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

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## 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, 2008. Please read it together with the Comptroller’s *Letter of Transmittal* at the front of this report and also 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 presented 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 causes 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, the format of this statement is quite different from the format of a business’s profit and loss statement. The statement of activities helps to show how much it costs the State to provide various services. It also helps to show the extent to which each government function covers its own costs through user fees, charges, or grants. The *net revenues (expenses)* column on the far right of this statement page 38 shows how much a particular function relies on taxes and other general revenues as opposed to program revenues to finance its programs.

The government-wide statements present 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 transportation. 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, and financing of housing facilities 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*:

## State of South Carolina

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***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 provided to 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 and other post-employment benefit plans. The State also is responsible for other assets that, because of a trust agreement, it is to use only for trust beneficiaries such as an investment pool operated on behalf of local governments. 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 identifies the State's major component units under the *Component units* subheading. More detailed financial statements which include 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 68 through 140 are necessary to fully understand the financial statements.

### **Required Supplementary Information**

This section addresses budgetary matters and provides 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 141 through 147 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  
Government-wide Net Assets  
As of June 30, 2008  
(Expressed in Thousands)

	Governmental Activities		Business-type Activities		Totals— Primary Government		Total Percentage Change
	2008	2007	2008	2007	2008	2007	2007-2008
<b>Assets</b>							
Current and other assets.....	\$ 8,904,987	\$ 9,770,290	\$ 5,362,336	\$ 5,241,492	\$ 14,267,323	\$ 15,011,782	(5.0%)
Capital assets.....	13,712,137	13,393,469	3,977,559	3,538,949	17,689,696	16,932,418	4.5%
<b>Total assets.....</b>	<b>22,617,124</b>	<b>23,163,759</b>	<b>9,339,895</b>	<b>8,780,441</b>	<b>31,957,019</b>	<b>31,944,200</b>	<b>0.0%</b>
<b>Liabilities</b>							
Long-term liabilities.....	4,492,716	5,233,071	3,980,021	3,758,680	8,472,737	8,991,751	(5.8%)
Other liabilities.....	4,681,350	4,122,957	1,001,889	887,398	5,683,239	5,010,355	13.4%
<b>Total liabilities.....</b>	<b>9,174,066</b>	<b>9,356,028</b>	<b>4,981,910</b>	<b>4,646,078</b>	<b>14,155,976</b>	<b>14,002,106</b>	<b>1.1%</b>
<b>Net Assets</b>							
Invested in capital assets, net of debt....	10,007,523	9,706,055	2,315,357	2,133,862	12,322,880	11,839,917	4.1%
Restricted.....	3,597,084	3,498,173	1,386,458	1,406,468	4,983,542	4,904,641	1.6%
Unrestricted.....	(161,549)	603,503	656,170	594,033	494,621	1,197,536	(58.7%)
<b>Total net assets.....</b>	<b>\$ 13,443,058</b>	<b>\$ 13,807,731</b>	<b>\$ 4,357,985</b>	<b>\$ 4,134,363</b>	<b>\$ 17,801,043</b>	<b>\$ 17,942,094</b>	<b>(0.8%)</b>

## 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 2007-2008 accounting year, the State's net assets totaled \$17.801 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 without restrictions—reported a balance of \$494.621 million at June 30, 2008. This represents a decline of \$702.915 million over the prior year. Much of this decline resulted from a \$765.052 million decrease in the unrestricted net assets reported for the State's *governmental activities*, which reported a \$161.549 million deficit in unrestricted net assets for the current fiscal year versus a \$603.503 million balance in the prior year. The decline was attributable to spending not keeping pace with revenue collections during the year; see section "Budgetary General Fund Highlights" for further detail.

The State's *business-type activities* reported a \$656.170 million unrestricted net asset balance. This resulted from net positive balances of \$853.787 million associated with higher education and certain other business-type activities. However, that positive balance was partially offset by a \$182.880 million accumulated deficit in the State-run medical malpractice insurance program and a \$14.737 million accumulated deficit in the State-run college tuition prepayment program.

