

State of South Carolina
Office of Comptroller General

1200 Senate Street
305 Wade Hampton Office Building
Columbia, South Carolina 29201

Telephone: (803) 734-2121
Fax: (803) 734-2064
E-Mail: cgooffice@cg.sc.gov

RICHARD ECKSTROM, CPA
COMPTROLLER GENERAL

NATHAN KAMINSKI, JR., Esq.
CHIEF OF STAFF

November 15, 2007

**To the Citizens, Governor and
Members of the South
Carolina General Assembly**

I am pleased to present to the citizens of South Carolina this Comprehensive Annual Financial Report for the State of South Carolina for the fiscal year ended June 30, 2007. The report provides financial information about the State's operations during the year and describes its financial position at the end of the year. For the convenience of users, we have divided the report into three sections as follows:

- The Introductory Section, containing this letter of transmittal; the Certificate of Achievement for Excellence in Financial Reporting that we recently received for our report as of June 30, 2006; a list of State officials; and an organizational chart of State government.
- The Financial Section, including the report of the independent auditors, management's discussion and analysis, government-wide financial statements, fund financial statements, required supplementary information, other combining financial statements, and schedules.
- The Statistical Section, presenting comparative financial data and other non-financial data.

Management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal controls that was established for this purpose. Because the cost of internal controls should not exceed the anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The State Auditor and Clifton Gunderson LLP, an independent certified public accounting firm, jointly performed an independent audit of the State's basic financial statements for the fiscal year ended June 30, 2007. The auditors have issued an unqualified opinion, the most favorable outcome of the audit process.

This letter of transmittal is designed to complement management's discussion and analysis that immediately follows the report of the independent auditors.

PROFILE OF THE GOVERNMENT

South Carolina extends from the Atlantic Ocean westward to the Blue Ridge Mountains, containing over 30,000 square miles. Fortieth in geographic area among the fifty states, South Carolina ranks twenty-fifth in population with approximately 4.3 million citizens.

As shown in the organization chart on page 17, State government is divided into three separate branches: legislative, executive, and judicial. The State's citizens elect the legislative and executive branch officials. The General Assembly elects certain members of the judicial branch, including the Supreme Court. The principal State officials currently in office are listed on page 16.

State government provides a full range of services to South Carolina's citizens including educational, health, social/human, transportation, public safety, regulatory, and conservation/natural resources services. In addition, the State provides grants and loans to assist local governments, including school districts, within its borders.

Certain legally separate entities are included in these financial statements because they function, in essence, as part of State government. The Governor appoints the governing boards for the Public Service Authority, a public utility company, and the State Ports Authority. The Connector 2000 Association, Inc. assists the State's Department of Transportation on a toll road project. The Lottery Commission transfers its net proceeds to the State for educational programs. Other entities benefit and support institutions of higher education, provide medical malpractice insurance, and address medical and educational needs of South Carolina's children. Additional information on these legally separate entities can be found in the notes to the financial statements.

South Carolina's annual Appropriations Act includes legally adopted budgets for the Budgetary General Fund and for Total Funds. The initial budget appears in the annual Appropriations Act. After the budget year begins, the State Budget and Control Board, comprised of five key executive and legislative officials, may order spending cuts if revenue collections fail to reach predicted levels. Departments and agencies may request transfers of appropriations among programs if the transfer request does not exceed 20% of the program budget. The Budget and Control Board has the authority to approve additional transfers of appropriations between personal service and other operating expense accounts. For additional information, see the notes to the required supplementary information - budgetary.

