
**MANAGEMENT'S DISCUSSION
AND ANALYSIS—
Required Supplementary Information
(Unaudited)**

Management's Discussion and Analysis

In this section of the State of South Carolina's annual report, we provide a narrative overview and analysis of the State's financial performance for its accounting year (*fiscal year*) that ended June 30, 2006. Please read it together with (1) the Comptroller's *Letter of Transmittal* at the front of this report and (2) the financial statements, which follow this section.

Overview of the Financial Statements

This discussion and analysis provides an introduction to the State of South Carolina's basic financial statements, which include the following parts: (1) *government-wide financial statements*, (2) *fund financial statements*, (3) *component unit financial statements*, and (4) *notes to the financial statements*. This annual report also contains certain *required supplementary information* and other *supplementary information*.

Government-wide Financial Statements

The government-wide statements present a long-term view of the State's finances *as a whole*, using *accrual-basis accounting*—the same accounting methods that most businesses use. The basic government-wide financial statements are on pages 34 through 39 of this report.

There are two government-wide financial statements:

Statement of net assets: This statement presents information on *all* of the State's assets and liabilities, both short-term (*current*) and long-term (*non-current*). In addition, the statement reports the difference between assets and liabilities as *net assets*. Over time, the comparison of net assets to liabilities may indicate whether the State's financial health is strengthening or weakening. However, the statement of net assets does not tell the whole story. To assess the State's overall financial health, you would also need to consider factors such as the State's economy and the condition of its *capital assets* such as its buildings and *infrastructure* (roads and bridges).

Statement of activities: This statement presents information showing how the State's overall net assets changed during the year. The State reports a change in its net assets as soon as an underlying event occurs that would cause a change. The statement of activities accounts for all current-year revenues and expenses, regardless of when the State received or paid cash. Although governments compile the statement of activities using accounting methods similar to businesses, this statement's format is quite different from the format of a business's income statement. The statement of activities can help to show how much it costs the State to provide various services. It also can help to show the extent to which each government function covers its own costs through user fees, charges, or grants. The net *revenue (expense)* column on the far right of this statement (page 38) shows how much a particular function relies on taxes and other general revenues to finance its programs.

The government-wide statements report three different kinds of *activities*:

Governmental activities: Most of the State's basic services are included here, such as general government, education, health and environment, social services, administration of justice, and intergovernmental (State aid to local governmental entities, including aid to the State's public school system). Taxes (primarily income and sales taxes) and federal grants finance most of these services.

Business-type activities: These activities usually recover all, or a significant portion, of the costs of their services or goods by charging fees to customers. Higher education (State-supported colleges and universities), unemployment compensation benefits, financing of housing facilities, operating hospitals and clinics, and financing of student loans are the most significant of South Carolina's business-type activities.

Component units: Although component units are legally separate from the State, the State's elected officials are financially accountable for them. The Public Service Authority (Santee-Cooper, an electric utility company), the State Ports Authority, the Connector 2000 Association, Inc. (which operates the Southern Connector, a toll road), and the Lottery Commission are the State's major component units. Some financial information for these component units is included in this report. You also can obtain complete financial statements for these component units from their respective administrative offices (see Note 1a of the notes to the financial statements).

Fund Financial Statements

The fund financial statements on pages 40 through 63 of this report provide detailed information about the State's most significant funds—not the State as a whole. Funds are accounting designations that the State uses to track specific funding sources and spending for particular purposes. South Carolina, like other governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The State reports three types of *funds*:

Governmental funds: The State reports most of its basic services in governmental funds. Governmental funds account for activities that the State reports as *governmental activities* in its government-wide statements. These funds focus on *short-*

term inflows and outflows of expendable resources. The balances remaining at the end of the year help determine whether a fund has more or less financial resources available to spend in the near future. Because the governmental fund statements lack the additional long-term focus of the government-wide statements, we provide a reconciliation that explains the relationship (or differences) between the two kinds of statements. By comparing the two kinds of statements and examining the reconciliation, you may better understand the long-term impact of the State's near-term financing decisions.

The basic governmental fund statements are on pages 40 through 47 of this report.

Proprietary funds: Proprietary funds charge customers for the services they provide—whether they are outside customers (*enterprise funds*) or other State agencies and other governments (*internal service funds*). Proprietary funds use the *accrual basis of accounting* like businesses use. The State reports all of its enterprise funds (proprietary funds providing services to outside customers) as *business-type activities* in the government-wide statements. However, because our internal service fund operations primarily benefit other State agencies or other governments, these proprietary funds are included as *governmental activities* in the government-wide financial statements.

The basic proprietary fund statements are on pages 48 through 61 of this report.

Fiduciary funds: The State is the trustee, or *fiduciary*, for its employees' retirement plans. The State also is responsible for other assets that, because of a trust agreement, it is to use only for trust beneficiaries. We *exclude* these activities from the State's government-wide financial statements because the State is not to use these assets to finance its operations. The State has an obligation to ensure that the net assets it reports in fiduciary funds are used for their intended purposes.

