



OSCAR

The OSC Activity Report

Office of the State Controller

Robert L. Powell, State Controller

Summer Quarter 2006

OSC wins financial excellence award for reports

For the 12th year in a row, the Office of the State Controller has been recognized for excellence in financial reporting by the Government Finance Officers Association.

The association has recognized North Carolina both for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2005, and for the Popular Annual Financial Report, a high-level report on the State's financial situation intended for general readers. Both reports are prepared by the Office of the State Controller.

The awards recognize that the State has met high standards of financial accounting and reporting as well as a "spirit of disclosure" to clearly communicate the State's financial history.

"I am proud that we continue to maintain the highest levels of integrity with our financial reporting and disclosure," said State Controller Robert L. Powell. "This is a credit to the OSC staff, which works diligently to pull these reports together, as well as the financial officers throughout state government and the Office of the State Auditor whose contributions helped lead to this distinction."

States submit their financial reports to the association, where they are reviewed by an impartial national panel of financial experts. Those states that meet the association's standards receive awards for excellence.

The Government Finance Officers Association is a nonprofit professional association serving about 16,000 financial professionals in the United States and Canada .

New master agreement reduces state fees for credit cards

The Office of the State Controller has negotiated a new master agreement for credit card transactions that will reduce "per transaction" fees by more than 60 percent. The new contract with SunTrust Merchant Services, LLC , which takes effect August 1, covers credit card transactions by participating agencies.

The new contract also includes enhanced security requirements imposed by the credit card industry.

The most significant enhancement in the new agreement is reduced fees for participants, said David Reavis, OSC's electronic commerce manager. The primary "per transaction" fee under the old contract was \$.108, while the new per transaction fee will be \$.04, representing a 63% decrease.

The per transaction fee is only one component of the total cost of processing a merchant card transaction. The pass-through fees, generally referred to as interchange fees charged by the card associations, will continue to be passed on at actual cost. Considering both vendor-levied and pass-through fees, the total fee for a typical transaction should be approximately 3.2% less than under the old contract. The actual fee reduction percentage will depend upon a participating agency's average-sized

transaction amount.

Other enhancements provided by the new agreement include point-of-sale terminal supplies at no cost, with only shipping costs being charged; a new web-based reporting system due this fall; and an option to use SunTrust Bank, in addition to Wachovia Bank, to obtain next-day availability of funds for community colleges and local governments that use SunTrust Bank as their official depository.

Before being allowed to participate under the new contract, merchants will be required to comply with all card association rules. This includes the rules pertaining to Payment Card Industry security standards. Agencies have been given a full year to become compliant with PCI Security Standards, said Ben McLawhorn, OSC's risk mitigation services manager. PCI compliance is a significant requirement of the new agreement. More information regarding this topic can be found on the State Controller's Web site, <http://www.ncosc.net/>.

In addition to PCI security compliance rules, there are other card association rules that apply to participants. Many of the rules have fines associated with violations and non-compliance, and some require services to the violating merchant to be terminated.

There will be a three-month transition period, during which current participants will be able to accomplish the tasks necessary to transition to the new contract. The old contract will remain in effect, concurrently with the new contract, until October 31, 2006. Until the participant completes the transition tasks, the participant will be operating under the old contract and subject to the old pricing schedule.

In order to transition to the new contract a participating agency must execute a new participant agreement and certify that it has achieved PCI security compliance. Because the new contract is clearer in disclosing a participant's obligations, it is important that participants read and understand the documents comprising the contract before executing the Agency Participation Agreement.

OSC is encouraging agencies to take advantage of the new agreement and do more business electronically in the future. But agencies should be careful to fully understand the conditions under which they enroll in this contract, especially from a security and liability standpoint.

Controller's Message: New budget shores up State's finances, reserves

The last four years for North Carolina State Government have been the equivalent of rebuilding a depleted football team after all the stars retire. The only difference is that the financial situation is substituted for the "stars" and the government operations represent the team itself. We have literally had to rebuild the financial structure since 2000-01, a job that has been painful for both policy makers and program providers. As we complete the 2006 legislative session, I believe we can once again declare North Carolina to be a contender in the Super Bowl of government finance.

The last four years have been riddled with difficult decisions related to taxes, budget reductions, human resource reductions and limitations, and delayed capital investment. Decision makers have faced issues like how to regain structural balance, restore depleted reserves, and meet fundamental government expectations with limited resources. These decisions have been difficult for elected leaders and painful for those of us charged with providing services to the public. But together we have survived this dilemma and the 2006-07 budget provides needed stimulation for starving service providers.