*Exhibit 2*  
**Government-wide Changes in Net Assets**  
**For the Fiscal Year Ended June 30, 2008**  
*(Expressed in Thousands)*

	Governmental Activities		Business-type Activities		Totals— Primary Government		Total Percentage Change
	2008	2007	2008	2007	2008	2007	2007-2008
<b>Revenues</b>							
Program revenues:							
Charges for services.....	\$ 2,160,768	\$ 2,071,357	\$ 3,961,748	\$ 3,614,333	\$ 6,122,516	\$ 5,685,690	7.7%
Operating grants and contributions.....	6,313,817	5,848,554	452,961	577,625	6,766,778	6,426,179	5.3%
Capital grants and contributions.....	333,255	503,633	47,226	86,807	380,481	590,440	(35.6%)
General revenues:							
Individual income tax.....	3,341,265	3,349,358	—	—	3,341,265	3,349,358	(0.2%)
Retail sales and use tax.....	4,236,156	3,803,732	—	—	4,236,156	3,803,732	11.4%
Other taxes.....	1,838,101	1,787,974	—	—	1,838,101	1,787,974	2.8%
Unrestricted grants and contributions.....	19,279	15,642	—	—	19,279	15,642	23.3%
Unrestricted investment income.....	156,974	134,196	—	—	156,974	134,196	17.0%
Tobacco legal settlement.....	83,494	79,912	—	—	83,494	79,912	4.5%
Other.....	62,867	61,926	19,118	—	81,985	61,926	32.4%
<b>Total revenues.....</b>	<b>18,545,976</b>	<b>17,656,284</b>	<b>4,481,053</b>	<b>4,278,765</b>	<b>23,027,029</b>	<b>21,935,049</b>	<b>5.0%</b>
<b>Expenses</b>							
Governmental activities:							
General government.....	4,531,636	3,434,216	—	—	4,531,636	3,434,216	32.0%
Education.....	4,401,108	4,078,954	—	—	4,401,108	4,078,954	7.9%
Health and environment.....	5,416,883	4,897,060	—	—	5,416,883	4,897,060	10.6%
Social services.....	1,300,347	1,152,324	—	—	1,300,347	1,152,324	12.8%
Administration of justice.....	789,071	742,064	—	—	789,071	742,064	6.3%
Resources and economic development.....	411,582	371,918	—	—	411,582	371,918	10.7%
Transportation.....	941,924	1,018,800	—	—	941,924	1,018,800	(7.5%)
Other.....	102,825	108,401	—	—	102,825	108,401	(5.1%)
Business-type activities:							
Higher education.....	—	—	3,405,491	3,120,278	3,405,491	3,120,278	9.1%
Higher education institution support <sup>a</sup> .....	—	—	1,121,483	965,686	1,121,483	965,686	16.1%
Unemployment compensation benefits.....	—	—	449,775	390,087	449,775	390,087	15.3%
Financing of housing facilities.....	—	—	174,152	158,031	174,152	158,031	10.2%
Medical malpractice insurance.....	—	—	13,259	24,809	13,259	24,809	(46.6%)
Financing of student loans.....	—	—	77,249	61,537	77,249	61,537	25.5%
Tuition prepayment program.....	—	—	(5,844)	8,100	(5,844)	8,100	(172.1%)
Other.....	—	—	37,139	36,072	37,139	36,072	3.0%
<b>Total expenses.....</b>	<b>17,895,376</b>	<b>15,803,737</b>	<b>5,272,704</b>	<b>4,764,600</b>	<b>23,168,080</b>	<b>20,568,337</b>	<b>12.6%</b>
<b>Excess (deficiency) before transfers and extraordinary items.....</b>	<b>650,600</b>	<b>1,852,547</b>	<b>(791,651)</b>	<b>(485,835)</b>	<b>(141,051)</b>	<b>1,366,712</b>	<b>(110.3%)</b>
Net transfers.....	(1,015,273)	(951,021)	1,015,273	951,021	—	—	—
<b>Increase (decrease) in net assets.....</b>	<b>(364,673)</b>	<b>901,526</b>	<b>223,622</b>	<b>465,186</b>	<b>(141,051)</b>	<b>1,366,712</b>	<b>(110.3%)</b>
<b>Net assets, beginning of year</b>	<b>13,807,731</b>	<b>12,906,205</b>	<b>4,134,363</b>	<b>3,669,177</b>	<b>17,942,094</b>	<b>16,575,382</b>	<b>8.2%</b>
<b>Net assets, end of year.....</b>	<b>\$ 13,443,058</b>	<b>\$ 13,807,731</b>	<b>\$ 4,357,985</b>	<b>\$ 4,134,363</b>	<b>\$ 17,801,043</b>	<b>\$ 17,942,094</b>	<b>(0.8%)</b>

<sup>a</sup> 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 total net assets decreased \$141.051 million (0.8%) over the prior year's net assets as a result of its governmental activities and its business-type activities.

