,885.61 during the year ended June 30, 2015.

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 \$226,762.88 during the year ended June 30, 2015.

NOTE 3 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Benefits

The Office participates in the North Carolina Teachers' and State Employees' 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. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 3 - OTHER POSTEMPLOYMENT BENEFITS (CONTINUED)

A. Health Benefits (CONCLUDED)

The Plan's benefit and contribution provisions are established by the State Treasurer and the Board of Trustees of the State Health Plan for Teachers' and State Employees' as authorized by Chapter 135, Article 3B, of the General Statutes. 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 the Teachers' and State Employees' Retirement System 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 determined by the State Treasurer and the Board of Trustees of the State Health Plan for Teachers' and State Employees'.

For the current fiscal year the Office contributed 5.49% of the covered payroll under the Teachers' and State Employees' Retirement System to the Fund. Required contribution rates for the years ended June 30, 2014 and 2013, were 5.40% and 5.30% respectively. The Office made 100% of its annual required contributions to the Plan for the years ended June 30, 2015, 2014, and 2013, which were \$545,639.77, \$558,197.46, and \$569,986.43, 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 by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports," or by calling the State Controller's Financial Reporting Section at (919)-707-0500.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 3 - OTHER POSTEMPLOYMENT BENEFITS (CONCLUDED)

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 the Teachers' and State Employees' Retirement System. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and can be amended only by the North Carolina General Assembly. The DIPNC does not provide for automatic postemployment benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2015, the Office made a statutory contribution of .41% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. Required contribution rates for the years ended June 30, 2014 and 2013, were .44% and .44%, respectively. The Office made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2015, 2014, and 2013, which were \$40,749.05, \$45,482.76, and \$47,319.63, respectively. The Office assumes no liability for long-term disability benefits under the DIPNC other than its contribution.

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

NOTE 4 - OPERATING LEASES

The Office leases some of its office space and equipment. Future minimum lease commitments for non-cancelable operating leases as of June 30, 2015 are as follows:

Fiscal Year	Amount
2016	\$ 54,547.23
2017	50,087.24
2018	42,663.24
2019	15,270.87
2020	4,195.68
	\$ 166,764.26

Rental expense for all operating leases during the year was \$41,257.02.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 5 - AUDIT FEES

The Office performs federal compliance audits as specified in Federal OMB Circular A-133. 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 the 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 various State-administered insurance programs, purchase of commercial insurance and self-retention of certain risks.

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

The 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.

The Office is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from State funds. The 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 \$75,000 deductible.

Employees and retirees are provided health care coverage by the State's Comprehensive Major Medical Plan (Plan), a discretely presented component unit of the State of North Carolina. The Plan is funded by employer and employee contributions and is administered by a third party contractor.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 6 - RISK MANAGEMENT (CONCLUDED)

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.

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

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 an other 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.

There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any past three fiscal years.

Additional details on the state-administered risk management programs are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports," 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.

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 7 - CAPITAL ASSETS (CONCLUDED)

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, 2014	Additions	Deletions/ Transfers	Balance June 30, 2015
Furniture	\$ 380,076.22	\$ 0.00	\$ 0.00	\$ 380,076.22
Data Processing Systems	923,760.87	20,840.36	103,792.34	840,808.89
Total Capital Assets	<u>\$ 1,303,837.09</u>	<u>\$ 20,840.36</u>	<u>\$ 103,792.34</u>	<u>\$ 1,220,885.11</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 2015 *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, 2014. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2013, and update procedures were used to roll forward the total pension liability to June 30, 2014. 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 the Office's general long-term liability and its composition is as follows:

	Balance July 1, 2014 (as restated)	Additions	Deletions	Balance June 30, 2015	Due Within One Year
Compensated absences	\$ 1,307,946.00	\$ 1,005,775.00	\$ 959,004.00	\$ 1,354,717.00	\$ 134,659.00
Net pension obligation	4,601,832.00	0.00	3,752,765.00	849,067.00	0.00
Long-Term Liabilities	<u>\$ 5,909,778.00</u>	<u>\$ 1,005,775.00</u>	<u>\$ 4,711,769.00</u>	<u>\$ 2,203,784.00</u>	<u>\$ 134,659.00</u>

NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2015

NOTE 9 – CONTINGENCIES

On September 19, 2013, the Superior Court of North Carolina ruled against the NC Office of the State Auditor in a personnel hearing. The Office filed an appeal to this decision with the North Carolina Court of Appeals June 24, 2014. However, if the ruling stands, the Office may be liable for back pay, attorney fees and related benefits, as well as reinstatement of an employee. At this time, the amount of the ultimate liability cannot be estimated.