From an OSC perspective, we are extremely pleased and excited about the prospect of the most impressive Comprehensive Annual Financial Report in recent years. Early indications are that we will have a positive fund balance for the first time in several years. The credit balance this year can be attributed to overcollections of revenue along with the frugal spending practices imposed over the last several years. In addition, the Governor and Legislature have invested heavily in the Savings Reserve Account, restored the Repair and Renovation Reserve, made significant investments in technology, established a State Emergency Response Account, continued the payback of retirement funds previously intercepted, and provided significant pay increases for the state workforce. And we should note that the Executive Budget Act has been rewritten to help clarify budget development and execution authority as well as simplify revisions made over the last 80 years.



In summary, this budget cycle is the culmination of wise decisions and investments made by elected leaders and state employees over the last several years. Our goal should be to learn from past experiences and do all we can to insure that future public leaders and managers avoid the problems we had to endure.

Blueprinting sessions bring new system design down to the fine points

Last year, in preparation for the BEACON payroll/human resources project, OSC spent a lot of time talking to state agency representatives about what they wanted and needed in a new technology system. Now, through blueprinting sessions, the BEACON team is gathering detailed information about how various payroll and personnel offices actually use the existing systems.



Paul Yenter, Julie New lead blueprinting session on personnel

What we're doing is capturing the requirements at a very detailed level," said BEACON program director Lowell Magee. "We're confirming what the systems do today so when we shut the other ones off, we won't lose any functionality. We want to begin envisioning what the 'to-be' system will look like when it is in place."

BEACON contractors and OSC employees who will operate the system once it is built will be spending the next few months talking with payroll and personnel workers from state agencies to nail down exactly how they use the existing systems. That information will be used to design the new technology and to develop more streamlined processes for agency business operations.

"We're looking not only from a data perspective, but also a process perspective from end to end," said Andrew Koenigsberg, BEACON's deputy program director. "We want to see how we're going to manage that process in the future -- how the forms will work, who will enter the information. That will be key for us in configuring the system, and also for how we do the training in the future.

"One of the outcomes we have had already is that there is no standardization," Koenigsberg said. "We are looking at where there are similarities and differences (in what individual agencies do) and what we can do to standardize and employ best practices to change the organization over time."

A factor in designing the new system and moving toward standardized processes, Magee said, is cost.

"You want to be prudent and not just go crazy," he said. "You do not want heavy customization of the system. That gets expensive, and what we want is a functional, efficient system that the State can afford."

Last year's sessions on what agencies wanted will be integrated with the new information on what they are actually doing and the possibilities of the SAP technology system to come up with the final design.

And the agency experts whose input is helping design the system will also be involved in refining the design.

“The subject matter experts (from agencies) are part of it all the way through,” Koenigsberg said. “We will bring people in to do the process walkthroughs, and we will bring them in to start testing. We've got a multitude of people coming in to help, so that when you get to the training aspect of the new system, it should not be a surprise to anybody.”

Data warehousing development expanding to three projects

Government, like any large business, compiles volumes of information – most of it on an agency-by-agency basis – but that information is only of limited use to decision-makers when it is scattered across a number of incompatible computer systems. But the relatively new technology of data warehousing, combined with business intelligence software, can put that scattered information to good use.

Data warehousing combines information collected by agencies into a standard format and central location, while business intelligence software allows decision makers to analyze that combined data for possible waste or fraud, long-range trends and effectiveness of programs. The State is making data warehousing products developed by Cary-based SAS available to all agencies.

“People expect more efficiency and effectiveness from their government,” said State Controller Robert L. Powell. “Data warehousing and business intelligence tools are a tremendous way to use innovative technology to achieve that efficiency. I am glad to see the State move into this relatively new area of technology that has already proved its value in the private sector.”

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.

An earlier project in the Revenue Department to analyze the taxation of guest workers working in the State also will be expanded. A pilot project already undertaken in the Office of State Personnel consolidated data from the State's legacy human resources system, several retirement systems and the federal Bureau of Labor Statistics. That data then was analyzed to assist with workforce planning. Predictive models developed as part of the project helped to forecast which employees would be most likely to retire in the near future.

“We did a one-time download of information in that project,” said Julie Batchelor, Assistant State Controller for OSC's Financial Services Division. “We want to expand the data warehouse so State Personnel can extract data regularly for ongoing workforce analysis.”