**Governmental Activities**

Net assets of the State's governmental activities decreased by \$364.673 million (2.6%). Revenue did experience growth over last year of \$889.692 million (5.0%), primarily due to modest gains in both general tax revenue and program revenue. General tax revenue increased \$474.458 million (5.3%) and program revenue increased \$384.296 million (4.6%) over prior year activity. Revenues that support governmental activities are derived mostly from taxes; grants and contributions, including federal aid; and charges for goods and services. *Exhibit 3* illustrates the comparative sources of revenues that support governmental activities.

However, expenses associated with governmental activities significantly increased by \$2.092 billion (13.2%) for the fiscal year ended June 30, 2008. These expenses were mostly associated with services provided for health and environment, education, general government, social services, and transportation. *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. For the fiscal year ended June 30, 2008, the State used \$9.738 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 \$1.015 billion 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 and expenses for governmental activities during the 2007-2008 fiscal year:

- Operating grants and contributions increased by \$465.263 million (8.0%). The increase was primarily due to the improved funding of public health and social services programs.
- General tax revenues increased \$474.458 million (5.3%) over last year. Individual income tax took an insignificant downturn (<1.0%), however, sales and use tax increased 11.4% primarily due to the new property tax exemption program and the accommodations and local option sales taxes. Corporate income and other taxes had moderate growth of 2.8%.
- General government expenses increased \$1.097 billion (32.0%) due in part to the increase of outflows to the new Homestead Exemption Act program, as well as increased distributions of accommodations and local option sales taxes, to participating counties.
- Expenses for education increased \$322.154 million (7.9%) because of spending for early childhood programs for at-risk students, school bus replacement, and increased funding over prior year levels for various other educational programs.

*Exhibit 3*  
**Sources of Revenues Supporting Governmental Activities**  
**For the Fiscal Year Ended June 30, 2008**

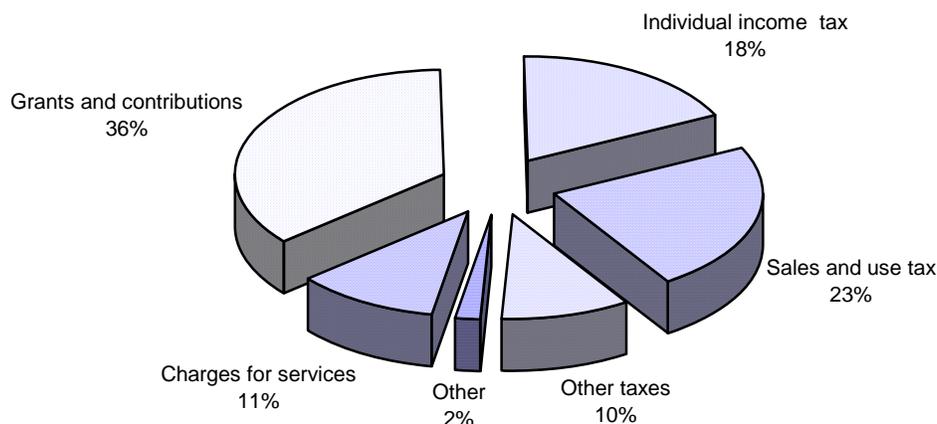
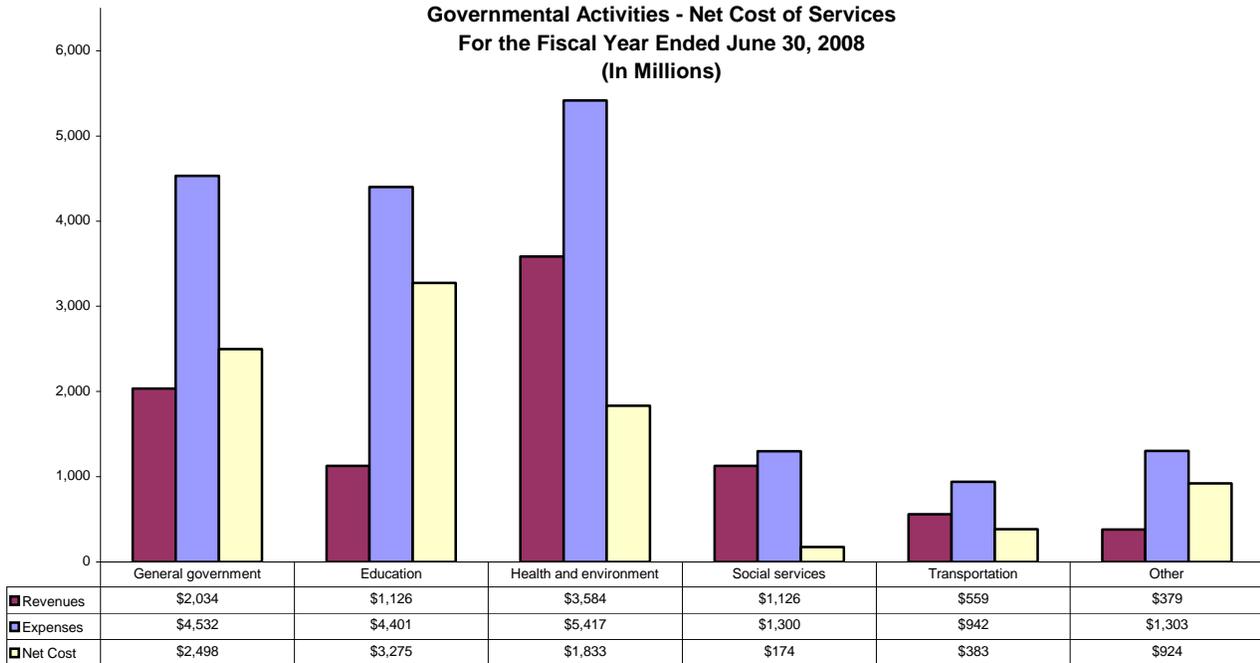


