



# OSCAR

## The OSC Activity Report

Office of the State Controller

Robert L. Powell, State Controller

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## Moody's upgrades North Carolina to Aaa

Moody's Investors Service upgraded the State of North Carolina's general obligation bonds to Aaa from Aa1 on January 12, and changed the rating outlook to stable from positive. The upgrade reflects the State's strong financial performance, replenishment of depleted reserves, recent economic gains that surpass national averages, and the State's effective fiscal management and healthy financial outlook, Moody's said in a press release.

Moody's cited the strong turn-around in General Fund balances, healthy economic growth and North Carolina's history of strong financial management. It listed challenges for the State including financing secondary education needs, rising debt levels and reserve levels that are below historic peaks.

"This is a welcome step forward for North Carolina, which again becomes one of the few states in the nation with a Aaa rating from all the bond rating houses," said State Controller Robert Powell. "A lot of people in the executive and legislative branches of government worked very diligently over the last several years to get this top rating restored. And it certainly will benefit taxpayers with favorable interest rates as we move forward to improve North Carolina's infrastructure."

In recent years, North Carolina experienced an unusual confluence of financial challenges that resulted in major one-time expenditures and lost revenue, Moody's analysts said. The early 2000s was a period of severe strain for the State as it suffered a series of adverse economic and fiscal events including costly legal judgments, hurricanes and floods, and revenue loss resulting from the national economic recession. In addition, the State experienced revenue erosion from sizable multi-year tax reductions, while spending pressures were rising.

To address its financial challenges, the State drew down its Rainy Day Fund (RDF), and unreserved general fund balances were drawn down steadily from positive \$445 million in 1998, to negative balances in 2000 through 2005. As the result of conservative budgeting, tight expenditure controls, and an improving economy the State's financial performance has made strong gains in recent years. Tax revenues exceeded budget forecast by 6.5% in fiscal 2006, and were 13.2% over fiscal 2005 revenues, resulting in a \$940 million revenue surplus. Corporate income tax collections were 33% above the budgeted forecast.

In addition, the RDF has been replenished: \$322 million was transferred into the fund, bringing the balance to \$634.6 million at the end of the year. With other reserves including \$142 million in the Disaster Relief Reserve and \$222 million in the Repairs and Renovations Reserve, available reserves rose to a healthy 5.7% of tax revenues. Despite its recent financial strain, North Carolina's liquidity position remains solid without the need to resort to borrowing for cash flow purposes.

Another indication of the State's improving financial position is its plan to reimburse the Highway Trust Fund for amounts that were transferred during the State's recent period of fiscal challenge during the recession, Moody's said. The amended 2006-2007 budget includes a \$195 million reduction of the amount originally budgeted to be transferred from the Highway Trust Fund to the General Fund. This would repay the \$125 million one-time transfer to the General Fund as well as the \$80 million inflationary increase adopted in fiscal year 2002-2003.

In the last few years, North Carolina, like many states in the country, suffered an economic slowdown as a result of the national recession. State employment growth slowed significantly to 1.6% in 2000, dropping below the national rate for the first time since the 1991 recession. Employment declined in 2000, 2001, and 2002, and then rebounded in 2004, 2005, and 2006.

Manufacturing, formerly a growth sector for the State, is still declining, but professional and business services and health and educational services have both shown healthy growth over the past two years. Employment in health and educational services grew 4.0% in North Carolina in 2005, compared to 2.3 % for the U.S. A similar pace has continued in 2006 with jobs in this sector growing by 3.8% in the first ten months of the year compared to the nation's growth of 2.3% for the same period.

Looking forward, Moody's believes that although manufacturing in the State has declined and will continue to decline, an expansion in services, high-technology, and research professionals, as well as improving demographic trends, will fuel growth in the State, and the State will continue to outperform the nation as a whole. While historically moderate, the State's net tax-supported debt outstanding has increased significantly in recent years, rising from \$1.6 billion in 1996 to \$6.4 billion in 2006, in part due to recent large issuances for higher education capital projects. Despite the sizeable increase in debt outstanding over the last several years, the State's debt burden remains relatively low compared with other states in the nation.

