

Financial Highlights — Fiscal Year 2006



I am pleased to present you with the *North Carolina Financial Highlights* for the fiscal year ended June 30, 2006. This *popular report* represents our continuing commitment in providing the highest standards of financial management and reporting, as well as fiscal accountability of the resources of the State of North Carolina reporting entity. We hope that you find this report both informative and beneficial and we welcome any questions or comments. If you need additional copies, or have questions about this report, please contact either me or our Statewide Accounting Division staff at (919) 981-5454.

Thank you for your interest in the State of North Carolina.

Sincerely,

A handwritten signature in cursive script that reads "Robert L. Powell".

Robert L. Powell
State Controller
December 16, 2006

Introduction

This popular report, *North Carolina Financial Highlights*, is intended to summarize basic financial information about our State. This information is supported in more detail in the State's Comprehensive Annual Financial Report (CAFR). The CAFR is prepared in accordance with generally accepted accounting principles and is independently audited by the North Carolina Office of the State Auditor. Much of the information in the CAFR is necessarily technical and complex. As a result, the full financial statements and note disclosures may not be as useful to the citizens of the State wishing to gain a more general understanding of the State's finances. Our report provides information at the government-wide level in addition to the major fund level, and certain selected statistical information cited in our CAFR. Coverage of legally separate, but related organizations is limited to universities and community colleges and is at a very high level.

The *popular report* is a report for the people. *North Carolina Financial Highlights* is the product of a coordinated effort on the part of state and local governments to issue simplified financial reports. It is our intent to provide you with information about the State's financial condition, without overwhelming detail and technical accounting terminology. This report contains financial information for the State's fiscal year ended June 30, 2006. The State's fiscal year starts July 1, and ends the following June 30. Information is presented in this report on the basis of generally accepted accounting principles (GAAP). This popular report and the State's complete financial statements, known as the CAFR, can be obtained on the internet at <http://www.ncosc.net>, by telephone at (919) 981-5454, or by writing to the N.C. Office of the State Controller, 1410 MAIL SERVICE CENTER, Raleigh, N.C. 27699-1410.



State Reporting Entity and Its Services

The State of North Carolina reporting entity includes all fund types of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches. In addition, the reporting entity includes legally separate component units for which the State is financially accountable. The State's component units are the University of North Carolina System, the State's community colleges, and various other organizations providing specific services to the public and private sector.

The State and its component units provide a broad range of services to its citizens, including

- ◆ K-12 public education
- ◆ higher education
- ◆ health and human services
- ◆ economic development
- ◆ environment and natural resources
- ◆ public safety, corrections, and regulation
- ◆ transportation
- ◆ agriculture
- ◆ general government services



Welcome to NC

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*



The Economy

The consensus revenue estimate for the upcoming fiscal year represented a very cautious stance regarding the portion of the 2005-06 revenue surplus counted as recurring. In addition, the economy-based revenue estimates for the year reflect the view that the combination of a rise in short-term interest rates to 5.25% (9.25% for prime rate) and persistently high energy prices will eventually lead to a “mid-decade slowdown” similar to 1984-86 and 1995. The result is that baseline General Fund tax growth is expected to be only 3.3%. This forecast is in line with the downward adjustments made in many states after a second year of strong April income tax payments.

The projection of slower job growth and retail sales is pretty much the same outlook adopted a year ago during the 2005-06 budget discussions. The difference this year has to do with the loss of the underpinning from the robust real estate market. As the weakness in this sector continues to filter through the economy, we think the Federal Reserve will take note and leave short-term rates at the current 5.25% level. If the economic slowdown accelerates, the Federal Reserve may begin to lower rates during the second half of the fiscal year.

An additional reason the 2006-07 economic outlook is cautious is that even if we get the change in direction of the economy and timing right, it is hard to project the magnitude of the decline. There have been numerous occasions in the past when the Federal Reserve overshot the mark and a planned slowdown turned into an outright recession. This has been especially true when the rate hikes are accompanied by external shocks such as a military engagement or a gas price spike.

Barring any unforeseen international events we think that a full-scale recession can be avoided. One reason has to do with stable long-term interest rates. During a typical monetary tightening phase, long-term rates will follow hikes in short-term rates for the first few moves before stabilizing as investors become comfortable that an economic slowdown and lessening of inflation pressures is underway. During the current cycle long-term rates have remained stable throughout the Federal Reserve actions. Part of the reason for the stability has been the continued supply of funds from overseas. The other reason that a full-scale recession can be avoided has to do with the fact that the sharp increase in energy prices has not translated into a major increase in “core inflation” (prices increase excluding the volatile energy and food components).

Though the risks to the economic outlook increased, the cautionary stance taken on the nonrecurring portion of the 2005-06 revenue surplus means that the State is well-positioned for the economic slowdown that is starting to unfold.

*— Economic analysis prepared by David Crotts, Economist
North Carolina General Assembly, Fiscal Research Division
October 31, 2006*



National Forest

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*



Financial Highlights



Baldhead Island Lighthouse

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

Government-Wide

- ◆ The State's total net assets increased by \$2.78 billion or 10.7% as a result of this year's operations. Net assets of governmental activities increased by \$2.46 billion, or 9.9% due, in part, to higher than expected growth in tax revenues. Net assets of business-type activities increased by \$319 million, or 29.2% due to the strong financial results of the Unemployment Compensation Fund. At year-end, net assets of governmental activities and business-type activities totaled \$27.43 billion and \$1.41 billion, respectively.
- ◆ Component units reported net assets of \$13.19 billion, an increase of \$1.08 billion or 8.9% from the previous year. About half of the increase (\$509 million) is due to the net increase in capital assets, net of related debt for the University of North Carolina System and community colleges. The capital asset additions were financed in part by state debt proceeds.

Fund Financials

- ◆ The fund balance of the General Fund more than doubled from \$953.51 million at June 30, 2005 (as restated) to \$1.93 billion at June 30, 2006. The increase is explained primarily by higher than expected growth in individual income, corporate income, and sales and use taxes. In fiscal year 2006, the State changed its methodology reporting individual income taxes, which increased beginning fund balance by \$1.04 billion.
- ◆ The fund balance of the Highway Fund increased from \$383.3 million at June 30, 2005 to \$568.79 million at June 30, 2006, an increase of 48.4%. The fund balance growth was attributable to increases in driver's license, vehicle registration and other fees and to increases in gasoline tax collections.
- ◆ The fund balance of the Highway Trust Fund decreased substantially from negative \$15.36 million at June 30, 2005 to a negative \$135 million at June 30, 2006. Higher construction inflation and non-appropriated spending for the Governor's *N.C. Moving Ahead!* program and other legislative initiatives contributed to the larger fund deficit.

- ◆ The net assets of the Unemployment Compensation Fund almost doubled from \$258.46 million at June 30, 2005 to \$507.48 million at June 30, 2006. The significant increase is explained by the State's lower unemployment rate and by a 20% surcharge on unemployment contributions.
- ◆ The N.C. Education Lottery (NCEL) began selling instant game tickets in March 2006 and Powerball tickets in May 2006. As required by statute, the Lottery's net profit of \$64.59 million was transferred to the Education Lottery Fund (nonmajor special revenue fund).

Capital Assets

- ◆ The State's investment in capital assets (net of accumulated depreciation) was \$29.21 billion, an increase of 5.9% from the previous fiscal year-end.
- ◆ This year's major capital asset additions were for highway construction (\$1.4 billion), highway land improvements (\$479 million) and the construction of correctional facilities (\$34 million). Also, construction was completed on two 1,000 bed close custody prisons.



