

State of South Carolina
Office of Comptroller General

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December 4, 2009

**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, 2009. 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, 2008; 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, 2009. 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-fourth in population with approximately 4.5 million citizens.

As shown in the organization 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 grants and loans to assist local governments, including school districts.

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 by operating 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.

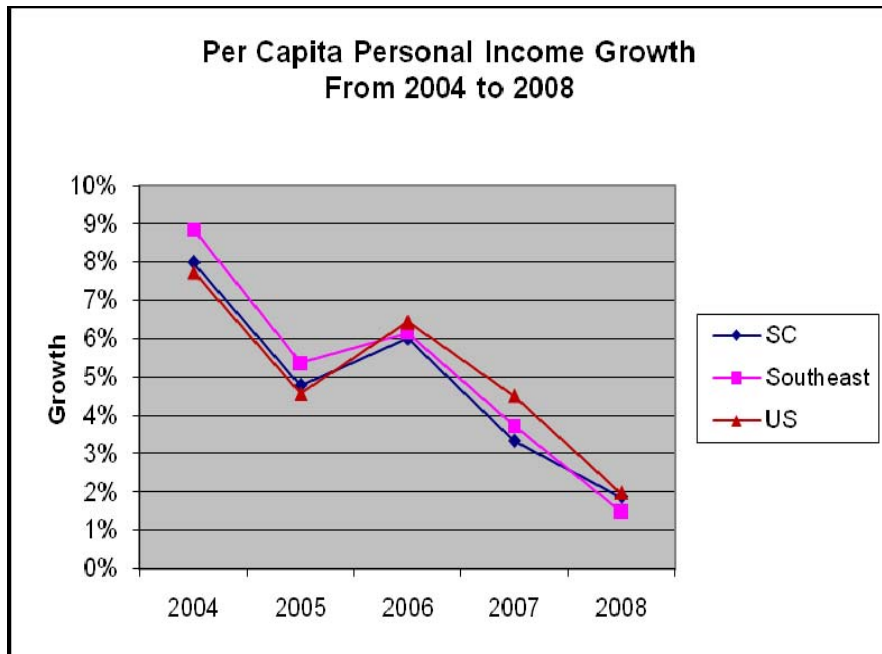
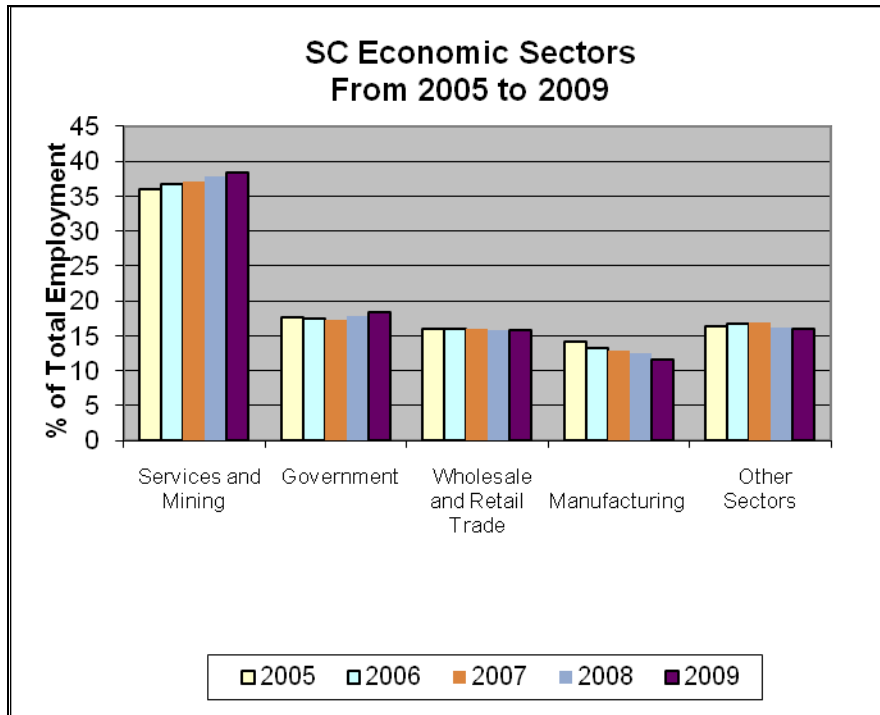
South Carolina's annual Appropriations Act includes legally adopted budgets for the Budgetary General Fund and for Total Funds. The initial budget appears in the annual Appropriations Act. After the budget year begins, the State Budget and Control Board, comprised of five key executive and legislative 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 has a diverse economic base, including manufacturing, trade, health care, services, and leisure/hospitality. 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 suffer job losses as the national recession progresses. During 2009, the State experienced a tremendous overall job loss of 92,700 as opposed to a decrease of 8,300 jobs during the same period in 2008. Manufacturing jobs had the highest loss equal to 29,800 (12.2%) as opposed to losses of 7,100 a year ago. The construction industry had less of a loss during 2009 (10,900) compared to 2008, which was down 13,800, despite residential property closings decreasing 11.2% from June 2008. During the past four years, the strongest employment gains have been in the State's service sector which has risen from 36.0% of total employment to 38.3% while manufacturing continued a steady decrease from 14.1% to 11.5%.