The outlook for the State of North Carolina is stable. Moody's believes that strong executive management, the stable economy, and the strong revenue growth in recent years will enable the State to steadily improve its fund balances and continue to replenish its reserve.

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## BEACON unveils 'Extreme Makeover' for payroll/human resource systems



State employees got a sneak preview of their own Extreme Makeover January 24 when OSC presented an overview of what they can expect to see when the new HR/Payroll system goes live in -- as Program Director Lowell Magee put it -- 491,400 minutes or 341 days or 48 weeks.

The presentation parodied the ABC Television Show "Extreme Makeover Home Edition, with BEACON staff, left, dressed in construction clothes and blue hard hats. The show was narrated by Ty -- not ABC's Ty Pennington, but OSC's Tyler Jones, below right.

After State Controller Robert Powell thanked employees for their hard work in blueprinting the new system, the Extreme Makeover parody started with a video snippet of Drake PMIS, played by the Office of State Personnel's Drake Maynard, and Edith Payroll, played by the Office of State Controller's Edith Cannady, explaining some of the reasons why the State needs a new personnel and payroll system. They pointed out that:

- The State's Central Payroll System was implemented 25 years ago;
- PMIS was implemented 30 years ago;
- In the current system the same information is keyed and re-keyed into various systems, which increases errors and impairs data integrity;
- Information cannot be shared among systems, which makes it difficult to produce accurate and timely information; and
- The systems are written in outdated programming languages that few people understand today.

During the blueprint highlight portion of the show, Julie New, the project's human resources lead, showed employees sample screen shots of how various human resource and benefits processes will work in the new system. Using the new system, she said, will be as simple as being able to "point and click" with a mouse.

As she wrapped up her presentation, New identified numerous key advantages that the new system will offer, including:

- **A unique employee identifier vs. SSN** – Employees will no longer be identified by their SSN, instead they will have a unique employee identifier that will follow them throughout their state career and into the retirement system.
- **Drop down boxes vs. memorized codes** – The current systems require users to memorize codes. In the new system drop down boxes eliminate this need.
- **Integration across application areas** – The current systems operate in silos and do not communicate well with each other. In the new system, because all data is stored in one database, information is accessible across application areas (e.g. HR actions automatically kick-off payroll and benefits activities).
- **Single entry vs. dual entry** – In the current system data has to be entered multiple times in multiple locations. In the new system, which features a single system of record, data needs only to be entered into the system once.

Following the HR and Benefit's highlights, attendees learned about Employee Self Service (ESS), which allows employees to access and maintain personal information in the new HR/Payroll system.

Employees will be able to access the ESS website, or portal, from any computer with Internet access. Once in the portal, among other things, employees will be able to:

- Securely update personal information;
- View and print past and current pay stubs; and
- Access multiple-year W-2 information.

In regard to the system's ability to capture time and leave, Anita Ward, the project's functional team lead explained that:

- Work time and leave time can be captured in one timesheet screen;
- Holiday calendars will be in the system and will be checked during the time evaluation process;
- Overdrawn leave will be prevented. However, there will be a process for advancing leave;
- Policy compliance can be better enforced, as all of the rules will be configured in the system; and
- The system supports positive and negative time reporting.

The integrated system, Ward said, will allow:

- Shift premium pay to be automated based on shift assignment;
- Automatic payout of comp time, when appropriate; and
- Direct feeding of the time evaluation process to payroll, eliminating the need to key information obtained from a separate time keeping system into the payroll system

One of the most anticipated portions of the show dealt with the new system's reporting capabilities. "Ooohs and Aaahs" abounded when Karen DeLeon, the project's reporting lead, demonstrated new report functions like:

- **Drag and Drop** – The ability to move data on and off the report view.
- **Drill Down** – The ability to move from a highly aggregated view of the data -- say a report that lists the total number of new hires in the last year -- to a more detailed view of the data like the names and hire dates of all the employees hired within the last year.
- **Filter** – The ability to narrow the focus of the report to the key data being analyzed, like focusing only on new hires who are minority females.
- **Sort** – The ability to automatically sort data in ascending or descending order.