The basic fiduciary fund statements are on pages 62 and 63 of this report.

Component Unit Financial Statements

The *Government-wide Financial Statements* section on the preceding page lists the State's major component units under the *Component units* subheading. More detailed financial statements for these component units are on pages 64 through 67 of this report.

Notes to the Financial Statements

Immediately following the financial statements are *notes* that help explain some of the information in the financial statements and provide more detailed data. The notes on pages 71 through 134 are necessary to fully understand the financial statements.

Required Supplementary Information

This section includes certain *required* reporting information that supplements the basic financial statements. Included in this section is a schedule that compares the State's legally adopted General Fund budget with actual revenues collected and expenditures paid for the year. Note 5 to the required supplementary information is a reconciliation that helps explain differences between the changes in fund balance of certain funds when presented on the budgetary-basis and the changes in fund balance of these funds when presented on the GAAP-basis as reported in the governmental fund statements. This required supplementary information is on pages 136 through 141 of this report.

Government-wide Financial Analysis

Exhibits 1 and *2* summarize the State's overall financial position and results of operations for the past two years based on information included in the government-wide financial statements.

Exhibit 1
State of South Carolina's Net Assets
 As of June 30, 2006, with Restated Comparative Data as of June 30, 2005
 (Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals - Primary Government		Total Percentage Change 2005-2006
	2006	2005	2006	2005	2006	2005	
Assets							
Current and other assets.....	\$ 8,876,671	\$ 7,632,230	\$ 4,876,142	\$ 4,565,513	\$ 13,752,813	\$ 12,197,743	12.7%
Capital assets.....	13,047,653	12,360,919	3,174,806	2,823,300	16,222,459	15,184,219	6.8%
Total assets.....	21,924,324	19,993,149	8,050,948	7,388,813	29,975,272	27,381,962	9.5%
Liabilities							
Long-term liabilities.....	5,178,649	5,122,938	3,476,631	3,135,539	8,655,280	8,258,477	4.8%
Other liabilities.....	3,836,837	3,429,415	910,027	882,346	4,746,864	4,311,761	10.1%
Total liabilities.....	9,015,486	8,552,353	4,386,658	4,017,885	13,402,144	12,570,238	6.6%
Net Assets							
Invested in capital assets, net of debt.....	9,371,744	8,877,813	1,973,060	1,778,072	11,344,804	10,655,885	6.5%
Restricted.....	3,089,781	2,735,158	1,248,472	1,232,819	4,338,253	3,967,977	9.3%
Unrestricted.....	447,313	(172,175)	442,758	360,037	890,071	187,862	373.8%
Total net assets.....	\$ 12,908,838	\$ 11,440,796	\$ 3,664,290	\$ 3,370,928	\$ 16,573,128	\$ 14,811,724	11.9%

Net Assets

As we noted earlier, the comparison of net assets to liabilities may serve, over time, as a useful indicator of the State's financial strength. At the end of the 2005-2006 accounting year, the State's net assets totaled \$16.573 billion.

The largest portion of the State's net assets reflects its investment in capital assets (for example, buildings, roads, and bridges), less any related debt used to acquire those assets that is still outstanding. The State uses these capital assets to provide services to citizens; consequently, they are *not* available for future spending. Further, the State cannot sell the capital assets themselves to repay the related debt because it needs the assets for its operations; so it must find other resources to repay the debt.

Restricted net assets generally are available for future spending but are subject to external restrictions, such as bond covenants, federal government grant restrictions, or restrictions imposed by enabling State legislation or through State constitutional provisions. The State's largest restricted balances include capital improvement bond proceeds (restricted for various capital projects), and loan program funds (restricted primarily for local government water and sewer projects).

Unrestricted net assets—resources available for future spending—reported a *positive* balance of \$890.071 million at June 30, 2006. This represents an improvement of \$702.209 million over the prior year. The majority of this improvement resulted from a \$619.488 million increase in the net assets reported for the State's governmental activities, which reported a \$447.313 million in unrestricted net assets for the current fiscal year versus a *negative* \$172.175 million balance in the prior year. This substantial improvement occurred primarily because of significant increases in fund balances for the State's General Fund and Departmental General Operating Fund, which are considered unrestricted for government-wide reporting.

The State's *business-type activities* also reported a *positive* \$442.758 million unrestricted net asset balance. This resulted from net positive balances of \$665.791 million associated with higher education and certain other business-type activities. However, that positive balance was offset by a \$223.033 million deficit related to the State-run medical malpractice insurance program.