Cold Mountain

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

Financial Highlights (cont'd)

Long-Term Debt

- ◆ The State had long-term debt outstanding of \$6.52 billion, an increase of less than 1% from the previous fiscal year-end. The long-term debt balance includes \$709.1 million of special obligation (non-voted) debt issued for governmental activities.
- ◆ The State maintained its AAA bond rating with Standard and Poor's and Fitch. In August 2002, Moody's downgraded the State's credit rating for general obligation debt from "AAA" to "Aa1", representing the first time since 1960 that North Carolina had less than a "AAA" rating. In September 2004, Moody's upgraded the State's outlook from stable to positive.

Financial Highlights – Fiscal Year 2006



Government-wide Financials

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better off or worse off as a result of this year's activities?

Both statements report three activities:

- ◆ Governmental Activities—Most of the State's basic services are reported under this category. Taxes and inter-governmental revenues generally fund these activities.
- ◆ Business-type Activities—The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund, the N.C. State Lottery Fund, and the EPA Revolving Loan Fund are the predominant business-type activities.
- ◆ Discretely Presented Component Units—Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. All component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State.



Lake Lure Golf

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

Statement of Net Assets

The Statement of Net Assets presents all of the State's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating. The following table was derived from the government-wide Statement of Net Assets:

Net Assets						
June 30, 2006 and 2005						
<i>(dollars in thousands)</i>						
	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Current and other non-current assets.....	\$ 15,171,216	\$ 12,609,752	\$ 1,717,372	\$ 1,439,494	\$ 16,888,588	\$ 14,049,246
Capital assets, net.....	29,159,235	27,542,758	53,029	54,645	29,212,264	27,597,403
Total assets.....	44,330,451	40,152,510	1,770,401	1,494,139	46,100,852	41,646,649
Long-term liabilities.....	7,281,649	7,027,869	14,064	13,018	7,295,713	7,040,887
Other liabilities.....	9,614,902	8,152,804	345,662	389,466	9,960,564	8,542,270
Total liabilities.....	16,896,551	15,180,673	359,726	402,484	17,256,277	15,583,157
Net assets:						
Invested in capital assets, net of related debt.....	28,035,283	26,435,216	44,196	44,007	28,079,479	26,479,223
Restricted.....	890,602	1,314,397	1,286,477	970,615	2,177,079	2,285,012
Unrestricted.....	(1,491,985)	(2,777,776)	80,002	77,033	(1,411,983)	(2,700,743)
Total net assets.....	\$ 27,433,900	\$ 24,971,837	\$ 1,410,675	\$ 1,091,655	\$ 28,844,575	\$ 26,063,492

- ◆ The largest component of the State's net assets (\$28.08 billion) reflects its investment in capital assets (land, buildings, machinery and equipment, state highway system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets.
- ◆ Restricted net assets are the next largest component (\$2.18 billion). Net assets are restricted when constraints placed on their use are 1) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or 2) legally imposed through constitutional provisions.
- ◆ The remaining portion, unrestricted net assets, consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Financial Highlights — Fiscal Year 2006



Statement of Activities

The Statement of Activities presents information showing how the State's net assets changed during the most recent fiscal year. The following financial information was derived from the government-wide Statement of Activities:

Condensed Statement of Activities Primary Government For the Fiscal Year Ended June 30, 2006 (dollars in thousands)			
	Primary Government		
	Governmental Activities	Business-type Activities	Total
Changes in Net Assets:			
Net (expense) revenue	\$ (17,599,168)	\$ 386,994	\$ (17,212,174)
General Revenues:			
Taxes:			
Individual income tax.....	9,336,745	—	9,336,745
Corporate income tax.....	1,306,193	—	1,306,193
Sales and use tax.....	5,033,040	—	5,033,040
Gasoline tax.....	1,514,626	—	1,514,626
Franchise tax.....	628,029	—	628,029
Highway use tax.....	577,237	—	577,237
Insurance tax.....	442,297	—	442,297
Beverage tax.....	233,315	—	233,315
Inheritance tax.....	133,158	—	133,158
Other taxes.....	482,552	—	482,552
Tobacco settlement.....	140,969	—	140,969
Federal grants not restricted to specific programs.....	—	—	—
Unrestricted investment earnings.....	123,170	—	123,170
State operating aid.....	—	—	—
State capital aid.....	—	—	—
Miscellaneous.....	37,248	4	37,252
Contributions to permanent funds.....	4,674	—	4,674
Contributions to endowments.....	—	—	—
Transfers.....	67,978	(67,978)	—
Total general revenues, contributions and transfers.....	<u>20,061,231</u>	<u>(67,974)</u>	<u>19,993,257</u>
Change in net assets.....	2,462,063	319,020	2,781,083
Net assets — July 1, as restated (Note 22).....	24,971,837	1,091,655	26,063,492
Net assets — June 30.....	<u>\$ 27,433,900</u>	<u>\$ 1,410,675</u>	<u>\$ 28,844,575</u>



NC Zoo

Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer

Governmental Activities:

- ◆ For fiscal year 2006, revenues outpaced expenses and when combined with transfers from the State's business-type activities, an increase of \$2.46 billion in net assets resulted for governmental activities.
- ◆ Total revenues increased 6.4% in fiscal year 2006 to \$34.39 billion.
- ◆ Net transfers-in were much higher in fiscal year 2006 due to the new State lottery.

Business-type Activities:

- ◆ Business-type activities reflect an increase in net assets of \$319.02 million or 29.2% from last fiscal year, primarily because of the strong financial results of the Unemployment Compensation Fund.
- ◆ For fiscal year 2006, the Unemployment Compensation Fund had an operating income (excess of operating revenues over operating expenses) of \$253 million.
- ◆ The Unemployment Compensation Fund and the EPA Revolving Loan Fund comprise 90.9% of the total net assets of business-type activities.

Financial Highlights – Fiscal Year 2006



Statement of Activities (cont'd)

- ◆ Total expenses increased by only 3.3% to \$32.01 billion from last fiscal year, primarily because of minimal growth (less than 1%) in the State's largest functional area, health and human services (HHS).
- ◆ Despite enrollment increases, higher education expenses fell in fiscal year 2006 due to larger distributions of higher education bond proceeds in the prior year. Distributions of bond proceeds to colleges and universities were \$725 million in fiscal year 2005 compared to \$291 million this year.
- ◆ Primary and secondary education expenses continued to grow because of enrollment increases and teacher pay raises and bonuses.