The State's September 2009 unemployment rate of 11.7% continues to be higher than the national unemployment rate of 9.8%. Out of 46 counties in South Carolina, only Aiken, Beaufort, Charleston, Lexington, Richland, and Saluda counties were below the national unemployment rate.



South Carolina's per capita income for 2008 increased to \$32,666, or 1.9% over 2007. Although the 2008 increase was below the national (2.0%) growth rate, it ranked higher than the southeastern states (1.5%) growth rate.

South Carolina's population at July 1, 2008, was 4.5 million. The State's rate of population growth is presently the tenth fastest in the nation.

Despite difficult economic times, the South Carolina Department of Commerce was involved in recruiting 19,000 new jobs and over \$4.1 billion in new capital investment to the State in 2008. Of all the jobs recruited during the past three years, 29% went to rural areas of the State where only 21% of the State's labor force resides.

LONG-TERM FINANCIAL PLANNING

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 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.

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 (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 Fund. If the anticipated deficit is greater than the 2% Capital Reserve Fund, then the Board must reduce most agency appropriations evenly across-the-board. The State also is required to maintain a 3% General Reserve Fund 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.

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 GAAP-basis General Fund reports a negative unreserved fund balance.

The State's General Fund experienced a budgetary operating deficit and a negative GAAP unreserved fund balance for the fiscal year ended June 30, 2009. Despite Legislative and Board mandated agency spending reductions and exhausting the entire Capital Reserve Fund of \$133.170 million coupled with the entire \$108.097 million of the General Reserve Fund, there remained a budgetary operating deficit of \$98.217 million. The Board has subsequently approved borrowing \$98.217 million from the General Deposit Account administered by the State Treasurer to balance the Budgetary General Fund with the stipulation that the borrowings are returned to the General Deposit Account on or before June 30, 2011.

MAJOR INITIATIVES

Finance and Budgeting

Due to the economic downturn, the General Assembly approved provisions for new terms and conditions for mandatory State agency furlough programs during budget shortfalls. The new provisions allow for flexibility during implementation by allowing programs to be based on pay band or pay rate and exemption for employees who provide direct essential patient/client/customer services. Furlough programs may not be more than ten working days in the fiscal year in which the projected deficit is projected to occur. During a furlough, affected employees shall be entitled to participate in the same State benefits as otherwise available to them except receiving their salaries.

The General Assembly approved the establishment of the South Carolina Taxation Realignment Commission to conduct a comprehensive study of the State's tax system. The commission is charged with developing criteria for assessing the effectiveness of the current tax system structure, as well as the likely systemic impact of any proposed changes affecting tax revenues. All such criteria must be designed with an emphasis on the systemic balance of the State's revenue structure from the standpoint of adequacy, equity, and efficiency and with the goal of maintaining the State as an optimum competitor in efforts to attract businesses and individuals to locate, live, work, and invest in the State.

Tourism Development

The General Assembly approved the "Local Option Tourism Development Fee Act" to provide a means of enhancing the State's tourism industry during the present economic downturn. The legislation impacts municipalities located in counties that collected at least \$14 million in State accommodations revenue during a fiscal year. Those counties may impose a fee not to exceed 1% of amount subject to the State sales and use tax for a period of up to ten years. Fees collected must initially be used exclusively for tourism advertisement and promotion directed at non-South Carolina residents. Beginning in the third year of imposition, the legislation allows a portion of the revenues to be used for property tax rollbacks on owner-occupied real estate and tourism-related capital projects.

Education

The General Assembly approved the "Federal Educational Tax-Credit Bond Implementation Act" to allow South Carolina school districts to take advantage of innovative financing programs for local governments that the United States Congress included among the many economic stimulus provisions of the American Recovery and Reinvestment Act of 2009 (ARRA). South Carolina has been allotted \$131 million to fund the Qualified School Construction Bond program plus special allocations that allow the school districts of Charleston and Greenville County to receive direct allocations from the Secretary of the United States Department of Education. The legislation establishes criteria for allocating South Carolina's bond program authority which provide for the allocation of 60% to school districts having the lowest capital resources, measured in terms of assessed value per pupil, not to exceed a maximum of \$20 million dollars per school district and forty percent to school districts having an ability to expeditiously issue bonds demonstrated through a high credit rating and timely start and completion of a project, not to exceed \$10 million dollars per school district.

The General Assembly approved and the Governor signed into law a joint resolution providing temporary funding flexibility provisions for school districts and special schools. For fiscal year 2009-2010, the school districts and special schools may transfer and expend State funds for school facilities and fixed equipment assistance to ensure the delivery of academic and arts instruction to students. Among additional provisions, school districts may suspend professional staffing ratios and expenditure regulations and guidelines at the sub-function and service area level (except for four-year old-programs) and are encouraged to reduce expenditures related to low enrollment courses, staff

and Board travel, activities requiring dues and memberships, and transportation costs for extracurricular and academic competitions.

Energy Conservation

The General Assembly approved legislation that defines renewable energy resources and establishes provisions for energy efficiency and renewable energy goals for State government requiring each agency to consider reductions of its energy, water, and wastewater use, and must implement recommended conservation measures to the degree the agency determines that the measures are cost effective. The legislation requires the State Energy Office to annually submit to the General Assembly a review of the State energy action plan.

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, 2008. This was the twenty-first 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,



Richard Eckstrom, CPA
Comptroller General