Other states that are experimenting with data warehousing have used the techniques to analyze which programs used in prison systems best reduce recidivism, to predict the long-range impact of legislative policy decisions and to combine financial data with performance data to analyze a program's effectiveness.

While the three pilot projects approved this year will be specific to the agencies involved, they also move the State forward in creating a statewide data warehouse.

“I'm really excited to be working on an enterprise data warehouse,” Batchelor said. “It's of great value to the General Assembly and the State's leadership. The more information you have, the better. You can meet the unique needs of an agency, but at the same time, you look strategically for government as a whole.”

NCAS Help Desk evolving to handle growing responsibilities

About 70 times a day on average the NCAS Help Desk in the Office of the State Controller fields calls ranging from the obscure – extremely technical questions on the technology systems used in North Carolina's business operations – to the mundane – trying to find a state employee who may or may not work for OSC.

“We can sometimes be the Help Desk of everything,” said Crystal Cole, one of the OSC analysts who field Help Desk calls.

"Sometimes, it's like people see our number on the website and think we 'control' everything because we're the Controller's Office," said Amy Whitley, another Help Desk analyst.

"You have to know how to pull the right information from a caller and point them in the right direction," said Linda Blackmon.

Like many other operations, the Help Desk will be evolving in August as OSC adjusts to changes expected to come with the BEACON payroll and human resources project. For one thing, its name will change from the NCAS Help Desk to the OSC Support Services Center, and callers will be directed by an automated system. The Help Desk number, 919-875-HELP (4357), will remain the same.

But callers will be given three options based on the kind of help they need. Option 1 will connect the caller with technicians who can answer questions dealing with the North Carolina Accounting System, Central Payroll, Foreign Nationals or a Payment Verification Form. Option 2 will connect with technicians specializing in electronic commerce, a new area for the Help Desk; and Option 3 will field questions related to training coordinated or provided by OSC.

"We're all looking forward to the changes being made on the Help Desk," said Jennifer Cuddington. "It's going to be something new and different than what we've been accustomed to."



Help Desk analysts, left to right, Jennifer Cuddington, Crystal Cole, Amy Whitley, Linda Blackmon and Doug Wentz

As OSC goes through the organization changes associated with BEACON, the Help Desk will become even more critical in helping agencies deal with problems, said Terry Senter, manager of OSC's Support Services Section. OSC staff members that agencies may have called directly for advice in the past could be shifting to BEACON teams as development of the new payroll/human resources system progresses.

Members of the Help Desk staff have backgrounds in accounting, technology and communications, which are critical to answering questions about the business operations that OSC oversees for the State. They must stay current on OSC services and the technology behind them, know which experts on OSC's staff to consult for questions they cannot immediately answer, and cross-train on OSC systems.

"They take their responsibility to follow through with a question seriously so they can learn from it for the next time that question comes up," Senter said. "They really play off each other in keeping current."

Help Desk analysts do more than just answer questions. They also are instructors in OSC's expansive training program, helping agency staff responsible for business operations keep up with changes. Those classes help the analysts keep in touch with more than 5,400 users of OSC's business services.

"You have to get pretty good at multi-tasking," said analyst Doug Wentz.

New budget advances BEACON, changes budget-writing rules

North Carolina's 2006 budget continues to advance the BEACON project, expands a pilot program in data warehousing associated with BEACON, gives state employees their first substantial raise in 16 years, and revises the rules used by the State to create its budget. Legislators also decided to slow the expansion of the career banding program and take the first steps to address changes in accounting rules that will require government to calculate its liability for health insurance programs for retirees.

"The State's leadership renewed its commitment to the BEACON project with this budget," said State Controller Robert L. Powell.

“Their continued support for this effort is critical as we work to modernize North Carolina 's core business systems.”

The revised budget includes about \$43 million for the BEACON project, which is currently designing a unified payroll and personnel network that will replace outdated and incompatible information technology systems used by individual state agencies. The phased project, which has been in the planning stages for more than four years, is scheduled to be implemented with a pilot project in October 2007 that will be expanded to all agencies with rollouts in January and April 2008.

Legislators also included \$1 million in the budget for enterprise data warehouse development. That project will expand existing pilot projects involving the Office of State Personnel and the Revenue Department. The Office of the State Auditor, in a new project, will use data warehousing techniques to analyze state grants to nongovernmental groups.