Condensed Schedule of Expenses & Program Revenues Primary Government For the Fiscal Year Ended June 30, 2006 (dollars in thousands)			
Functions/Programs	Expenses	Program Revenues	Net (Expense)/Revenue
Governmental Activities:			
General government.....	\$ 1,039,513	\$ 556,173	\$ (483,340)
Primary and secondary education.....	8,215,445	1,187,631	(7,027,814)
Higher education.....	3,472,024	22,338	(3,449,686)
Health and human services.....	13,491,119	9,449,502	(4,041,617)
Economic development.....	647,434	402,160	(245,274)
Environment and natural resources.....	676,049	323,477	(352,572)
Public safety, corrections, and regulation.....	2,304,900	650,371	(1,654,529)
Transportation.....	1,781,865	1,785,264	3,399
Agriculture.....	112,467	29,019	(83,448)
Interest on long-term debt.....	264,287	—	(264,287)
Total Governmental Activities.....	32,005,103	14,405,935	(17,599,168)
Business-type Activities:			
Unemployment Compensation.....	849,945	1,107,267	257,322
N.C. State Lottery.....	153,125	217,714	64,589
EPA Revolving Loan.....	11,414	69,751	58,337
Regulatory commissions.....	28,526	34,400	5,874
Insurance programs.....	16,051	15,712	(339)
North Carolina State Fair.....	10,497	12,690	2,193
Other business-type activities.....	10,255	9,273	(982)
Total Business-type Activities.....	1,079,813	1,466,807	386,994
Total Primary Government.....	\$ 33,084,916	15,872,742	(17,212,174)



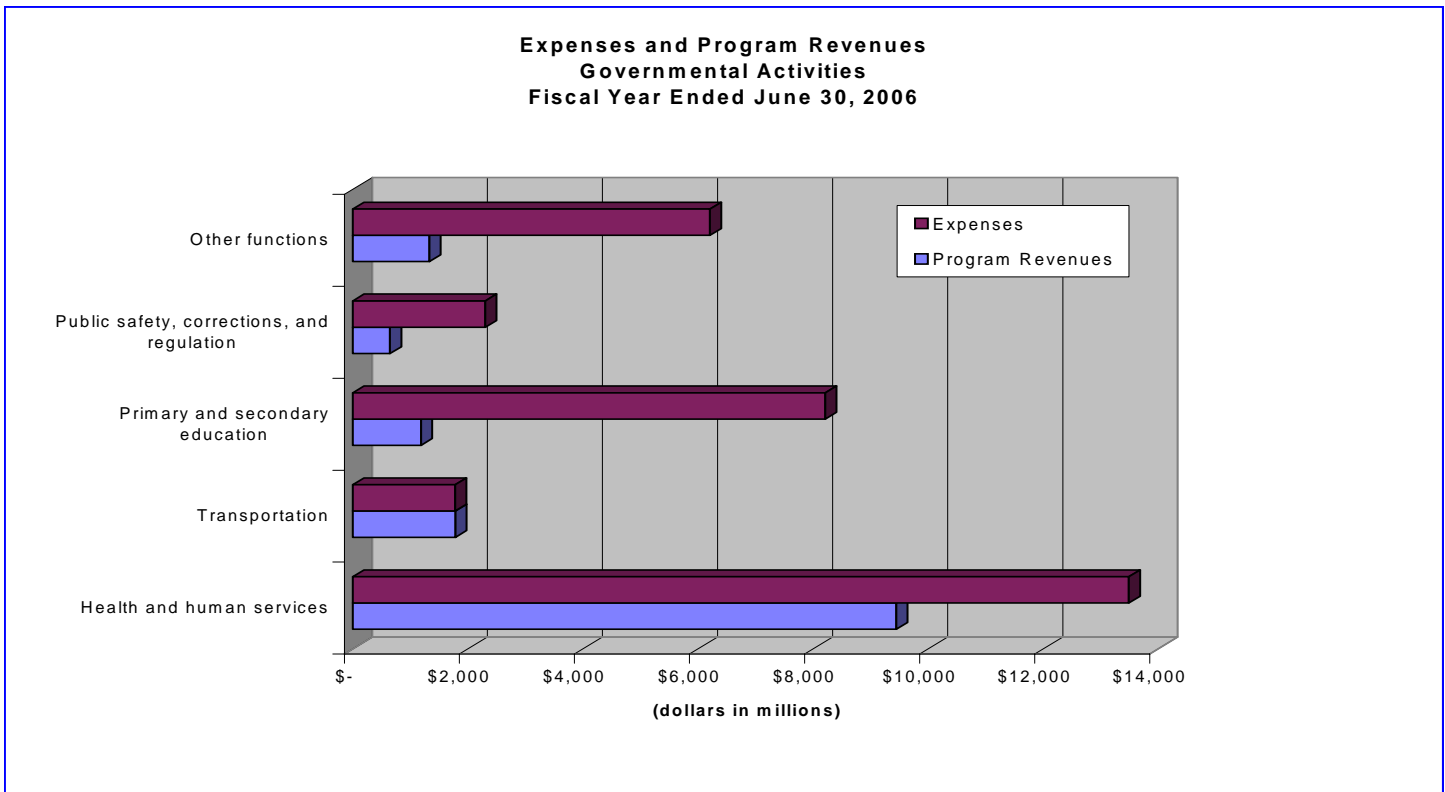
Emerald Isle Rainbow

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer*

Financial Highlights – Fiscal Year 2006



A comparison of the cost of services by function with the related program revenues is shown below. This format identifies the extent to which each governmental function is self-financing through fees and intergovernmental aid or draws from the general revenues of the State:



- ◆ As noted earlier, the State's largest functional area, health and human services (HHS) had minimal growth for the fiscal year 2006. Thus HHS expenses increased by only .94%, as compared to an increase of 14.1% in 2005 and 10.5% in 2004.

Capital Assets

As of June 30, 2006, the State's investment in capital assets was \$29.21 billion, an increase of 5.85% from the previous fiscal year-end.

Capital Assets as of June 30, 2006
(net of depreciation, dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Land.....	\$ 9,439,616	\$ 8,913,829	\$ 3,147	\$ 3,147	\$ 9,442,763	\$ 8,916,976
Buildings.....	1,824,190	1,632,941	14,698	15,510	1,838,888	1,648,451
Machinery and equipment.....	566,018	554,484	2,462	1,839	568,480	556,323
Infrastructure:						
State highway system.....	15,368,302	14,247,222	—	—	15,368,302	14,247,222
Other infrastructure.....	77,240	79,058	28,972	30,769	106,212	109,827
Intangible assets.....	105,256	106,045	1,457	1,569	106,713	107,614
Art, literature, and other artifacts.....	60,485	48,975	—	—	60,485	48,975
Construction in progress.....	1,718,128	1,960,204	2,293	1,811	1,720,421	1,962,015
Total.....	<u>\$ 29,159,235</u>	<u>\$ 27,542,758</u>	<u>\$ 53,029</u>	<u>\$ 54,645</u>	<u>\$ 29,212,264</u>	<u>\$ 27,597,403</u>
Total percent change between fiscal years 2005 and 2006	5.87 %		(2.96)%		5.85 %	

- ◆ This year's major capital asset additions were for highway construction (\$1.4 billion), highway land improvements (\$479 million), and the construction of correctional facilities (\$34 million).

Financial Highlights – Fiscal Year 2006



Capital Assets (cont'd)



Eno River State Park

*Photo Courtesy of NC Division of Tourism,
Film, and Sports Development.
Bill Russ, Photographer.*

- ◆ The largest component of capital assets is the State highway system. North Carolina has a 79 thousand mile highway system, making it the second largest state maintained highway system in the nation.
- ◆ The State has commitments of \$1.43 billion for the construction of highway infrastructure, which are expected to be financed by gasoline tax collections, motor vehicle fees, and federal funds.
- ◆ Other commitments for the construction and improvement of state government facilities totaled \$580 million, which are expected to be financed primarily by debt proceeds (certificates of participation), state appropriations, and federal funds.
- ◆ In fiscal year 2006, the N.C. Department of Correction completed construction on Maury Correctional Institution (Maury) in Greene County and Bertie Correctional Institution (Bertie) in Bertie County, both of which are 1,000 bed close custody prisons. Total construction and design costs for Maury and Bertie were \$82.3 million and \$84.2 million, respectively.
- ◆ Another 1,000 bed close custody prison is under construction in Columbus County, with an estimated completion date of February 2008. The total estimated cost of this facility is \$104.3 million. The primary funding sources for all three prisons were certificates of participation.

