



State of South Carolina

Office of Comptroller General

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December 22, 2014

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, 2014. The report provides financial information about the State's operations during the year and describes its financial position at the end of the year.

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 CliftonLarsonAllen 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, 2014. The auditors have issued an unmodified 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-fourth in population with approximately 4.7 million citizens. According to the U.S. Census Bureau, the State's rate of population growth is presently the fourteenth fastest in the nation.

As shown in the organizational chart on page 15, 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 14.

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 funds, grants, and loans to assist local governments, including school districts.

The State's reporting entity includes the primary government and its component units. The primary government includes all funds, departments, agencies, and institutions. The State's component units are legally separate organizations for which the State is accountable for purposes of financial reporting. The Management's Discussion and Analysis (MD&A) and the Basic Financial Statements focus on the activities of the primary government.

Additional information on the State's component units can be found in the notes to the financial statements and in the separately issued financial statements of those organizations.

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, composed of five key executive and legislative officials, may order spending cuts if revenue collections fall short of predicted levels. Departments and agencies may request transfers of appropriations between programs if the transfer request does not exceed 20% of the program budget. The Budget and Control Board has the authority to approve additional requested transfers of appropriations between personal services and other operating expenditure accounts. For additional information, see the notes to the required supplementary information - budgetary.

STATE ECONOMY

South Carolina has a diversified economic base, including manufacturing, trade, healthcare, services, and leisure/hospitality. Businesses have relocated here from all over the world taking 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 and other economic incentives.

Businesses continue to choose South Carolina as a place to locate or expand, and the State of South Carolina is committed to working with employers to meet their workforce needs through state-supported workforce development initiatives.

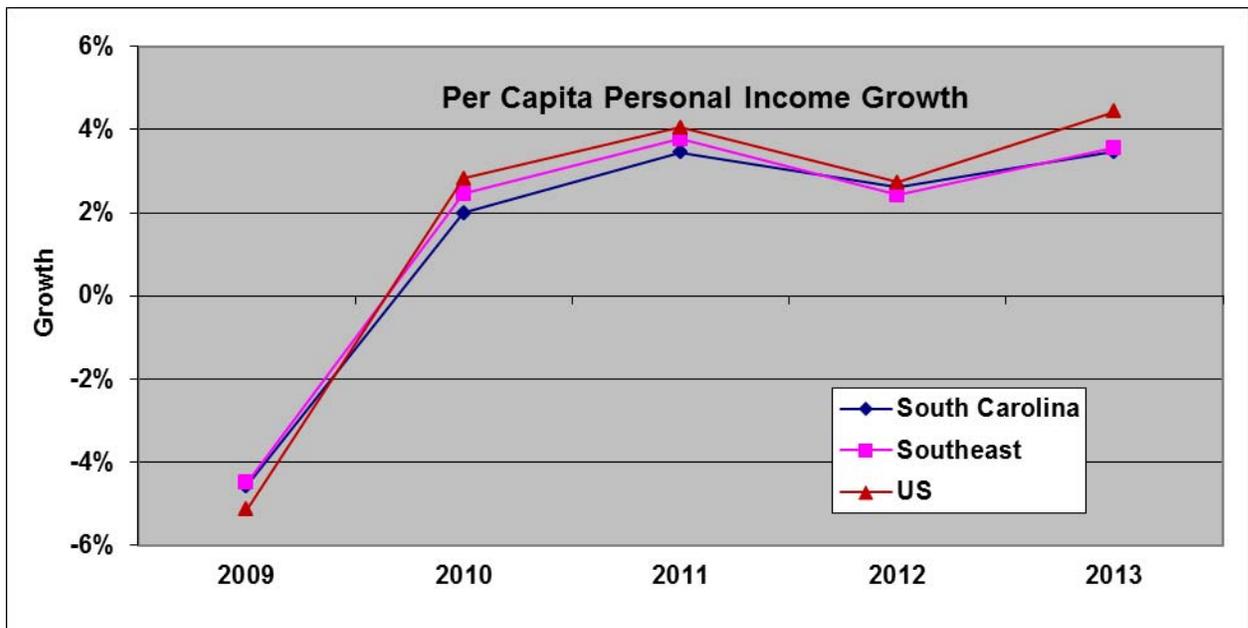
During the year ended June 30, 2014, total non-farm employment in the state increased by 42,400 to 1,933,000. Industry sectors reflecting gains were Professional and Business Services (+11,000); Leisure and Hospitality (+7,800); Manufacturing (+7,800); Education and Health Services (+7,100); Trade, Transportation, and Utilities (+5,500); Government (+2,200); Construction (+1,300); Information (+600); Other (+300). A decline was experienced in the Financial Activities (-1,200), and Mining and Logging remained unchanged.