Exhibit 2
State of South Carolina's Changes in Net Assets
 For the Fiscal Year Ended June 30, 2006, with Restated Comparative Data for the Fiscal Year Ended June 30, 2005
 (Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals - Primary Government		Total Percentage Change
	2006	2005	2006	2005	2006	2005	2005-2006
Revenues							
Program revenues:							
Charges for services.....	\$ 2,003,181	\$ 1,816,591	\$ 3,410,800	\$ 3,173,818	\$ 5,413,981	\$ 4,990,409	8.5%
Operating grants and contributions.....	5,774,762	6,052,454	478,462	423,946	6,253,224	6,476,400	(3.4%)
Capital grants and contributions.....	621,512	650,384	74,224	55,166	695,736	705,550	(1.4%)
General revenues:							
Individual income tax.....	3,156,028	2,762,538	—	—	3,156,028	2,762,538	14.2%
Retail sales and use tax.....	3,613,754	3,221,466	—	—	3,613,754	3,221,466	12.2%
Other taxes.....	1,753,214	1,469,701	—	—	1,753,214	1,469,701	19.3%
Unrestricted grants and contributions.....	18,664	26,391	—	—	18,664	26,391	(29.3%)
Unrestricted investment income.....	69,438	32,628	—	—	69,438	32,628	112.8%
Tobacco legal settlement.....	67,841	73,231	—	—	67,841	73,231	(7.4%)
Other.....	67,012	71,090	—	—	67,012	71,090	(5.7%)
Total revenues.....	17,145,406	16,176,474	3,963,486	3,652,930	21,108,892	19,829,404	6.5%
Expenses							
Governmental activities:							
General government.....	1,768,034	1,727,612	—	—	1,768,034	1,727,612	2.3%
Education.....	1,402,446	1,280,791	—	—	1,402,446	1,280,791	9.5%
Health and environment.....	4,766,947	4,767,155	—	—	4,766,947	4,767,155	(0.0%)
Social services.....	1,051,343	992,960	—	—	1,051,343	992,960	5.9%
Administration of justice.....	683,180	629,185	—	—	683,180	629,185	8.6%
Resources and economic development.....	181,375	197,351	—	—	181,375	197,351	(8.1%)
Transportation.....	905,050	664,125	—	—	905,050	664,125	36.3%
Intergovernmental.....	4,061,996	3,848,454	—	—	4,061,996	3,848,454	5.5%
Other.....	72,247	67,705	—	—	72,247	67,705	6.7%
Business-type activities:							
Higher education.....	—	—	2,871,493	2,679,238	2,871,493	2,679,238	7.2%
Higher education institution support ^a	—	—	881,583	800,151	881,583	800,151	10.2%
Unemployment compensation benefits.....	—	—	365,091	366,820	365,091	366,820	(0.5%)
Financing of housing facilities.....	—	—	150,626	147,021	150,626	147,021	2.5%
Medical malpractice insurance.....	—	—	52,598	47,432	52,598	47,432	10.9%
Financing of student loans.....	—	—	61,472	43,567	61,472	43,567	41.1%
Tuition prepayment program.....	—	—	38,849	26,653	38,849	26,653	45.8%
State maritime museum.....	—	—	6,911	6,638	6,911	6,638	4.1%
Insurance claims processing.....	—	—	1,536	1,655	1,536	1,655	(7.2%)
Other.....	—	—	24,172	29,055	24,172	29,055	(16.8%)
Total expenses.....	14,892,618	14,175,338	4,454,331	4,148,230	19,346,949	18,323,568	5.6%
Excess (deficiency) before transfers and extraordinary items.....	2,252,788	2,001,136	(490,845)	(495,300)	1,761,943	1,505,836	17.0%
Extraordinary items.....	—	—	(539)	(556)	(539)	(556)	3.1%
Net transfers.....	(784,746)	(714,238)	784,746	714,238	—	—	N/A
Increase in net assets.....	1,468,042	1,286,898	293,362	218,382	1,761,404	1,505,280	17.0%
Net assets, beginning of year (restated).....	11,440,796	10,153,898	3,370,928	3,152,546	14,811,724	13,306,444	11.3%
Net assets, end of year.....	\$ 12,908,838	\$ 11,440,796	\$ 3,664,290	\$ 3,370,928	\$ 16,573,128	\$ 14,811,724	11.9%

^a The higher education institution support activity represents certain associations, foundations, and authorities created for the benefit of the State's higher education institutions.

Changes in Net Assets

The State's net assets increased \$1.761 billion (11.9%) over the prior year's net assets.

Governmental Activities

Net assets of the State's governmental activities increased by \$1.468 billion (12.8%) primarily due to increased revenues. Governmental activities' revenues are derived mostly from taxes; grants and contributions, including federal aid; and charges for goods and services. *Exhibit 3* illustrates the sources of revenues that support governmental activities.