Debt Administration

At year-end, the State had total long-term debt outstanding of \$6.52 billion, an increase of 0.5% from the previous fiscal year-end:

Outstanding Debt as of June 30						
<i>(dollars in thousands)</i>						
	Governmental Activities		Business-type Activities		Total	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
General obligation bonds.....	\$ 5,738,815	\$ 5,698,535	\$ —	\$ —	\$ 5,738,815	\$ 5,698,535
Revenue bonds.....	255,045	265,045	8,800	9,070	263,845	274,115
Certificates of participation.....	454,060	475,170	—	—	454,060	475,170
Notes payable.....	60,841	37,107	1,457	1,569	62,298	38,676
Total.....	\$ 6,508,761	\$ 6,475,857	\$ 10,257	\$ 10,639	\$ 6,519,018	\$ 6,486,496
Total percent change between fiscal years 2005 and 2006	0.51 %		(3.59)%		0.50 %	

During the 2005-06 fiscal year, the State

- ◆ issued \$370 million in general obligation bonds, which consisted of \$300 million in higher education bonds and \$70 million in clean water bonds for providing grants and loans to local government units
- ◆ entered into installment financing contracts (e.g., notes payable) exceeding \$30 million, in which the majority were for the financing of energy conservation improvements at the N.C. Museum of Art and the downtown state government complex

Legislation was enacted during the 2005-06 session of the General Assembly that authorized the issuance of special indebtedness of up to \$20 million for the purchase of State game lands and up to \$20 million for the construction of a parking facility in downtown Raleigh.



Future Highlights

North Carolina State Government is a large, complex organization. With an annual General Fund budget of \$26.8 billion and over 264,000 employees, the State would be a Fortune 500 company if it were a private organization. Although the State's agencies have different missions and serve different constituencies, they share similar business functions, such as human resources (HR), payroll, budget management, accounting and more.

The State's current core business systems have limited functionality. They rely on dated technology, do not communicate well with each other, are difficult to change for new operational requirements, and are hard to operate and maintain. Moreover, they do not provide information needed for management decision-making in today's business climate, and they are at risk of failure due to old age, withdrawal of vendor support, and being run by a workforce that is rapidly reaching retirement age.

BEACON is a statewide collaborative effort aimed at transforming the way we do business in North Carolina by modernizing and standardizing key business processes in human resources, payroll, budget management, taxation, data storage and accounting. With the implementation of SAP's Enterprise Resource Planning software solution, the goal of BEACON is to build a foundation for management flexibility, increased efficiency, improved access to information, and ultimately to enhance the quality of services provided to the citizens of North Carolina.

The Office of the State Controller, Information Technology Services, the Office of State Budget and Management, the Office of State Personnel, and the Department of Transportation are overseeing the implementation effort with the full support of Governor Easley and the General Assembly. BEACON will impact many of the systems and processes utilized by state agencies and universities. Representatives from nearly every agency in the State are participating in the design of the new infrastructure.

Session Law 2004-129 appropriated \$2.7 million from the IT Fund to the Office of the State Controller in 2004 to begin implementation of the recommendations found in the Statewide Business Infrastructure Study. Of the \$2.7 million, \$1.8 million was allocated to the HR/Payroll Initiative and \$900 thousand to the Enterprise Data Warehouse Initiative. The fiscal year 2005-06 appropriation for the HR/Payroll project was \$20.875 million. Funding for fiscal year 2006-07 is \$44.3 million. The overall estimated cost for the HR/Payroll project is \$125.5 million. The HR/Payroll project is on budget and on schedule to be operational, with the first agency group brought on-line during January 2008, and the second agency group scheduled to be on-line during April 2008.



BEACON—Building Enterprise Access
for NC's Core Operation Needs



Dogwood Tree

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*

Enterprise Data Warehouse Initiative

As part of the BEACON program, the BEACON Steering Committee has identified data warehousing and business intelligence as a key technology infrastructure necessary for delivering better citizen services and more effective operations of State government. In an environment where efficiency, accountability and transparency are paramount to the operations of each and every government entity, it is essential that data formerly housed in disparate "silos" be made available for agency and enterprise reporting and analysis.

The State of North Carolina has undertaken a number of initiatives recently to allow the State to better leverage its data assets. These activities have demonstrated the clear need for a more comprehensive approach to data warehousing and business intelligence in the State. From a statewide perspective, the highest value of business intelligence and data warehousing is realized when information is globally consistent and standardized, enabling decision-makers to query across agencies to perform forecasting, trending and data analysis. The

Data Warehousing Needs Assessment revealed a number of immediate opportunities for implementation of data warehousing and business intelligence that would allow agencies to better leverage their data assets to provide improved operations or services.

The General Assembly this year approved \$1 million in spending to expand North Carolina's data warehousing effort under the BEACON program. Those funds will be used to develop the data warehouse infrastructure and undertake a new pilot project. The Office of the State Auditor will use data warehousing to analyze grants made to non-state groups in the new project.



North Carolina Education Lottery

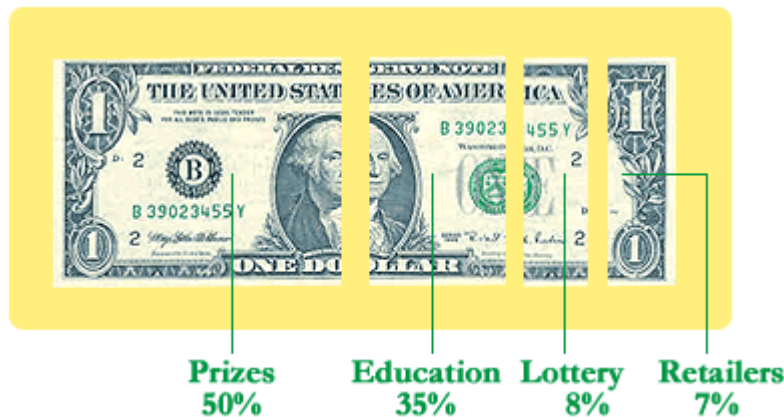


In August 2005, Governor Mike Easley signed into law the North Carolina State Lottery Act and the 2005 Appropriations Act which established the North Carolina Education Lottery (NCEL). The act created the nine-member North Carolina Lottery Commission to initiate, supervise, and administer the education lottery. The Commission was appointed in September 2005 and its initial meeting was held in October 2005. The Executive Director, Thomas N. Shaheen was hired by the Commission in November and began work in December 2005.

The first scratch off tickets began selling on March 30, 2006 and on that day, brought in an estimated \$8 million in sales. Nearly 5,000 retailers were on line and selling the scratch off tickets.

The first Powerball sales began on May 30, 2006, with nearly 5,000 retailers signed on and selling the Powerball tickets. The Powerball is a multi-state lottery game that has multi-million dollar jackpots. North Carolina, the last state on the east coast to approve a lottery, joins 28 states, Washington D.C. and the U.S. Virgin Islands in providing Powerball. In just two days, the NCEL had the highest Powerball sales than any other state for the May 31 drawing. Sales for the first Powerball drawing for the NCEL were over \$3.1 million.