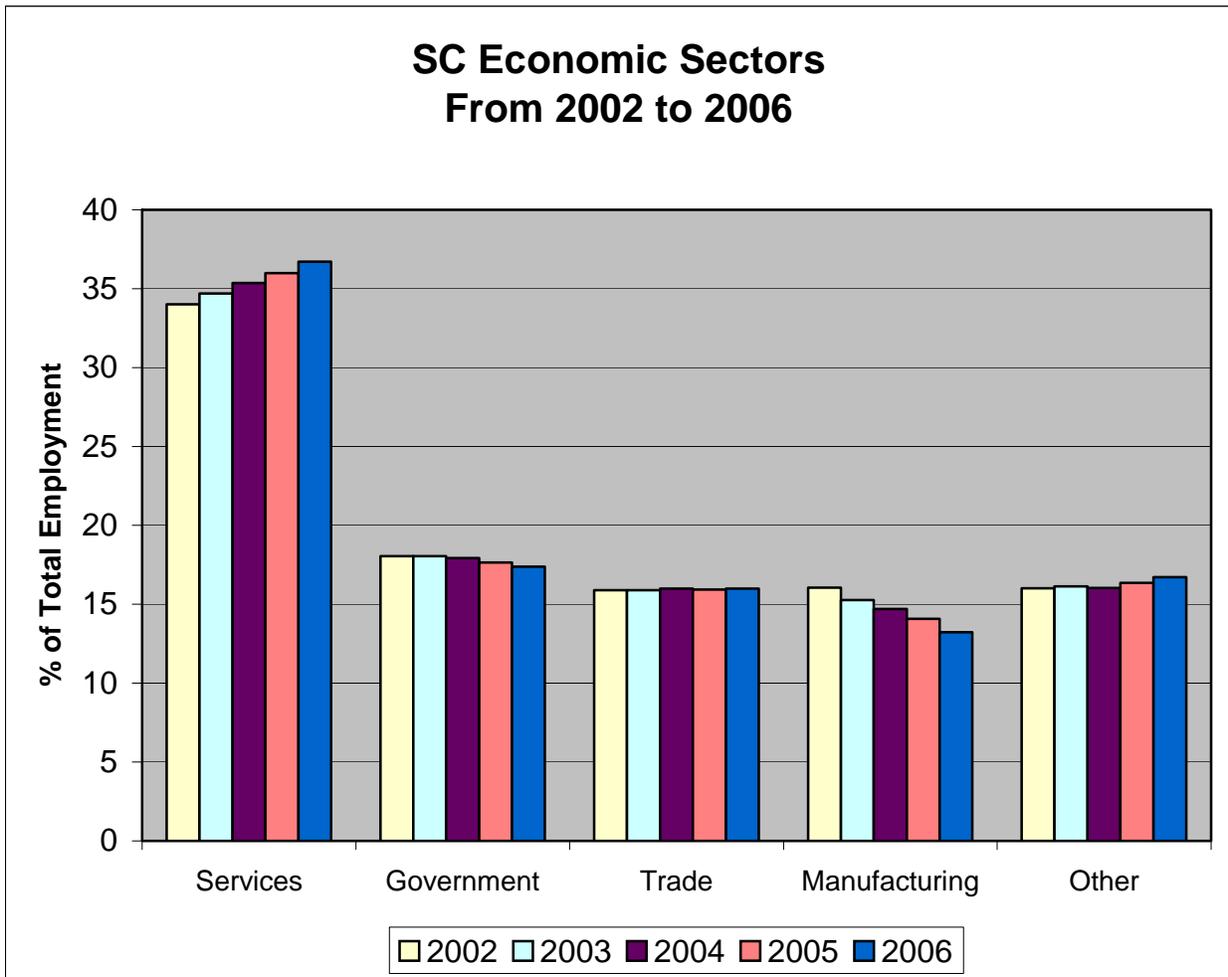
STATE ECONOMY

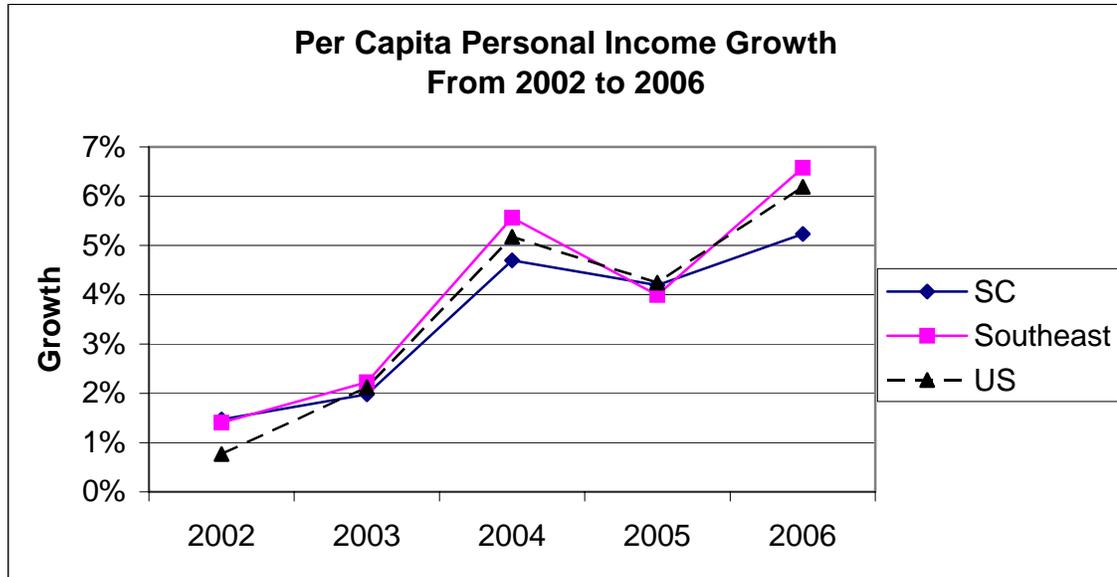
South Carolina historically has been a diverse manufacturing state; however, the State's economic base has undergone a gradual transition to other sectors such as trade, health care, services, and durable goods manufacturing. Businesses have migrated here from all over the world to take advantage of the State's skilled labor force, competitive wages, lower-priced land, excellent port facilities, and accessibility to markets, and in recent years, substantial tax incentives.