Governmental activities' expenses were mostly associated with services provided for health and environment, intergovernmental, general government, education, and social services. *Exhibit 4* compares the cost of these services with their *program revenues*—revenues derived directly from the program itself or from parties outside the State's taxpayers or citizenry. The difference between the two represents the *net cost* of these services that taxes and other general revenues financed. Intergovernmental expenses of \$4.062 billion represent aid provided to local governments, including local school districts; taxes and other general revenues entirely supported these expenses. This aid includes formula-based State revenue

sharing, aid to local school districts for public education, and subsidies to reimburse counties for the State’s residential property tax relief program. For the accounting year ended June 30, 2006, the State used \$8.746 billion in tax and other general revenues to finance the net cost of all services that the State’s governmental activities provided. Governmental activities reported \$784.746 million in net transfers to the State’s business-type activities, most of which represents support provided to the State’s public colleges and universities.

The following paragraphs highlight the most significant changes in revenues, expenses, and net transfers for governmental activities during the 2005-2006 accounting year:

- Charges for services grew by \$186.590 million (10.3%) primarily because two of the State’s internal service funds, the Employee Insurance Programs and the Insurance Reserve Fund, increased premiums to subscribers.
- Operating grants and contributions decreased \$277.692 million (4.6%) because of a change in the mechanism for funding disproportionate share for public hospitals. In prior years, that funding was provided through contributions received from public hospitals. Beginning with fiscal year 2005-2006, the State began assessing a hospital provider tax on all general hospitals in lieu of contributions, due to a change in Federal Medicaid requirements.
- Tax revenues increased \$1.069 billion (14.4%) over last year. Individual income taxes were up 14.2%; sales taxes increased 12.1%; and corporate income and other taxes grew by 19.3%, due to favorable economic conditions. In addition, the hospital provider tax (discussed above) added \$264.000 million in tax revenues during the year.
- Unrestricted investment income was up \$36.810 million (112.8%) due to increased cash balances and higher rates of return on those balances.
- Transportation expenses rose \$240.925 million (36.3%) because of an increase in highway construction and maintenance projects.

Exhibit 3
Revenues Supporting Governmental Activities - By Source
For the Fiscal Year Ended June 30, 2006

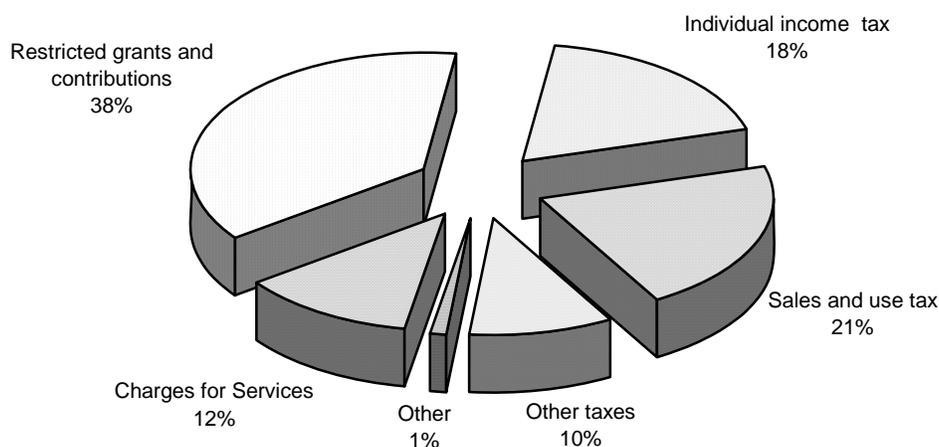
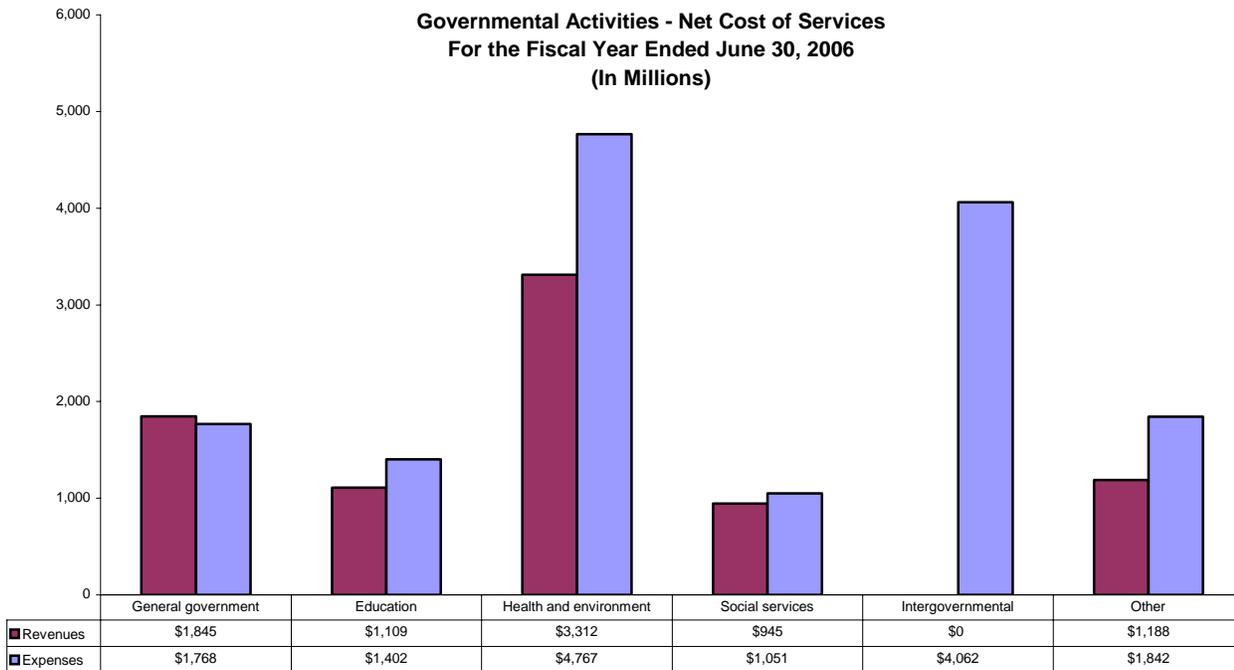