The overall use of each lottery dollar as assigned in the lottery legislation is broken down below:



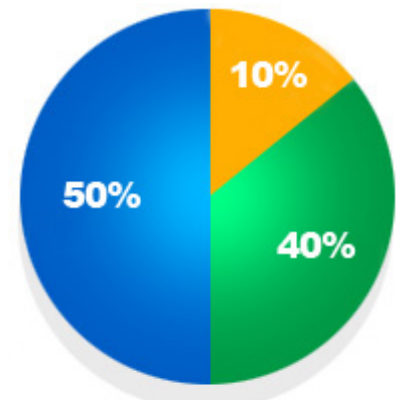
As required by the enabling legislation, the NCEL must transfer 100% of its net proceeds to the Education Lottery Fund. By the end of fiscal year 2006, the NCEL earned \$64.59 million net profit for the Education Lottery Fund.

The breakdown of the net proceeds to education flow as follows:

- ◆ **5 percent** goes to the Education Lottery Reserve Fund to be used when lottery proceeds fall short of target. The Reserve Fund may not exceed \$50 million.

The remainder of the Education Lottery Fund shall be distributed in the following manner:

- ◆ **50 percent** of the total remainder shall be used for reduction of class size ratios in early grades to 18 children per teacher and for pre-kindergarten programs for at-risk four year olds who would not otherwise be served in high-quality settings.
- ◆ **40 percent** of the total remainder shall be used for school construction. Roughly 65 percent of this total shall be distributed to each county based on total school enrollment. The remaining 35 percent of this total shall be distributed to each county with average effective county property tax rates above the state average based on total school enrollment.
- ◆ **10 percent** of the total remainder shall be used for college scholarships for students who qualify for the federal Pell Grant. These scholarships can be used at North Carolina public and private universities and community colleges.



■ At Risk Pre-K Programs & Class Size Reduction
 ■ School Construction
 ■ College Scholarships

Information provided by the North Carolina Education Lottery at www.lottery.nc.gov or www.nc-educationlottery.org.

Financial Highlights — Fiscal Year 2006

North Carolina Aquarium at Pine Knoll Shores



The North Carolina Aquarium at Pine Knoll Shores is one of three state Aquariums operated by the North Carolina Aquariums Division, part of the N.C. Department of Environment and Natural Resources. The Aquariums opened in 1976 as the North Carolina Marine Resources Center. The names changed in 1986 and the facilities broadened their focus to include more public education. In the late 1990's the General Assembly appropriated \$15 million for each Aquarium for major expansions at each facility. The Roanoke Island Aquarium reopened in 2000, after a two-year renovation. The Fort Fisher Aquarium followed in 2002. The renovation plans for the Pine Knoll Shores Aquarium were stalled in 1999 when the State diverted the \$15 million in expansion funds for the Hurricane Floyd recovery effort.



Pine Knoll Shores Aquarium

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*

In response, the Aquarium Division and the North Carolina Aquarium Society, a membership-based, non-profit support organization for all three Aquariums, forged a public-private partnership to raise funds for a \$25 million expansion. Construction began in January 2004 and the newly renovated Aquarium reopened on May 19, 2006, under the theme, "North Carolina Aquatic Life from the Mountains to the Sea."

Expansion facts of the new Aquarium:

- ◆ 93,000 square feet (29,000 in the former facility)
- ◆ 2,500-3,000 animals in nearly 40 exhibits
- ◆ 306,000 gallon *Living Shipwreck* (12,000 gallons before expansion)
- ◆ 50,000 gallon *Queen Anne's Revenge*
- ◆ River Otter exhibit, inhabited by two playful otters, Neuse and Pongo
- ◆ Roaring 32 foot Smoky Mountain waterfall

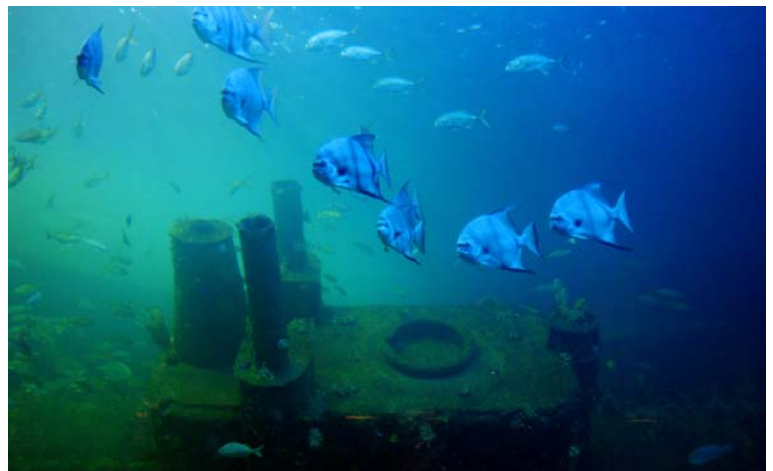
Other new exhibits include a trout pool, a jellyfish gallery, a sportfishing display and a cypress swamp display.

The *Living Shipwreck* display features a three-quarter size replica of a German U-boat that was sunk off Cape Lookout during World War II. The *Queen Anne's Revenge* duplicates the 18th century artifacts in Beaufort Inlet thought to be the wreckage of the pirate Blackbeard's flagship.

There have been great economic benefits from the reopening of the newly expanded Aquarium. New jobs for the area were created, including 45 full-time state government positions (compared to 14 before the Aquarium closed for renovations). Over the summer, temporary and part-time jobs and internships raised the total work force to more than 90 employees.

The Aquarium is expecting to host at least 500,000 visitors annually, more than double the annual average of years past. According to a 2003 economic impact study by N.C. State University, the increase in visitors will translate into an additional \$4.7 million annually for the regional economy, including Carteret, Onslow, Jones, Craven and Pamlico counties. The study predicted the bigger crowds would generate another 132 jobs in the community to meet demands for other services. The construction itself would account for 124 local jobs and will have infused \$8.2 million in new income into the five county area by completion. "The Aquarium reopening is the economic equivalent of a major new industry moving to the county," said Dave Inscoe, Executive Director of the Carteret County Economic Development Council.

Information provided by the North Carolina Aquariums at www.ncaquariums.com.



Aquarium at Pine Knoll Shores

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*



Transportation Highlights

For the calendar year 2005, the North Carolina Department of Transportation (NCDOT) listed the following as its top accomplishments:

Economic Development

- ◆ Contributed \$11.3 million to economic development projects across the state to support business and industry in both our urban and rural areas.
- ◆ Invested \$1.85 million to fund 12 rail industrial access projects in Calypso, Mocksville, Rocky Mount, Taylorsville, Mount Holly, Aurora, Kinston, Asheboro, Statesville, Warsaw and Severn. Once completed, the companies will ship a combined 17,700 carloads annually and employ or preserve 640 jobs.
- ◆ Provided \$642,402 in grants through *N.C. Moving Ahead!* for four short line railroad rehabilitation projects benefiting the communities of Laurinburg, Raeford, Pittsboro, Sanford, Terra Ceia, Bishops Cross, Pantego, Belhaven Tunis and Coefield.

Highway Projects

- ◆ Completed U.S. 17 Jacksonville Bypass from U.S. 258/N.C. 24 around Jacksonville and back to N.C. 24, reducing travel time along the U.S. 17 corridor through eastern North Carolina.
- ◆ Widened U.S. 64 from Plymouth to Columbia to four lanes including the Creswell Bypass, nearly completing the four-laning of U.S. 64 from Raleigh to the Outer Banks.
- ◆ 3,285 miles of highways were improved.
- ◆ 128 bridges replaced.
- ◆ 363 *N.C. Moving Ahead!* projects completed improving safety and mobility.