South Carolina's unemployment rate decreased to 5.3% in June 2014 (and increased to 6.7% in October 2014), which was well below the June 2013 rate of 7.8%. In comparison, the U.S. unemployment rate for June 2014 was 6.1% (and decreased to 5.8% in October 2014).

After four consecutive months of positive movement, the South Carolina Leading Index (SCLI) dipped 0.11 points in June 2014 to 101.38. Above the 100 mark, the SCLI forecasts improving economic conditions for South Carolina over the upcoming three to six months. Several factors led to the decline of the SCLI in June, including an increase in initial claims for Unemployment Insurance for the month, a 2.7 percent drop in building permits for new residential construction, and a 0.2 percent decline in the duration of the average manufacturing workweek. Gains in the stock market helped moderate the SCLI's dip in June. The SCLI closed the month of September 2014 at 101.54, the most current month available.

The number of real estate closings in June 2014, up 1.6 percent compared to a year ago, and the declining number of foreclosures in the state, down 22.5 percent in June 2014 compared to June 2013, have reduced the supply of available homes on the market. As inventory tightens, real estate values in South Carolina have gained ground. Residential building permits compared to a year ago are up 18.9 percent in volume and 18.8 percent in valuation.

The South Carolina housing market continued to improve, with the Charleston and Spartanburg housing markets continuing to lead the state in recovery. Median home prices were 6 percent higher when comparing June 2014 to June 2013. Improvements in the Columbia and Myrtle Beach areas also helped push the statewide sales volume up with a 5 percent increase in their respective median sales prices even with a decline of 4 percent in sales volumes compared to last year.



LONG-TERM FINANCIAL PLANNING

State law requires agencies that receive 1.0% 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 assists 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.

Significant financial challenges facing state government include anticipated future spending increases for Medicaid, State retirement and post-retirement health benefits, and elementary and secondary education.

The State’s long-term financial management practices include a five-year capital improvement plan that 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 (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 during the year, it must reduce most agency appropriations evenly across-the-board. The State is also required to maintain a 4.5% General Reserve Fund (the required level increases to 5.0% in 2015) 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 eliminate the deficit and restore a balanced budget. Additionally, the State is required to annually fund a 2% Capital Reserve to be used for capital improvements, debt retirement, or other nonrecurring purposes appropriated by the General Assembly. The foregoing percentages are multiplied against total General Fund revenues for the latest completed fiscal year.

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 Fund appropriations if the State’s Generally Accepted Accounting Principles-basis General Fund reports a negative unrestricted, unassigned fund balance.

The State ended fiscal year 2014 with a positive General Fund fund balance of \$1.163 billion, which was made up of legislatively approved agency carryover appropriations of \$489.877 million, the General Reserve of \$292.889 million, the Capital Reserve of \$117.156 million, the Contingency Reserve of \$68.370 million, and unassigned surplus of \$194.982 million.

MAJOR INITIATIVES

In accordance with the *Restructuring Act of 2014*, effective July 1, 2014, the State Budget Division was eliminated and its functions divided among two newly created offices: the Executive Budget Office and the Revenue and Fiscal Affairs Office.

The Executive Budget Office is a stand-alone agency reporting to the Governor's Office. It now performs many of the former Budget Division's responsibilities, including development and oversight of the process for preparing the annual state budget. Beginning July 1, 2015, the Executive Budget Office will become a component of the new Department of Administration.

The Revenue and Fiscal Affairs Office consists of the Division of Research and Statistics and Board of Economic Advisors. The director of the State Budget Division now works within the Revenue and Fiscal Affairs Office. Functions of the Revenue and Fiscal Affairs Office include preparing fiscal and revenue impact statements on proposed legislation and assisting the General Assembly and the House Ways and Means and Senate Finance Committees in the development of the annual general appropriations act.

The State also continues to fund programs related to job creation. In fiscal year 2014, the State committed \$37.8 million to the South Carolina Coordinating Council on Economic Development and the State's Rural Infrastructure Authority for a land purchase and site development, which helped to attract Giti, the world's tenth largest tire maker to Chester County, South Carolina. It is anticipated that 1,700 jobs will be created from this deal. Additionally, the State has recently attracted two other large companies, Lash Group and LPL Financial to Fort Mill, South Carolina. These moves are expected to create up to 5,400 jobs in the coming years.

South Carolina's job recruitment and capital investment from manufacturers have experienced steady growth since the end of the Great Recession. In 2013 alone, the state attracted more than \$5.4 billion in new capital investment from manufacturing companies, which resulted in the creation of more than 15,457 jobs.

South Carolina consistently ranks high on Site Selection magazine's "Top State Business Climate Rankings". The state ranked 7th overall in the most recently released 2013 survey. South Carolina scored high with business executives surveyed by Site Selection, ranking 2nd, only behind Texas.