Exhibit 4

**Governmental Activities - Net Cost of Services
For the Fiscal Year Ended June 30, 2006
(In Millions)**



Business-type Activities

Net assets of the State’s business-type activities increased \$293.362 million (8.7%).

Revenues from business-type activities included charges for services (86.1%) and grants and contributions (including federal aid) (13.9%). Expenses from business-type activities were mostly to provide higher education services and support (84.3%), unemployment compensation benefits (8.2%), and financing of housing facilities (3.4%).

Most business-type activities are self-supporting. Tuition and student fees, research and other grants (both private and governmental), and other charges primarily pay for the services that the Higher Education Fund provides. However, the Higher Education Fund receives substantial resources (primarily transfers of annual appropriations) from the State’s governmental activities. Essentially, net transfers to the Higher Education Fund represent the cost of educational services that taxes and other general revenues of governmental activities support.

The following paragraphs highlight the most significant changes in revenues, expenses, and net transfers for business-type activities during the 2005-2006 accounting year:

- Charges for services increased \$236.982 million (7.5%), primarily because of increases for higher education activities. Revenues of State-supported colleges and universities increased because of higher tuition and student fees as well as from increased enrollment. Higher education revenues also increased because of lottery-funded scholarships to in-State students who met certain requirements.
- Operating grants and contributions increased \$54.516 million (12.9%). These were attributable to increased federal and state student grants and research grants and contracts,
- Higher education and support expenses increased \$273.687 million (7.9%). This increase resulted primarily from increases in compensation and benefits; services and supplies; and utility costs due to rate increases and the construction of new buildings. Other increases are the result of growth in both research and institutional programs.

Financial Analysis of the State’s Funds

The State of South Carolina uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Within the fund financial statements, the focus is on reporting major funds.

Governmental Funds

Exhibit 5 shows the components of fund balance for the State’s various governmental funds as of June 30, 2006.

Exhibit 5
State of South Carolina’s Governmental Fund Balances
(Expressed in Thousands)

	General Fund	Departmental General Operating	Local Government Infrastructure	Department of Transportation Special Revenue	State Tobacco Settlement	Nonmajor Governmental Funds	Total Governmental Funds
Reserved.....	\$ 280,169	\$ 16,911	\$ 1,820,493	\$ 13,503	\$ —	\$ 176,476	\$ 2,307,552
Unreserved, designated.....	555,378	—	—	—	—	322,336	877,714
Unreserved, undesignated.....	278,298	514,282	(386,935)	(64,369)	495,365	537,745	1,374,386
Totals.....	\$ 1,113,845	\$ 531,193	\$ 1,433,558	\$ (50,866)	\$ 495,365	\$ 1,036,557	\$ 4,559,652
Change from prior year.....	\$ 625,746	\$ 41,053	\$ (56,982)	\$ (107,662)	\$ 4,724	\$ 213,137	\$ 720,016
Percentage change.....	128.2%	8.4%	(3.8%)	(189.6%)	1.0%	25.9%	18.8%

At June 30, 2006, total ending fund balance for the State’s governmental funds was \$4.560 billion, which represents an increase of \$720.016 million (18.8%) from the prior year. Approximately half of this total (49.4%) makes up the *unreserved* fund balance—the amount available for spending in the coming year. The remaining fund balance is *reserved* and is *not* available for future appropriation because it is accessible only for specific purposes. The following paragraphs discuss the major governmental funds that had significant changes in fund balance:

The *General Fund* is one of two large State operating funds. This fund includes resources that pay for the services that the State traditionally has provided to its citizens. These resources, such as taxes, are accounted for in the General Fund unless State law requires them to be accounted for in another fund. During the 2005-2006 accounting year, the total fund balance of the General Fund increased \$625.746 million (128.2%) over last year. The increase was due to a combination of favorable economic conditions and conservative budgeting. Improvement in the national economy favorably affected the State’s economy in the form of job growth, corporate profits, and increased consumer spending. Individual income taxes increased \$361.410 million (13.1%); sales and use taxes increased \$192.296 million (8.2%); and corporate and other taxes increased \$93.141 million (11.9%). In addition, interest earnings increased \$35.170 million (127.4%) due to increased cash balances and higher interest rates. Overall, revenues were \$616.706 million (9.2%) greater than the previous year. Expenditures grew at a lesser pace primarily because conservative budget estimates limited the amount of authorized spending during the year. As a result, total expenditures increased by only \$377.487 million (7.0%) over the prior year. The most significant expenditure increases were attributable to education, up \$31.038 million (12.5%), and administration of justice, up \$52.036 million (11.3%). Operating transfers out of the General Fund increased \$122.374 million (15.5%). This increase was attributable in part to legislation that distributed increased tax revenues to certain State agencies.

The *Department of Transportation (DOT) Special Revenue Fund* accounts for various gasoline taxes, fees, fines, and federal grant resources. The DOT uses these resources to pay for its general operations, which include maintenance, regulation, and construction of public highways and bridges. Fund balance decreased \$107.662 million during 2005-2006 resulting in a negative total fund balance of \$50.866 million at the end of the fiscal year. This occurred primarily because of long-term commitments by DOT to provide funding for highway construction projects administered by the State Infrastructure Bank (included within the Local Government Infrastructure Fund which is presented with the other major governmental funds in the basic financial statements). These commitments are recorded as interfund payables by the DOT Special Revenue Fund and as interfund receivables by the Local Government Infrastructure Fund. The commitments will be discharged (i.e., reduced) as DOT provides construction services to the Bank.

Proprietary Funds

Exhibit 6 shows the components of net assets for the State’s various proprietary funds at June 30, 2006.

Exhibit 6
 State of South Carolina's Proprietary Fund Net Assets
 (Expressed in Thousands)

Fund Net Assets	Enterprise Funds							Internal Service Funds
	Higher Education	Unemployment Compensation	Housing Authority	Medical University Hospital Authority	Education Assistance Authority	Nonmajor Enterprise	Total Enterprise	
Invested in capital assets (net of related debt).....	\$ 1,867,185	\$ —	\$ 865	\$ 61,407	\$ 223	\$ 43,380	\$ 1,973,060	\$ 113,486
Restricted, expendable.....	278,484	386,932	242,416	67,781	129,105	45,297	1,150,015	236,216
Restricted, nonexpendable.....	72,889	—	—	—	—	25,568	98,457	109
Unrestricted.....	461,673	—	19,062	101,937	1,113	(157,163)	426,622	(46,212)
Totals.....	\$ 2,680,231	\$ 386,932	\$ 262,343	\$ 231,125	\$ 130,441	\$ (42,918)	\$ 3,648,154	\$ 303,599
Change from prior year.....	\$ 237,364	\$ (13,547)	\$ 18,450	\$ 30,625	\$ 505	\$ 7,481	\$ 280,878	\$ 203,442
Percentage change.....	9.7%	(3.4%)	7.6%	15.3%	0.4%	(14.8%)	8.3%	203.1%

The State has two kinds of proprietary funds: enterprise funds and internal service funds.

Enterprise funds are reported as business-type activities in the government-wide financial statements. Enterprise funds sell goods or services primarily to parties outside of State government.

The *Medical University Hospital Authority*, another enterprise fund, manages and operates the hospitals and clinics associated with the Medical University of South Carolina (MUSC). MUSC is included in the *Higher Education Fund* described above. The Authority's net assets increased \$30.625 million (15.3%) primarily due to increases in patient activity and comprehensive rate increases.

South Carolina's *internal service funds* provide certain services (including maintenance, insurance, printing, data processing, and motor pool services) and some goods (such as office supplies) primarily to other State funds but sometimes to local governments as well. The objective of an internal service fund is to charge its customers for the costs of the services or goods that it provides. Because internal service funds primarily benefit State government, South Carolina reports them as governmental activities in the government-wide financial statements.

Budgetary General Fund Highlights

The State's *Board of Economic Advisors (BEA)* is responsible for forecasting revenues for the budget. State law requires that the BEA meet at least quarterly to review revenue collections and to adjust its forecasts if necessary. If the BEA reduces revenue projections significantly once the budget year begins, the State's *Budget and Control Board* is responsible for mandating spending cuts to keep the budget in balance.

Original estimated revenues for the 2005–2006 accounting year were \$5.473 billion. The BEA revised its original revenue estimate three separate times during the course of the year by a total of \$505.667 million. The upward revisions resulted from their review of tax revenue collections and economic conditions as the year progressed. Actual revenues at June 30, 2006, were \$247.268 million more than the BEA's final revised estimate, and \$752.935 million (13.8%) over the original revenue estimate. Actual revenues exceeded prior year revenue collections by \$634.966 million (11.4%). Individual income and sales taxes, the fund's primary revenue sources, were greater than expected because of conservative revenue estimates and favorable economic conditions that lead to increased job growth and consumer spending.