Random N.C. highway image

Photo courtesy of NC Department of Transportation website

Alternate Modes of Transportation

- ◆ Added more than 200 miles of additional bicycle routes in Cabarrus and Dare counties.
- ◆ Completed several significant new greenway projects, including the award-winning second phase of the Reedy Creek Greenway and the new pedestrian bridge over the I-440 Beltline in Wake County.
- ◆ Completed \$22 million in bicycle and pedestrian enhancements through 16 projects in 11 counties throughout the state.

Governor's Highway Safety Program (GHSP)

- ◆ Increased seatbelt use to 86.7%, the highest ever in North Carolina, through ongoing "*Click it or Ticket*" public awareness campaigns.
- ◆ Launched "*R U Buckled,*" a program to promote safety belt use among teenage drivers.
- ◆ Provided \$200,000 for booster/car seats for needy families.
- ◆ More than tripled checkpoints and saturation patrols as part of GHSP's "*Booze It & Lose It*" campaign over the past five years. This campaign included 82,249 checkpoints; 46,120 DWI arrests; 141,039 total criminal violations; 2,500 stolen vehicles recovered; and 987 fugitive arrests.

Awards

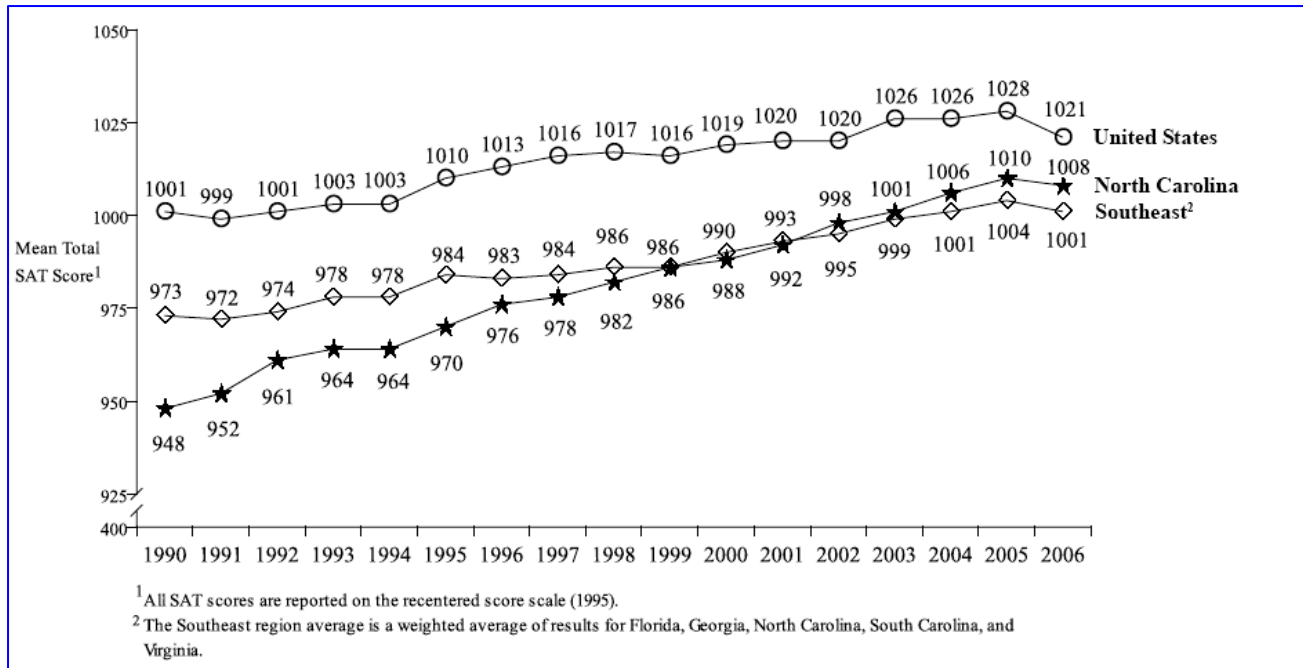
- ◆ U.S. 64/264 Knightdale Bypass named one of the top 10 roads in the nation by *Roads and Bridges* magazine in October.
- ◆ The Federal Highway Administration's 2005 Excellence in Scenic Byways award for the department's efforts to create and expand the N.C. Scenic Byways Program.
- ◆ The Federal Highway Administration's 2005 Excellence in Non-Motorized Transportation Award for the NCDOT Reedy Creek Greenway and the I-440 pedestrian bridge in Wake County.
- ◆ Sir Walter Raleigh Award for Community Appearance for the Reedy Creek Pedestrian Bridge and Trail, Interstate 440 Beltline north of Wade Avenue interchange.

Information provided by the NCDOT website, www.ncdot.org.



Education Highlights

North Carolina students are continuing to close the gap between the state and the national average scores on the SAT college entrance exam. North Carolina has narrowed the gap from 53 points in 1990 to 13 points in 2006. North Carolina also continues to outpace the Southeast. In 1990, the State's score was 25 points lower than the Southeast average score. In 2006, North Carolina's score is seven points higher than the Southeast score. The chart below, taken from *The North Carolina SAT Report 2006*, illustrates the continued improvement in North Carolina's high school students' SAT scores.

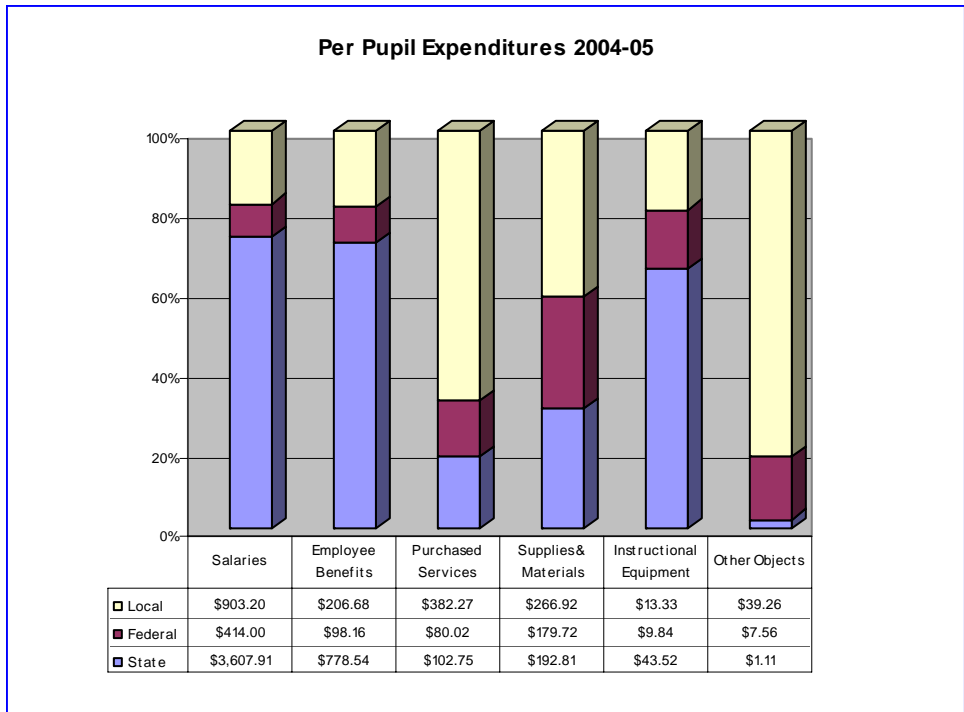


State Superintendent Dr. June Atkinson says, "North Carolinians can look at our state's performance on the SAT over the past few years and be proud that our state has out-performed the nation in the amount of points gained over time. By encouraging a high participation rate and demonstrating strong improvements for minority students over time, our state has shown that we are raising expectations for educational achievement for all."