Exhibit 4

**Governmental Activities - Net Cost of Services  
For the Fiscal Year Ended June 30, 2008  
(In Millions)**



**Business-type Activities**

Net assets of the State’s business-type activities increased \$223.622 million (5.4%).

Revenues from business-type activities included charges for services (88.4%) and grants and contributions, including federal aid (11.6%). Expenses from business-type activities were mostly to provide higher education services and support (85.9%), unemployment compensation benefits (8.5%), and financing of housing facilities (3.3%).

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, which totaled \$1.015 million for the year ended June 30, 2008, represent the cost of educational services that taxes and other general revenues of governmental activities support.

Higher education and related institution support expense increased \$441.010 million during the 2007-2008 fiscal year. This increase resulted primarily from a rise in general operations and administrative costs.

**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, 2008.

*Exhibit 5*  
**Governmental Fund Balances**  
**As of June 30, 2008**  
*(Expressed in Thousands)*

	<b>General Fund</b>	<b>Departmental General Operating</b>	<b>Local Government Infrastructure</b>	<b>Department of Transportation Special Revenue</b>	<b>State Tobacco Settlement</b>	<b>Nonmajor Governmental Funds</b>	<b>Total Governmental Funds</b>
Reserved.....	\$ 341,773	\$ 11,063	\$ 1,941,384	\$ 11,375	\$ —	\$ 114,003	\$ 2,419,598
Unreserved, designated.....	—	—	—	—	—	250,005	250,005
Unreserved, undesignated.....	(77,715)	605,340	(285,134)	(50,427)	49,091	785,399	1,026,554
<b>Totals.....</b>	<b>\$ 264,058</b>	<b>\$ 616,403</b>	<b>\$ 1,656,250</b>	<b>\$ (39,052)</b>	<b>\$ 49,091</b>	<b>\$ 1,149,407</b>	<b>\$ 3,696,157</b>
<b>Change from prior year...</b>	<b>\$ (828,879)</b>	<b>\$ 71,840</b>	<b>\$ (62,186)</b>	<b>\$ 2,679</b>	<b>\$ (461,809)</b>	<b>\$ 32,802</b>	<b>\$ (1,245,553)</b>
<b>Percentage change.....</b>	<b>(75.8%)</b>	<b>13.2%</b>	<b>(3.6%)</b>	<b>6.4%</b>	<b>(90.4%)</b>	<b>2.9%</b>	<b>(25.2%)</b>