Budgetary General Fund appropriations increased during the year by \$13.454 million. During 2005–2006, the General Assembly approved supplemental appropriations totaling \$13.095 million for the purchase of school bus fuel and parts. Those appropriations were funded from the 2004–2005 excess budgetary surplus funds. The remaining appropriation increase was needed to fund certain State-mandated programs that were underestimated in the Appropriations Act.

Furthermore, actual revenues were \$685.590 million greater than actual expenditures because conservative revenue estimates limited increases in agency spending. Transfers out during the year totaled \$231.183 million, which included \$99.356 million of 2004–2005 Capital Reserve Appropriations and \$131.827 million of increased tax enforcement collections transferred to the State's Other Budgeted Funds for agency spending. The State was able to end the year with an accumulated budgetary general fund balance of \$987.772 million.

See the *Required Supplementary Information* section on pages 136 through 141 of this report for a detailed budgetary comparison schedule.

Capital Assets and Debt Administration

Capital Assets

At the end of the 2005-2006 accounting year, the State had \$16.222 billion invested in capital assets. This represented a net increase (including additions and deductions) of \$1.038 billion, or 6.8%, over the previous accounting year (see *Exhibit 7*).

Exhibit 7
State of South Carolina's Capital Assets
As of June 30 for the Years Indicated
(Net of Depreciation, Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals—Primary Government	
	2006	2005	2006	2005	2006	2005
Land and improvements.....	\$ 1,522,999	\$ 1,459,853	\$ 223,495	\$ 209,351	\$ 1,746,494	\$ 1,669,204
Infrastructure.....	6,423,305	5,883,421	—	—	6,423,305	5,883,421
Buildings and improvements.....	1,009,521	903,596	2,150,777	1,967,494	3,160,298	2,871,090
Vehicles.....	155,527	155,218	12,391	12,358	167,918	167,576
Machinery and equipment.....	123,424	116,606	238,105	205,489	361,529	322,095
Works of art and historical treasures.....	3,596	3,712	23,666	19,746	27,262	23,458
Construction in progress.....	3,800,167	3,833,664	522,507	404,255	4,322,674	4,237,919
Intangible assets.....	9,114	4,849	3,865	4,607	12,979	9,456
Total.....	\$ 13,047,653	\$ 12,360,919	\$ 3,174,806	\$ 2,823,300	\$ 16,222,459	\$ 15,184,219

The State's investment in buildings and improvements increased significantly, primarily because the Department of Commerce completed the Vought Manufacturing Complex, a large economic development construction project, at a cost of approximately \$110.000 million. The South Carolina School for the Deaf and Blind also completed several large construction projects on the campus at a cost of approximately \$17.178 million.

Machinery and equipment assets increased significantly due, in large part, to the public universities. The Medical University of South Carolina made significant investments in medical, scientific, and laboratory equipment this year. Also, the University of South Carolina opened a new facility, which was equipped with laboratory and computer equipment.

The State's investment in works of art and historical treasures increased significantly due to Patriot's Point Development Authority completing an overhaul project on the aircraft carrier Yorktown at a cost of \$4.206 million.

Intangible assets increased from last fiscal year primarily because of the Department of Commerce's Virtual One Stop software system for workforce development at a cost of approximately \$1.355 million.

See Note 7 in the notes to the financial statements within this report for additional information on the State's capital assets.

Long-term Debt

At the end of the accounting year, the State had \$8.217 billion in bonds and notes outstanding—an increase of \$320.946 million, or 4.1%, over last year (see *Exhibit 8*). Note 12, in the notes to the financial statements, includes more detailed information about the State's long-term debt.

Exhibit 8
State of South Carolina's Outstanding Bonds and Notes
As of June 30 for the Years Indicated
 (Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals—Primary Government		Total Percentage Change
	2006	2005	2006	2005	2006	2005	2005-2006
Backed by the State:							
General obligation bonds.....	\$ 2,405,119	\$ 2,298,253	\$ 249,514	\$ 230,423	\$ 2,654,633	\$ 2,528,676	5.0%
Backed by specific revenues:							
Revenue bonds and notes.....	43,190	33,832	2,782,026	2,536,112	2,825,216	2,569,944	9.9%
Infrastructure Bank bonds.....	1,917,706	1,947,393	—	—	1,917,706	1,947,393	(1.5%)
Tobacco Authority bonds.....	796,900	820,905	—	—	796,900	820,905	(2.9%)
Limited obligation bonds.....	15,291	19,392	—	—	15,291	19,392	(21.1%)
Bond anticipation notes.....	—	—	6,855	9,345	6,855	9,345	(26.6%)
Total.....	\$ 5,178,206	\$ 5,119,775	\$ 3,038,395	\$ 2,775,880	\$ 8,216,601	\$ 7,895,655	4.1%

New debt resulted mainly from the issuance of revenue bonds by the *enterprise funds* reported in the business-type activities. The Housing Authority issued \$98.000 million in bonds for housing programs while the Education Assistance Authority issued \$208.300 million in bonds to provide financing for student loans.