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, 2015

	General Fund			
	Budgeted Amounts		Actual (Cash Basis)	Under (Over)
	Original	Final		Final Budget
Revenues:				
Reimbursement from Primary Government	\$ 3,089,665.00	\$ 3,089,665.00	\$ 3,488,380.50	\$ (398,715.50)
Reimbursement from Component Units	2,482,030.00	2,482,030.00	2,645,719.00	(163,689.00)
Transfer In-Prev Yrs Budget	58,814.00	58,814.00	58,814.00	0.00
Prior Year Refund for Unemployment	0.00	22,611.00	22,610.05	0.95
Sale of Equipment	50.00	50.00	50.00	0.00
Procurement Card Rebates	0.00	0.00	520.24	(520.24)
Other Miscellaneous Revenue	0.00	0.00	600.00	(600.00)
Total Revenues	5,630,559.00	5,653,170.00	6,216,693.79	(563,523.79)
Expenditures:				
Personal Services	12,205,472.00	10,484,596.00	9,862,602.57	621,993.43
Employee Benefits	4,076,748.00	3,377,790.00	3,170,230.28	207,559.72
Contracted Audits and Services	172,864.00	1,994,803.00	1,900,920.30	93,882.70
Utility/Energy Service	8,053.00	5,053.00	3,109.34	1,943.66
Repair Service	2,326.00	1,276.00	1,084.53	191.47
Maintenance Agreements	70,000.00	283,087.00	233,965.40	49,121.60
Rental/Leases	29,585.00	48,119.00	45,185.02	2,933.98
Travel /Other Employee Expense	292,038.00	250,394.00	189,817.14	60,576.86
Communication/Data Processing	172,181.00	174,620.00	156,724.01	17,895.99
Other Services	136,958.00	148,497.00	123,175.48	25,321.52
General Administrative Supplies	41,182.00	35,091.00	28,926.99	6,164.01
Equipment and Intangible Assets	127,915.00	165,679.00	160,739.85	4,939.15
Other Expenditures	35,285.00	92,527.00	87,716.17	4,810.83
Reserves	0.00	331,686.00	331,686.00	0.00
Total Expenditures	17,370,607.00	17,393,218.00	16,295,883.08	1,097,334.92
Deficiency of Revenues Under Expenditures	(11,740,048.00)	(11,740,048.00)	(10,079,189.29)	(1,660,858.71)
Other Financing Sources (Uses):				
State Appropriations	11,740,048.00	11,740,048.00	10,079,189.29	1,660,858.71
Total Other Financing Sources (Uses)	11,740,048.00	11,740,048.00	10,079,189.29	1,660,858.71
Net Change in Fund Balance	0.00	0.00	0.00	0.00
Fund Balance July 1, 2014	0.00	0.00	0.00	0.00
Fund Balance June 30, 2015	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00

**NORTH CAROLINA OFFICE OF THE STATE AUDITOR
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY REPORTING
FOR THE FISCAL YEAR ENDED JUNE 30, 2015**

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.

Timing differences. A significant variance between budgetary practices and GAAP is the authorized carry forward of appropriated funds, which is treated as an expenditure in one year and a revenue in the next year.

The following table presents a reconciliation of resulting entity, basis, and timing differences in the fund balance (budgetary basis) to the fund balance on a modified accrual basis (GAAP) at June 30, 2015.

	General Fund
Fund Balance (Budgetary Basis), June 30, 2015	\$ 0.00
Reconciling Adjustments:	
<i>Basis Differences:</i>	
Accrued Revenues	93,299.16
Accrued Expenditures	(34,379.40)
<i>Other Adjustment:</i>	
Inventories	43,607.90
<i>Timing Difference:</i>	
Cash Carry-forward	331,686.00
Fund Balance (GAAP Basis), June 30, 2015	\$ 434,213.66