At June 30, 2008, total ending fund balance for the State's governmental funds was \$3.696 billion, which represents a decrease of \$1.246 billion (25.2%) from the prior year. Approximately one-third of this total (34.5%) consists of *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 activities of the General Fund and other 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 2007-2008 accounting year, the total fund balance of the General Fund decreased \$828.879 million (75.8%) from last year. Overall, revenues were \$152.085 million (2.0%) less than the previous year, the largest portion of the decline being sales and use taxes, which decreased \$174.776 million (6.6%). Total expenditures increased by \$327.866 million (5.0%) over the prior year. The most significant expenditure increase was attributable to health and environment, up \$278.661 million (16.0%). Operating transfers out of the General Fund increased \$309.475 million (25.8%). This increase was attributable in part to transfers of \$329.962 million of tax revenues from the General Fund to the Homestead Exemption Fund for subsequent distribution for property tax relief.

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. While this fund had a negative fund balance at the beginning of the fiscal year, the fund balance increased \$2.679 million during 2007-2008 leaving a negative fund balance of \$39.052 million at the end of the fiscal year. The negative fund balance occurred primarily because of long-term commitments by DOT to provide funding to local governments for highway construction projects administered by the State Infrastructure Bank (included within the Local Government Infrastructure Fund, a major governmental fund). 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 are discharged (i.e., reduced) as DOT provides construction services to the Bank.

The *State Tobacco Settlement Fund* accounts for revenues received from the General Fund and from the Tobacco Settlement Revenue Management Authority, a blended component unit and nonmajor governmental fund designated to receive and manage the State's share of the multi-state legal settlement with the tobacco industry. Fund balance declined \$461.809 million (90.4%) during 2007-2008 because the fund transferred \$469.408 million to the Tobacco Settlement Revenue Management Authority for the purpose of bond defeasance.

**Proprietary Funds**

*Exhibit 6* shows the components of net assets for the State’s various proprietary funds at June 30, 2008.

*Exhibit 6*  
**Proprietary Fund Net Assets**  
**As of June 30, 2008**  
*(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).....	\$ 2,182,295	\$ —	\$ 684	\$ 80,806	\$ 223	\$ 51,349	\$ 2,315,357	\$ 98,319
Restricted, expendable.....	466,638	262,499	252,237	78,306	143,388	55,464	1,258,532	336,764
Restricted, nonexpendable.....	95,871	—	—	—	—	32,055	127,926	—
Unrestricted.....	563,460	—	46,969	78,741	1,218	(36,439)	653,949	(22,204)
<b>Totals.....</b>	<b>\$ 3,308,264</b>	<b>\$ 262,499</b>	<b>\$ 299,890</b>	<b>\$ 237,853</b>	<b>\$ 144,829</b>	<b>\$ 102,429</b>	<b>\$ 4,355,764</b>	<b>\$ 412,879</b>
Change from prior year..	\$ 259,880	\$ (92,934)	\$ 15,461	\$ (19,651)	\$ 6,903	\$ 56,367	\$ 226,026	\$ (116,583)
Percentage change.....	8.5%	(26.1%)	5.4%	(7.6%)	5.0%	122.4%	5.5%	(22.0%)

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 *Unemployment Compensation Benefits Fund*, a major enterprise fund, decreased by \$92.934 million (26.1%) primarily due to the increasing unemployment rate and the increased amount of unemployment benefits the Fund paid out, without a corresponding increase in assessment revenue. As discussed in Note 22h, as a result of this situation, there is substantial doubt about the Fund’s ability to continue as a going concern. Management plans to ask the General Assembly to increase the taxable wage base of employers in order to raise employer contributions.

The net assets of the State’s *nonmajor enterprise funds* increased by \$102.429 million (122.4%). This increase was due in part to reduced benefits and claims paid out of the *Patients’ Compensation Fund* and the reduction in the accrual for tuition benefits payable from the *Tuition Prepayment Program Fund*. Additional information concerning the *Tuition Prepayment Program Fund’s* change in accounting estimate can be found in Note 2b of the financial statements.

South Carolina’s *internal service funds* provide certain services (including maintenance, insurance, printing, information technology, 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.

The net assets of the State’s *internal service funds* decreased by \$116.583 million (22.0%) due in part to *Employee Insurance Programs* contributing Plan reserves to the newly established *South Carolina Retiree Health Insurance Trust Fund* effective May 1, 2008. For more information on other post-employment benefit trust funds, see Note 9 of the financial statements.