South Carolina's Growing Economic Environment

Over the last several years, South Carolina has continued to demonstrate its ability to facilitate expanded economic opportunities for citizens. Manufacturing has grown substantially. South Carolina has also experienced a state-wide decrease in its unemployment rate, which has shown that even in the midst of challenging national economic conditions our state's business-friendly climate and committed workforce continue to attract investment that creates well-paying jobs.

We have seen an emerging trend of companies investing and expanding in South Carolina. Several of South Carolina's industry leaders have expanded and created high-quality jobs within the state. In 2012, the State established an Aerospace Task Force to position the state for future growth. The task force is focused on growing the aerospace supply chain for companies like Boeing and GE Turbine and supporting initiatives to assure that South Carolina has a workforce ready for the aerospace industry.

South Carolina's exports reached record levels in 2013. Exports from South Carolina increased by 4.6% from 2012 to 2013. In 2013, South Carolina's export growth ranked the state 17th in the United States. Export figures are expected to continue to increase as Boeing has begun to deliver the aircraft made in South Carolina. The State also recently established a Transportation, Distribution and Logistics (TDL) Council that includes strong private sector participation. Part of the mission of this council is to prepare South Carolina for the Panama Canal expansion, providing South Carolina with a world-class port that will have the capacity to support the expected increase in merchant shipping.

Due in part to the State's economic outreach initiatives, South Carolina's total economic output or gross domestic product (GDP) was \$183.561 billion in 2013. Between 2012 and 2013, our real GDP grew 3.1%, which compares to the southeast states average growth of 3.2%.

With our cost of living 8.5% below the national average, South Carolina offers exceptionally productive employees at one of the lowest labor costs in the nation. South Carolina is a right-to-work state and in 2013

was tied with Mississippi for the third lowest unionization rate in the nation, at 3.7% of the workforce. CNBC recently ranked the South Carolina workforce sixth in the nation in terms of quality and availability of workers, as well as lower union membership and the success of state worker training programs in placing people in jobs.

The State Budget

The General Assembly approved a budget totaling \$23.6 billion for fiscal year 2015, which includes \$6.7 billion in recurring general funds and \$127.792 million in capital reserve funds. The budget fully funds the General Reserve Fund that totals \$292.889 million at June 30, 2014, and is available for management of revenue shortfalls.

The State's fiscal year 2015 budget includes \$130 million for Medicaid Maintenance of Effort. Eligibility was not expanded by legislation for the State's Medicaid Program in connection with the federal "Patient Protection and Affordable Care Act" of 2010. Instead, budget legislation includes a redirection of Medicaid spending under a new comprehensive Medicaid Accountability and Quality Improvement Initiative to be undertaken by the South Carolina Department of Health and Human Services upon approval by the Centers for Medicare and Medicaid Services (CMS).

Under this initiative, the Healthy Outcomes Initiative provides financial incentives for hospitals to reduce reliance on comparatively expensive emergency room treatment and also involves participating in price and quality transparency efforts and entering into agreements with primary care providers to help meet the needs of chronically ill uninsured patients through home visits and care in other settings outside the emergency room.

An additional \$10.5 million was included in the State's budget for the Department of Mental Health to address budget cuts sustained by the agency during the most recent recession. Also, \$15.5 million was included for the Department of Disabilities and Special Needs for individuals with complex care needs to be transitioned out of institutional settings.

The budget devotes approximately \$180 million in new funding to K-12 education for fiscal year 2015. Additional funding in the amount of \$137.5 million was directed to the Education Finance Act, with \$35 million to be used to address enrollment growth and an additional \$54.3 million to be used to increase the base student cost from \$2,100 to \$2,120 per student, or 1.0%. Additionally, the budget includes a four-year-old kindergarten initiative for school districts with a poverty index of 70% or more, with the plaintiff districts in the *Abbeville School District vs. the State of South Carolina* lawsuit given preference.

K-12 instructional materials funding of \$8.56 million was included in the budget and additional \$18 million was devoted for school transportation for the maintenance and upkeep of the state's school bus fleet. Additionally, \$29.5 million was included in the budget to provide for reading coaches in the state's elementary schools along with \$4.5 million devoted to expanding summer reading camps. Also, \$29.3 million was included in the State's budget for a K-12 technology initiative.

The State also provided for a 2% employee pay increase with an appropriation of \$30.6 million. Increased costs for operating the state employees' health insurance plan were addressed by budgeting \$57 million to cover increases in employer premiums, and by increasing employee coinsurance payments and deductibles of up to 9%. The actual health insurance premiums paid by employees were not changed.

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 that ended June 30, 2013. This was the twenty-sixth consecutive year that the State of South Carolina 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 GFOA to determine its eligibility to be awarded a Certificate of Achievement.

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. I extend special appreciation for the members

of my staff who devoted many of their nights and weekends over the past few months working as a team to produce this comprehensive document. I also express special appreciation for the generous sacrifices made by their families who endured the many extra hours they devoted to successfully complete this project.

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