Three bond rating services assign ratings to bonds that the State backs with its own taxing authority (*general obligation bonds*). Fitch Ratings rated these bonds as “AAA” and Moody’s Investors Service rated them as “Aaa” during the fiscal year ended June 30, 2006, the highest ratings that these services assign. Standard & Poor’s rated these bonds as “AA+” during the same period.

The State limits the amount of annual payments for principal and interest on general obligation bonds and notes rather than directly limiting the amount of those bonds and notes that the State may have outstanding. At June 30, 2006, the State legally could issue additional bonds as long as the new debt would not increase the State’s annual principal and interest payments by more than the following amounts: \$46.990 in total for all institution bonds, \$18.335 million for highway bonds, \$101.998 million for general obligation bonds, excluding institution and highway bonds, \$6.335 million for economic development bonds, and \$13.697 million for research university infrastructure bonds. (*Institution bonds* are general obligation bonds that benefit the State’s Higher Education Fund.)

Economic Factors and Next Year’s Budget

The “Rainy Day Account”

At June 30, 2006, the General Reserve Fund, sometimes called the *rainy day account*, was fully funded at \$153.488 million. The State’s Constitution requires restoration of the reserve to full funding within three years after a withdrawal. State law defines full funding for the reserve as 3% of the Budgetary General Fund’s revenues for the latest completed accounting year. The 2005-2006 Appropriation Act passed by the General Assembly appropriated \$78.333 million to fully restore the rainy day account.

Budgetary General Fund for the 2006-2007 Accounting Year

For fiscal year 2006-2007, estimated revenues per the Appropriation Act were \$6.085 billion, or \$141.000 million *less* than 2005–2006 revenue collections. This estimate was subsequently revised. On November 9, 2006, based on most recent revenue collection trends, the State’s Board of Economic Advisors (BEA) revised its original revenue estimate for fiscal year 2006-2007 upward by \$180.000 million (3.0%) to a total of \$6.265 billion.

See the *Budgetary General Fund Highlights* subsection above for additional information about the responsibilities of the BEA and the State Budget and Control Board.

Economic Conditions

Budgetary General Fund revenues for the first four months of the 2006-2007 fiscal year were \$200.992 million, 10.2% higher than during the same period for fiscal year 2005-2006. South Carolina’s three major revenue sources continue to experience significant gains, reinforcing the fact that economic conditions are improving in the State. Individual income taxes are up 9.0%, as withholdings increased 4.8% and estimated tax payments increased 19.3%. Corporate income taxes have grown by 16.0%. Sales taxes have increased 12.6% despite higher gasoline prices experienced during this period.

The BEA has adopted a preliminary Budgetary General Fund revenue estimate of \$6.581 billion for the 2007-2008 accounting year. This revenue forecast represents a 5.0% increase over the revised base for 2006-2007. The BEA will review this estimate again in February 2007 and either adjust or finalize it then.

Other Issues Expected to Impact Future Operations

In June 2004, the Governmental Accounting Standards Board (GASB) adopted Statement No. 43 and No. 45 which are new accounting and reporting standards for other post employment benefits (OPEB). OPEB include post employment benefits such as medical, prescription drug, and dental insurance benefits, provided to retired State government and school district employees. Currently, the State funds these benefits on a pay-as-you-go basis. The new standards will require the State to report the actuarially determined unfunded liability (an estimate of accumulated benefits expected to be paid in future years) along with the current costs associated with these benefits. Although these standards do not become effective until fiscal years 2006–2007 (GASB 43) and 2007–2008 (GASB 45), the State hired an independent actuarial firm to provide an estimate of the State’s OPEB liability at June 30, 2006 (as if the new standards had been in effect). The actuary’s report projects that the combined OPEB liability at June 30, 2006 for State and school district employees was estimated to be \$9.227 billion.

The General Assembly enacted legislation in 2005–2006 that provides for the establishment of a special committee to study the State’s OPEB obligation. The study is to address current funding and potential pre-funding of OPEB. The committee’s report is to be provided to the Governor and the General Assembly by January 15, 2007. Because the State has not completed the process of evaluating the impact of these new reporting standards, the financial impact on future years’ financial position and results of operations is not known at this time.

Requests For Information

The primary purpose of this financial report is to provide South Carolina’s citizens, taxpayers, customers, investors, and creditors with a general overview of the State’s finances and to demonstrate the State’s accountability for the money it receives. Please address your questions concerning information in this report to:

Office of the Comptroller General
1200 Senate Street
305 Wade Hampton Office Building
Columbia, South Carolina 29201