Overall, South Carolina continues to post strong job growth with total employment up 33,100 jobs, a gain of 1.7% over the last twelve months. Although manufacturing still plays a big role in the State's economy, South Carolina's economic base has become more diversified including growth in leisure and hospitality, retail trade and service. Employment in the State's manufacturing sector has been declining and now represents only about 14%, a decrease from 16% over the past five years. Non-durable goods manufacturing, primarily related to the textile and apparel industry, has seen the greatest decline over the past five years. Offsetting these declines was growth in the manufacturing of other goods, such as the production of transportation equipment, fabricated metals, and chemicals. The strongest employment gains have been in the State's service sector which has risen from 34% of

total employment to 37% during the past five years. This sector, fueled by tourism, educational, and healthcare industries has contributed to a more diversified overall employment base and improved income levels.

Although the State's unemployment rate is higher than the national average, the State has experienced growth in its labor force. As the State's economy has continued to generate jobs, the jobless rate has fallen from 6.8% for the calendar year 2005 to 6.5% for the calendar year 2006. However, because the size of the labor force had been growing at approximately the same pace as total employment, the unemployment rate has not decreased substantially. Beginning in calendar year 2006 and continuing into 2007, the rapid influx of new job seekers slowed, resulting in a decrease in the unemployment rate.





South Carolina's per capita income for 2006 increased to \$29,688, or 5.2% over 2005. Although the 2006 increase was below the national (6.2%) and southeastern states (6.6%) growth rates, it ranked as the highest per capita personal income growth rate for the State in the last five years.

South Carolina's population at July 1, 2006, was 4.3 million. The State's rate of population growth is presently the fourteenth fastest in the nation.

For the calendar year 2006, the South Carolina Department of Commerce reported \$2.99 billion in new capital investment that is expected to create about 14,000 new jobs. The State's rural communities will benefit from this growth with nearly 30% of the newly created jobs being located in rural communities.

LONG-TERM FINANCIAL PLANNING

Beginning with fiscal year 2005–2006, State law requires agencies receiving 1% or more of the total annual General Fund appropriations to provide an estimate of their general fund expenditures for the next three fiscal years. The State Budget Office combines these expenditure estimates with long-term revenue estimates made by the State's *Board of Economic Advisors* (BEA) to create a three-year financial plan. The three-year financial plan will assist the State in strategically assessing its future financial commitments. The plan is updated annually and provided to the State's Budget and Control Board, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate during the second quarter of each fiscal year.

Principal financial challenges facing state government include anticipated future spending increases for Medicaid, State retirement and health benefits (including post employment benefits), and elementary and secondary education.

The State's long-term financial management practices include a five-year capital improvement plan, which requires funding to be in place before beginning construction on any capital improvement projects.

RELEVANT FINANCIAL POLICIES

The State's legislature is required to adopt a balanced budget annually based on revenue projections provided by the BEA. State law requires the BEA to meet at least quarterly to review how actual revenue collections compare with its earlier projections, and to adjust its projections if necessary. If the BEA reduces revenue projections significantly once the budget year begins, the State's Budget and Control Board is responsible for taking appropriate action to keep the State's budget in balance. If the Board anticipates a year-end operating deficit as a result of the BEA reducing its revenue projections, it must first reduce amounts set-aside in the Annual Appropriations Act for the 2% Capital Reserve. If the anticipated deficit is greater than the 2% Capital Reserve, then the Board must reduce most agency appropriations evenly across-the-board. The State also is required to maintain a 3% General Reserve that can be used only for eliminating a year-end operating deficit. If the State's budgetary General Fund subsequently experiences a year-end operating deficit even after applying all the actions described above, the Board is required to meet within sixty days of August 31 to adopt a plan to liquidate the deficit.