North Carolina public schools have three distinct funding sources:

- ◆ state government
- ◆ federal government
- ◆ local revenue

This chart illustrates the per pupil expenditures by source of funds for the fiscal year 2004-05. (Since the fiscal and school years do not coincide, the data in this chart is a year behind.)

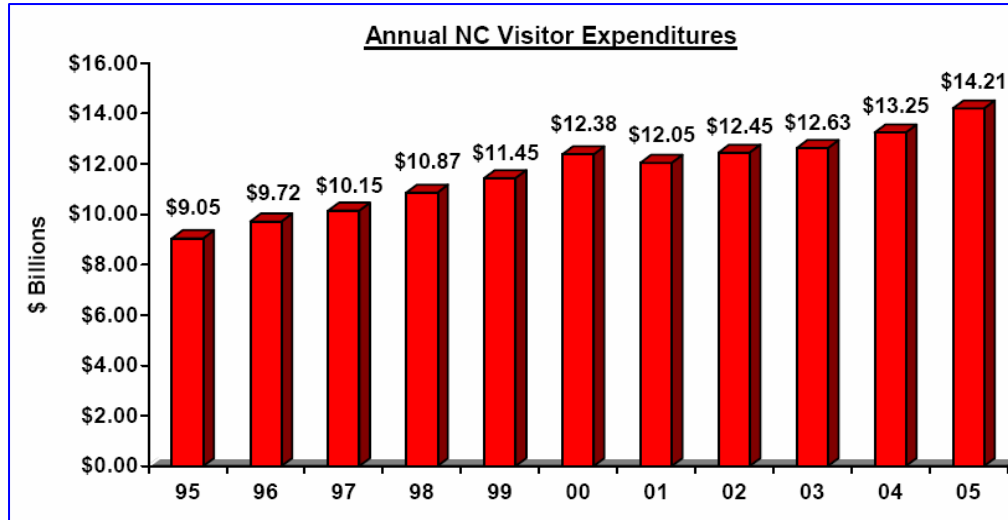


Information provided by the NC Department of Public Instruction website, www.ncpublicschools.org.

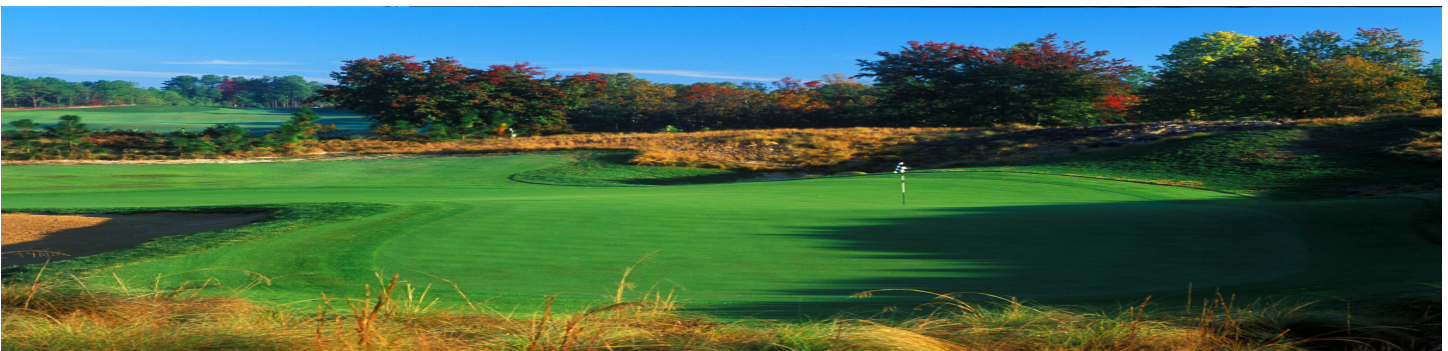


N.C. Tourism Highlights

- ◆ Tourism is one of North Carolina's largest industries. In 2005, domestic travelers spent \$14.2 billion across the state. (7.3% increase over 2004).



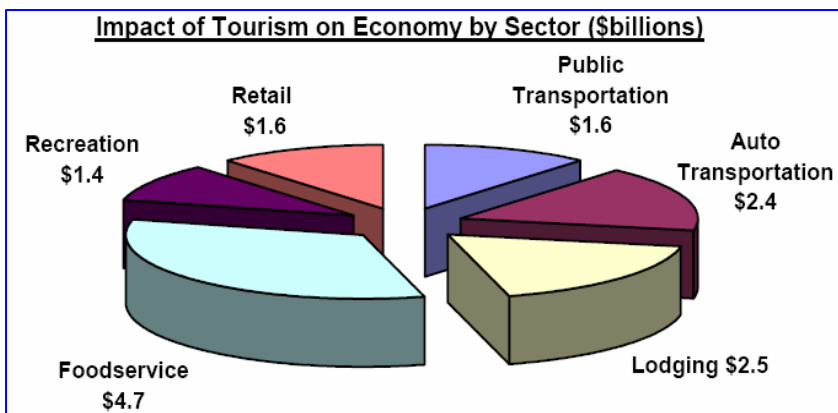
Sources: TravelScope/Directions by DKS&A, Travel Industry Association of America, 2006
 The 2005 Economic Impact of Travel on North Carolina Counties, Travel Industry Association of America, 2006



Tobacco Road Golf Course

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
 Bill Russ, Photographer.*

- ◆ Traveler spending generated over \$2.3 billion in tax receipts; \$1.1 billion in federal taxes, and \$1.2 billion in state and local taxes. (\$747.7 million in state tax revenue and \$461 million in local tax revenue)



- ◆ Domestic tourism expenditures directly supported 185,200 jobs for North Carolina residents.
- ◆ The tourism industry contributed \$3.75 billion to the state's payroll in 2005.
- ◆ Over 64.5 million visitors traveled to North Carolina, ranking us eighth in person-trip volume by state behind California, Florida, Texas, Pennsylvania, New York, Ohio and Michigan.

Sources: TravelScope/Directions by DKS&A, Travel Industry Association of America, 2006
 The 2005 Economic Impact of Travel on North Carolina Counties, Travel Industry Association of America, 2006



N.C. Tourism Highlights (cont'd)



Asheville

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*

Asheville, North Carolina, has been recognized as one of the top 12 travel destinations in the world. That's according to Frommer's, one of the country's top travel publications. Asheville shares the spotlight with Zurich, Switzerland; Virgin Gorda, British Virgin Islands; and Tokyo, Japan.

Located in the Smoky Mountains, Asheville is a small college town with a thriving arts and culture scene. It is home to the Biltmore Estate, the Thomas Wolfe Memorial, and Carl Sandburg's birthplace in nearby Flat Rock. Recently, Asheville has been drawing literary figures and celebrities. With the Blue Ridge Parkway nearby, the area is also great for driving tours and shopping trips to numerous crafts and pottery shops.