A rewrite of the Executive Budget Act increased the State Controller's responsibilities related to the application of statewide budgetary control, management reporting, and financial reporting

This new State Budget Act, which takes effect July 1, 2007, clarifies the procedures for preparing, enacting, and administering the state budget, while making conforming changes, and repealing various statutes and session laws.

The new legislation includes key state budget definitions such as appropriations and unreserved fund balance; budget fund type definitions to agree with the provisions of the Governmental Accounting Standards Board; and the determination and designation of appropriate budgetary fund types as defined by generally accepted accounting principles.

The act also raises the target balance of the Savings Reserve Account from 5% to 8% of the prior year appropriations. This new provision raising the target balance is expected to be well received by credit rating agencies.

The budget also included a 5.5 percent pay raise for all state employees, the first significant pay raise in several years as North Carolina struggled with shortfalls. It also included a provision slowing the expansion of the career banding program until the General Assembly can study the impact of the changes on the State's personnel rules.

In separate legislation, lawmakers also approved a change for the retirement system that will require state employees hired after October 1 to work for 20 years before receiving free health care as a retiree. Employees who work for 10 years would get health insurance in retirement at a 50 percent discount. The current plan provides free health care after retirement for anyone who vests their pension at five years.

But changes in accounting rules will require governments and businesses next year to report their liability for retiree health care and other non-pension benefits in annual financial statements. In North Carolina 's case, the liability for retiree health care is projected to amount to billions of dollars.

OSC moving forward with internal control monitoring, reviews

The Office of the State Controller is legally empowered to establish the internal controls that state agencies use to keep track of the funds they receive and spend. And it is moving ahead with a monitoring system to see how well those controls are working.

The statewide initiative is similar to efforts in the federal government and the monitoring of private companies under the Sarbanes-Oxley Act, said Ben McLawhorn , manager of OSC's Risk Mitigation Section.

“We prescribe the internal control standards,” McLawhorn said. “Our reviews check whether those standards are being met.”

All state entities must provide a self-assessment of their internal controls each year. The Risk Mitigation staff then follows up with reviews of selected agencies to test the effectiveness of their controls.

“We are working closely with the Office of the State Auditor to make sure our review efforts dovetail with their work,” McLawhorn said. “Our reviews are not audits, and will not substitute for the work done by the Auditor's Office. We are working with the auditors to form a statewide Internal Control Task Force that will have a role developing our review initiatives.”

The OSC reviews are intended to help agency managers assess their risk tolerance through the identification of existing or potential internal control weaknesses. The reviews also help raise awareness of the importance of appropriate internal controls and best practices.



*Service Awards highlight
OSC recognition event
for state employees*

State Controller Robert Powell, right, gives 30-year service award to Bonnie Jones as staff members look on. The service awards were part of OSC's State Employee Recognition Day in May.

CAFR packages must be submitted by August 31

The deadline is looming to submit financial information for North Carolina's Comprehensive Annual Financial Report. By law, the year-end CAFR packages completed by agencies and other state entities are due at the Office of the State Controller by August 31.

Because of changes in national accounting standards, several new worksheets are required this year, and an extra file has been included for agencies to submit narratives to support certain CAFR worksheets.

OSC has committed to provide a statewide accrual file to the Office of the State Auditor by September 15, so it is critical that agencies meet the August 31 accrual closing deadline, said Anne Godwin, manager of the Accounting and Financial Reporting Section.

"These deadlines make it so the process can work," Godwin said. "The August 31 deadline gives us two weeks to review what is submitted and get it to the auditors, so we will be working through the Labor Day weekend to get the files nailed down. We compare everything that is submitted with what the agencies have in the accounting system to make sure what goes into the report is accurate."

The accounting and research functions that support the CAFR preparation process are year-round activities for the Statewide Accounting Division. The CAFR includes management discussion and analysis, informative statements, disclosures, and trend information related to the fiscal operations of state government in North Carolina. North Carolina has been awarded the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting 12 years in a row for the fiscal years 1994 to 2005.

The State Controller's web page <http://www.ncosc.net/financial/financial.html> now provides public access to nine years of CAFRs (1997 to 2005).

The State Controller also publishes *North Carolina Financial Highlights* to serve as a layman's summary of the State's annual financial condition. This report is based on the CAFR, and includes narrative and graphical trend analysis to compliment the basic financial disclosures of the CAFR. This report also has been recognized for excellence by the Government Financial Officers Association.