Legislation also exists directing that in closing the books each year the Comptroller General shall suspend, to the extent necessary, any budgetary surplus appropriations in a general or supplemental act or Capital Reserve appropriations, if the State's GAAP-basis General Fund reports a negative unreserved fund balance.

The State's General Fund experienced a budgetary operating surplus and a positive GAAP unreserved fund balance for the fiscal year ended June 30, 2007. Therefore, no appropriation reductions were necessary.

MAJOR INITIATIVES

Finance and Budgeting

The General Assembly made tax relief a priority again this year by approving a budget for fiscal year 2007-2008 that includes \$221 million in tax relief. The tax relief will be applied principally to reduce homeowner property taxes. Also, the tax rate imposed on the lowest bracket of taxable income for individuals is being reduced from 2.5 percent to zero percent, effective for taxable years beginning after 2006. In addition, certain groceries were exempted from sales tax beginning November 1, 2007.

The 2007-2008 Appropriations Act includes a 3% pay raise for state employees, a cost of living adjustment for public retirees, and funding for increased health insurance costs to avoid increasing premiums to subscribers.

Reforms

The General Assembly agreed on a plan to reform the South Carolina Department of Transportation. Reforms include establishing qualifications and requiring screening for Commissioners, creating a Secretary of Transportation appointed by the governor, providing for ethics training for employees, creating the position of chief internal auditor who reports directly to the Commission, requiring compliance and performance audits by external parties, and mandating objective criteria to prioritize road projects.

The State reformed the workers' compensation system through legislation that establishes new requirements for proving claims using expert medical testimony and increases penalties for making fraudulent claims.

Business and Economic Development

The General Assembly approved a joint resolution that creates the South Carolina Broadband Technology and Communications Study Committee to examine opportunities for providing all South Carolinians with affordable high-speed Internet access and other broadband products and services critical for economic development and educational advancement.

The “Omnibus Coastal Property Insurance Reform Act of 2007” was signed into law which addresses the recent scarcity of affordable insurance for homes located along the South Carolina coast. This comprehensive legislation provides, among other things, for a state tax deduction for a contribution by a homeowner to a Catastrophe Savings Account to cover deductibles and self-insured losses under residential property insurance policies for floods and catastrophic windstorm events. This law also contains provisions for certain tax credits for 1) homeowner insurance premium costs for flood and windstorm policies; 2) costs for retrofitting residences to make them more storm resistant; and 3) a nonrefundable credit against the premium tax for insurers providing full property and casualty coverage, including wind and hail, to property owners in the coastal area.

Education

The 2007-2008 Appropriations Act provides an additional \$94 million to fully fund the Education Finance Act. Other important legislation in support of education includes the enactment of the South Carolina Virtual School Program (which expands educational opportunities by using computer technology), school bus safety reforms, scholarship enhancements for students majoring in science or mathematics, and funding to provide nurses in every elementary school.

Energy Conservation

The State encourages renewable energy infrastructure through programs that award grants and provide low interest loans for building production facilities that produce energy through biomass, solar, or wind resources. The newly-approved South Carolina Hydrogen Infrastructure Development Act promotes the growth of hydrogen and fuel cell technologies, and the Energy Freedom and Rural Development Act provides tax credits, rebates, and incentives to encourage biomass fuel development and use. The Energy Independence and Sustainable Construction Act of 2007 establishes standards for “green buildings” for construction and renovation projects by the State.

AWARDS AND ACKNOWLEDGMENTS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of South Carolina for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2006. This was the nineteenth consecutive year that the State of South Carolina has achieved this recognition. In order to be awarded a Certificate of Achievement, a government must publish a timely, easily readable, and efficiently organized CAFR. The CAFR must comply with both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program’s requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Production of the CAFR was made possible only by the support of all State agencies and component units that supplied financial data to our office on a timely basis. We extend special appreciation to Mr. Larry Pearce, Director of Publications and Printing at the University of South Carolina, for providing the CAFR's attractive cover.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard Eckstrom". The signature is written in a cursive style with a large initial "R".

Richard Eckstrom, CPA
Comptroller General