**Budgetary General Fund Highlights**

Original estimated revenues for the 2007–2008 accounting year were \$6.622 billion. The BEA revised downward its original revenue estimate during the course of the year by a total of \$112.713 million. The revisions resulted from the BEA’s review of tax revenue collections and declining economic conditions as the year progressed. Actual revenues at June 30, 2008, were \$116.912 million (1.8%) under the BEA’s final revised revenue estimate and were \$229.625 million less than the BEA’s original estimate. Actual revenues also declined from prior year revenue collections by \$266.109 million (4.0%). Individual income and sales taxes, the fund’s primary revenue sources, were less than forecasted because of unfavorable economic conditions and continued legislative emphasis on tax relief.

Actual expenditures were \$644.906 million greater than actual revenues because State official revenue collection projections were increased over FY07 collections based on the expectation of a steadily improving economy. In addition, transfers out to the agencies during the year totaled \$111.821 million of 2007–2008 Capital Reserve Appropriations.

Based on the above results of operations, 2007-2008 ended with a budgetary deficit. After funding the deficit by drawing down the General Reserve, Capital Reserve, and FY07 spending surplus funds, the State was able to end the year with an accumulated budgetary general fund balance of \$324.254 million, comprised of \$95.123 million remaining in General Reserve Funds (Rainy Day Account) and \$229.131 million in carried-forward appropriations.

See the *Required Supplementary Information* section on pages 141 through 147 of this report for a detailed budgetary comparison schedule.

**Capital Assets and Debt Administration**

**Capital Assets**

At the end of the 2007-2008 accounting year, the State had \$17.690 billion invested in capital assets. This represented a net increase (including additions and deductions) of \$757.278 million, or 4.5%, over the previous accounting year (see *Exhibit 7*).

*Exhibit 7*  
**Capital Assets, Net of Depreciation**  
**As of June 30 for the Years Indicated**  
*(Expressed in Thousands)*

	Governmental Activities		Business-type Activities		Totals—Primary Government	
	2008	2007	2008	2007	2008	2007
Land and improvements.....	\$ 1,703,402	\$ 1,589,510	\$ 364,032	\$ 330,991	\$ 2,067,434	\$ 1,920,501
Infrastructure.....	6,726,093	6,476,211	—	—	6,726,093	6,476,211
Buildings and improvements.....	989,685	1,019,474	2,769,120	2,339,054	3,758,805	3,358,528
Vehicles.....	235,764	197,595	16,287	13,634	252,051	211,229
Machinery and equipment.....	140,006	138,454	358,576	270,885	498,582	409,339
Works of art and historical treasures.....	3,968	3,957	25,484	25,975	29,452	29,932
Construction in progress.....	3,911,874	3,961,700	440,784	555,545	4,352,658	4,517,245
Intangible assets.....	1,345	6,568	3,276	2,865	4,621	9,433
<b>Total.....</b>	<b>\$ 13,712,137</b>	<b>\$ 13,393,469</b>	<b>\$ 3,977,559</b>	<b>\$ 3,538,949</b>	<b>\$ 17,689,696</b>	<b>\$ 16,932,418</b>

The State’s investment in buildings and improvements increased significantly, primarily because of the public colleges and universities expanding their campus facilities. The Medical University of South Carolina completed a cancer center expansion while MUSC Hospital Authority completed the first phase of replacement of its current patient care facilities. The College of Charleston added a new campus building, residence hall and an athletic facility.

State vehicles increased significantly due to the Department of Education upgrading the bus fleet and the Budget and Control Board upgrading the state fleet of vehicles.

As in prior years, machinery and equipment increased significantly due, in large part, to acquisitions by public universities. Clemson University, The Medical University of South Carolina, and the University of South Carolina all made significant investments in computing, testing, medical, scientific, and laboratory equipment and equipping newly-established facilities.

Intangible assets decreased from last fiscal year primarily because state-wide depreciation expense exceeded investment in additional intangible assets.

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 June 30, 2008, the State had \$8.105 billion in bonds and notes outstanding—a decrease of \$434.114 million, or 5.1%, over last year (see *Exhibit 8*).