The General Assembly took action this year to strengthen North Carolina 's financial condition by continuing to rebuild budgetary reserves that had been seriously affected by the economic downturn of the last several years. Those reserves may be needed to absorb future downturns or to cope with natural disasters.

With a revenue surplus for the first time since 2000, legislators set aside an additional \$323.87 million for the Savings Reserve Account, bringing its balance to \$636.5 million. Additionally, \$222.2 million was earmarked for the Repairs and Renovations Fund.

Information technology report tracks growth, importance of systems

If there is one area of government spending that has become increasingly critical over the last few years, it is the information technology area. Once limited to a few computer terminals scattered through state agencies, information technology now encompasses complex networks and key systems that are essential for any agency to carry out its mission.

In response to the growth of technology spending, the General Assembly is requiring that agencies improve their reporting on what technology costs. An annual report produced by the Office of the State Controller by October 1 each year outlines what the State is spending on technology.

"The IT Expenditures Report has enhanced our understanding of what goes into technology across the State," said Julie Batchelor, Assistant State Controller for the Financial Services Division. "There are a lot of components to it. It's a baseline to show us how we're doing."

Thirty years ago, IT expenditures generally amounted to buying a computer and developing programs to perform specific tasks.

"We used to have custom programs with few or no licensing fees attached," Batchelor said. "Those costs have mushroomed now as we use more and more proprietary products."

In addition to licensing fees, infrastructure and personnel are significant cost components. "Not only do you stand it up, you then have to maintain it," Batchelor said, "and that can get expensive."

Information Technology Services has started using project management tools that help capture all the costs associated with developing complicated technology projects. The State is now moving toward an application portfolio management tool that will help capture more accurately the costs associated with software.

State preparing for accounting change on retiree health liabilities

North Carolina is preparing for a change in the national accounting standards that will force governments to calculate and disclose their liabilities related to health care for retirees in much the same way they must report liabilities for pensions.

In 2004 the Government Accounting Standards Board issued Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans (effective for fiscal year 2006-07), and Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (effective for fiscal year 2007-08).

Many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered. For North Carolina , OPEB includes retiree healthcare, as well as long-term disability. Currently, the State and most local governments finance retiree healthcare plans on a pay-as-you-go basis. The financial statements generally do not report the financial effects of retiree healthcare plans until the promised benefits are paid, years after the related employee services are received.

The State's retiree healthcare plan covers former employees of state government, the University of North Carolina system, community colleges, local educational units (teachers), and certain participating component units.

For the fiscal year ended June 30, 2005, pay-as-you-go funding for state employees retiree healthcare totaled \$183.36 million; Funding for teachers retiree healthcare totaled \$197.07 million. Total retiree healthcare plan pay-as-you-go funding was \$380.43 million. For fiscal year 2006, we estimate the total retiree healthcare plan pay-as-you-go amount to exceed \$450 million.

North Carolina has monitored the issues related to this new standard for a number of years prior to the final standard being issued. Three actuarial studies related to retiree healthcare have been completed as part of the State's process of formulating strategy. Historically our funding practice has been pay-as-you-go. A continuation of pay-as-you-go funding will result in a substantially higher unfunded liability for retiree healthcare.

The State is scheduled to have an official actuarial study completed by October 31, 2006. The study will indicate the State's unfunded retiree healthcare liability under an assumption of full funding of the actuarially-based annual required contribution, and also will indicate the unfunded retiree healthcare liability under an assumption of pay-as-you-go funding.

The actuary will include information related to retiree healthcare liability management in other states, and the estimated impact on North Carolina 's liability if it were to implement similar changes. Beginning in fiscal year 2006-07, for North Carolina 's circumstance and in accordance with generally accepted accounting principles, the unfunded actuarial liability will not be recorded as an accounting liability but will be disclosed in the notes to the financial statements, and required supplementary information. We currently plan to have actuarial valuations conducted on an annual basis.

Legislation approved this year will impact the State's future retiree healthcare costs. Currently, North Carolina allows employees to be fully vested for retiree healthcare coverage after 5 years of service. But the new legislation would extend the vesting eligibility for employees hired after October 1 to 10 years for 50% vesting, and 20 years for full vesting of retiree healthcare benefits. This change in vesting period will not have an immediate effect on the retiree healthcare costs but will reduce future healthcare obligations.

OSCAR, The OSC Activity Report, is published quarterly by the North Carolina Office of the State Controller
1410 Mail Service Center; Raleigh, NC 27699-1410