Information provided by the NC Department of Commerce website, www.nccommerce.com and Frommer's Travel Guides.

The Biltmore Estate

- ◆ Located in the Asheville mountains, the Biltmore Estate was originally the home of George W. Vanderbilt's family and was opened in 1895 to his family and friends.
- ◆ The home was opened to the public in 1930, and celebrated 75 years of hospitality in 2005.
- ◆ Approximately one million visitors tour the estate each year.
- ◆ According to a study by Dr. Tammy Ross Huffman of the Department of Management and Accountancy at the University of North Carolina at Asheville, the estimated economic impact of the Biltmore Estate on western North Carolina in 2004 was more than \$351 million. The Biltmore Estate also contributes to the region by serving as a primary employer with approximately 1,500 employees on the payroll.
- ◆ The Biltmore Estate winery is the most visited winery in the United States, with approximately 600,000 visitors touring each year. The winery produces more than 140,000 cases of wine each year and has received numerous honors.
- ◆ The Biltmore Estate has been the location of numerous films over the years from 1948, *Tap Roots*, to most recently 2002, *The Clearing*.



Biltmore Estate

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*



- ◆ The Biltmore Estate has 250 acres of landscaped gardens.
- ◆ There are 2,300 roses in the Rose Garden.
- ◆ Approximately 1,000 azaleas are located in the Azalea Garden.

Biltmore Estate Garden

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*

Information provided by The Biltmore Estate website, www.biltmore.com.



North Carolina Accolades

Sports:



2006 Stanley Cup Champions

Photo Courtesy of Gregg Forwerck, Carolina Hurricanes Team Photographer

Raleigh, N.C. was host to the 2005-06 National Hockey League (NHL) Stanley Cup finals, with our own Carolina Hurricanes winning the Stanley Cup in a 4-3 series against the Edmonton Oilers.

- ◆ The Hurricanes franchise began in 1971 as the Hartford Whalers. In 1997, the franchise relocated to Raleigh N.C., becoming the Carolina Hurricanes.
- ◆ They played for two years in Greensboro, and won the Southeast Division title in 1999. They moved into their new home, now the RBC center, in 1999.
- ◆ In 2002, the Hurricanes clinched their second Southeastern Division title as well as their first Eastern Conference champions title.
- ◆ In the 2005-06 season, they again clinched the Southeastern Division title, the Eastern Conference champions title and their first Stanley Cup; thus giving North Carolina its first major league sports championship.

Information provided by the Carolina Hurricanes website, www.carolinahurricanes.com.

Other North Carolina sports recognitions for the 2005-06 season:

- ◆ Duke University's women's cross country team won its second straight Atlantic Coast Conference (ACC) title and North Carolina State University's (NCSU) team came in second place
- ◆ The University of North Carolina's (UNC) women's soccer team won its 16th ACC tournament title in the past 17 years
- ◆ Duke University's men's soccer team and the UNC men's soccer team played in the ACC championship final with Duke winning on penalty kicks, 5-4
- ◆ The UNC women's basketball team won the ACC championship, making it back to back ACC championships for them
- ◆ The UNC men's wrestling team won its second consecutive ACC championship title, with the NCSU men's team placing second
- ◆ Duke University won the ACC men's basketball championship
- ◆ Duke University's women's golf team won its 11th straight ACC championship and its third national title
- ◆ Duke University men's tennis team took its 12th straight ACC title
- ◆ The UNC men's golf team shared the ACC title with the Georgia Tech team
- ◆ The NCSU softball team won the ACC championship against UNC, 2-0

Awards:

- ◆ North Carolina tops the Southeast in attracting new industrial plants and ranks fifth nationally in business growth, according to *Site Selection* magazine's annual ranking. The magazine ranked the Mooresville-Statesville area as the nation's No. 1 rural region. "North Carolina continues to lead the nation in expanding plants and attracting new business," said Governor Mike Easley. "This ranking proves that there is no better place to live, work or raise a family. We are committed to providing a top-ranked business climate and high skill workforce, not only in our large cities but also in our small towns, enabling companies across our state to find qualified employees to meet their needs."
- ◆ In May, Governor Easley announced that the North Carolina Department of Commerce was named the winner of the 2005 Competitiveness Award by *Site Selection*, one of the nation's premier magazines in the economic development industry. The award is given to the state-level economic development department that scores the highest based on 10 criteria.
- ◆ In June, North Carolina was named "State of the Year" by *Southern Business & Development* magazine for the second consecutive year. North Carolina and Alabama again tied for the No. 1 spot in the magazine's 14th annual Top 100 issue, which ranks southern states in terms of business investment and job creation. "The economy is changing rapidly and, in North Carolina, we are determined to build a future of growth industries based on knowledge and talent," said Governor Easley. "We are building the workforce and pursuing the right jobs to transition our economy into the best in the world."



NC Flag

*Photo Courtesy of NC Division of Tourism, Film, and Sports Development.
Bill Russ, Photographer.*

Information provided by the North Carolina Department of Commerce's news releases at www.nccommerce.com.

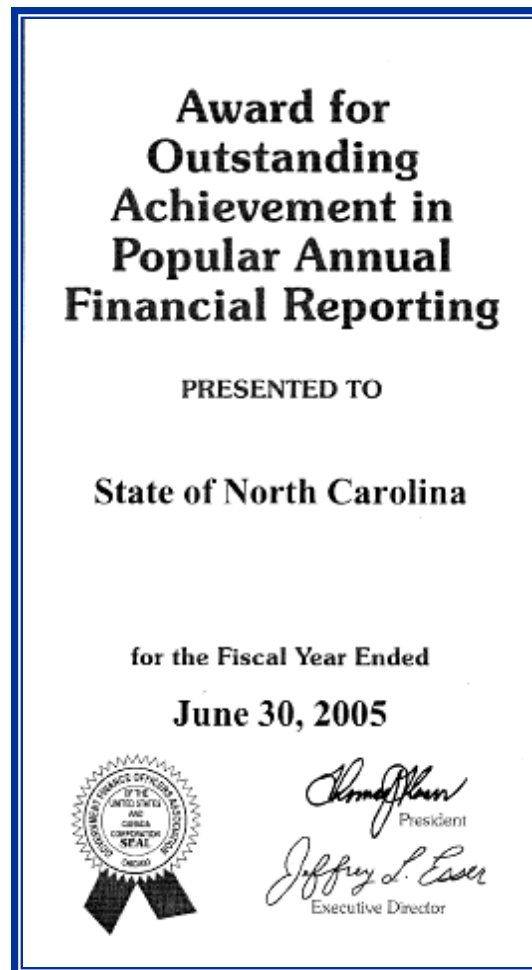


Award for Outstanding Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) has given an Award for Outstanding Achievement in Popular Annual Financial Reporting to the State of North Carolina for its Popular Annual Financial Report for the fiscal year ended June 30, 2005. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular reports.

In order to receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a Popular Annual Financial Report, whose contents conform to program standards of creativity, presentation, understandability and reader appeal.

An Award for Outstanding Achievement in Popular Annual Financial Reporting is valid for a period of one year only. The State of North Carolina has received a Popular Award for the last eight consecutive years (fiscal years ended 1998-2005). We believe our current report continues to conform to the Popular Annual Financial Reporting requirements, and we are submitting it to GFOA.



300 copies of this public document were printed at a cost of \$1,639.13 or \$5.46 per copy.