*Exhibit 8*  
**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
	2008	2007	2008	2007	2008	2007	2007-2008
Backed by the State:							
General obligation bonds.....	\$ 2,016,952	\$ 2,214,865	\$ 351,481	\$ 356,795	\$ 2,368,433	\$ 2,571,660	(7.9%)
Backed by specific revenues:							
Revenue bonds and notes.....	58,960	56,666	3,269,650	2,962,501	3,328,610	3,019,167	10.2%
Infrastructure Bank bonds.....	2,125,640	2,162,973	—	—	2,125,640	2,162,973	(1.7%)
Tobacco Authority bonds.....	242,891	769,755	—	—	242,891	769,755	(68.4%)
Limited obligation bonds.....	9,352	10,985	—	—	9,352	10,985	(14.9%)
Bond anticipation notes.....	—	—	30,000	4,500	30,000	4,500	566.7%
<b>Total.....</b>	<b>\$ 4,453,795</b>	<b>\$ 5,215,244</b>	<b>\$ 3,651,131</b>	<b>\$ 3,323,796</b>	<b>\$ 8,104,926</b>	<b>\$ 8,539,040</b>	<b>(5.1%)</b>

The reduction in debt reported in governmental activities resulted primarily from the defeasance of \$575.200 million of Tobacco Authority revenue bonds. The Tobacco Settlement Revenue Management Authority defeased the bonds with a portion of the proceeds of \$275.730 million in Tobacco Settlement Revenue Asset-Backed Refunding Bonds, along with funds transferred from the Tobacco Settlement Fund. New debt reported in business-type activities resulted mainly from the issuance of revenue bonds by the *enterprise funds*. The Housing Authority issued \$103.000 million in bonds for housing programs, the Education Assistance Authority issued \$131.700 million in bonds to provide financing for student loans, and the College of Charleston and the University of South Carolina issued \$95.930 million and \$94.185 million, respectively, in facilities revenue bonds. In addition, the Medical University of South Carolina drew down \$48.800 million on a note payable to finance the acquisition of equipment for a new hospital facility and issued \$30.000 million in short-term general obligation bond anticipation notes. The Housing Authority entered into a \$50.000 million mortgage revenue note payable.

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, 2008, 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, 2008, 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: \$29.277 million for institution bonds (*Institution bonds* are general obligation bonds that benefit the State’s Higher Education Fund.), \$30.087 million for highway bonds, \$176.033 million for general obligation bonds, excluding institution and highway bonds, \$11.901 million for economic development bonds, and \$19.353 million for research university infrastructure bonds.

See Note 12 in the notes to the financial statements for additional information about the State’s long-term debt.

**Economic Factors and Next Year’s Budget**

**The “Rainy Day Account”**

At June 30, 2008, the General Reserve Fund, sometimes called the *rainy day account*, was funded at \$95.123 million, which is \$91.658 million below the full funding requirement. 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 2007-2008 Appropriations Act passed by the General Assembly appropriated \$19.049 million to fully fund the rainy day account; however, \$91.658 million was drawn out to cover the 2007-2008 Budgetary General Fund deficit.

**Budgetary General Fund for the 2008-2009 Accounting Year**

For fiscal year 2008-2009, estimated revenues in the 2008-2009 Appropriations Act were \$6.736 billion or \$343.690 million more than 2007-2008 revenue collections. Subsequently, legislation has been enacted that reduces appropriations by \$488.000 million. Additional revisions could be subsequently enacted based on continued monitoring of revenue collections and economic conditions.

**Economic Conditions**

Budgetary General Fund revenues for the first three months of 2008-2009 fiscal year were \$1.556 billion, \$59.501 million (3.7%) lower than during the same period for 2007-2008. South Carolina's three major revenue sources are not as strong as the prior year for the same three months. Individual income taxes are up \$1.720 million (0.2%), compared to a stronger increase of \$33.930 million (3.7%) in 2007-2008. Corporate income taxes have declined by \$9.501 million (16.7%) over the same three month period 2007-2008; however in 2007-2008 the decline was \$17.485 million (23.5%) over the prior year. Sales taxes have also decreased \$57.122 million (12.4%) from 2007-2008 due to unfavorable economic conditions and consumer tax relief legislation. Sales taxes experienced a moderate increase of \$12.495 million (2.8%) for the same period in 2007-2008.

The BEA has adopted a preliminary Budgetary General Fund revenue estimate of \$7.246 billion for the 2008-2009 fiscal year. The BEA has since reduced their revenue estimate by \$554.000 million (7.6%).

**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 any questions concerning information in this report to:

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