Unlike with current reports, DeLeon said the new system reports can be run on demand by designated personnel and payroll users without impacting transaction processing. Additionally, reports are easy to download to Excel and combine with non-SAP data and navigation software to provide multiple views of single datasets.

DeLeon stressed that in the new system reporting capabilities will be secure, accessible, flexible and easy to use.



Deputy State Controller Gwen Canady reviewed standardization issues that must be addressed before and after the new system goes live. Some of the pre-implementation issues include requiring that all employees paid through Central Payroll participate in Direct Deposit as a condition of their employment and replacing the three different job description forms (PD-102R, the PD-OSS and Career Banding) with one form that can be used by OSBM and OSP for both graded and banded positions.

Some of the standardization issues following implementation include requiring all agencies to use two decimal places (1/100th increments) to record time, defining a single leave accrual period and treating all parking deductions as pre-tax deductions.

Magee and Edward Brodsky, the project's change and communications team lead, provided a timeline of key activities, clarified the roles BEACON Support Team members will play and outlined various agency resource requirements throughout the next phase of the project.

Shirley Patterson, the project's training lead, said that all the State's HR/Payroll professionals will receive the appropriate training for their specific job functions. Additionally, the BEACON HR/Payroll Project Team will offer multiple training opportunities using both classroom and online methods.

Patterson said four streams of training will start in September. These include:

- Four months prior to go-live offering SAP basic navigation;
- Three months prior to go-live reviewing new business processes and policy changes;
- Two months prior to go-live offering classes with "hands-on" exercises for SAP transactions; and
- One month prior to go-live encouraging as many practice sessions as possible.

Deputy Program Director Andrew Koenigsberg discussed deployment and support. Specifically, he explained that once the new system goes live, BEACON personnel will be available to assist agencies with support, identifying additional training needs and working on process improvements.

Transition centers, staffed with BEACON personnel, will be set up around the State to assist agencies with software and/or process issues. Moving forward, a BEACON Support Center, called BEST (BEACON Enterprise Support Team); will be established to assist agencies throughout 2008 and beyond.

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## *Controller's Message: New legislative session, new challenges*

The North Carolina General Assembly has kicked off its 2007 session, bringing new leadership and facing a session full of challenges and opportunities for elected officials and state government.

The Office of the State Controller has been working hard to provide opportunities for improving the way we conduct the State's business, and we are trusting that legislators will give our proposals both a good look...and perhaps a few dollars to help out.

The final funding component of the BEACON HR/Payroll project is the top priority for OSC. We go live January 1, 2008, with the first wave of agencies, and finish with a second wave in April 2008. Funding is needed to ensure that this schedule is met and that all systems continue on go.

But we are also looking to begin work on three other pieces of BEACON. To expand the usefulness of the HR/payroll package, we are asking for funds to add a recruiting module and a training module to the system. These components, which have been sought by many agencies, would be added immediately after the second wave in 2008.

In addition, we hope to secure BEACON planning funds for the "Financials" component of the SAP software. This planning, which would begin in the next fiscal year, includes evaluating the computer systems that support budget functions, accounting, and cash management.

OSC also has initiatives in the areas of Risk Mitigation, further investment in assisting ag



program, and security support for our electronic commerce activities.

Working with the Office of the State Auditor and our Statewide Internal Control Task Force, we have developed an expanded agenda that will include the adoption of professional standards, policies and procedures for internal control, and proposed training to improve the quality of internal control in state government.

It is our hope that we can work with the GPAC II Committee to identify the best approach for internal auditing and internal control, including legislation that may strengthen that area. The Foreign Nationals Program has proved to be an important compliance activity for agencies and we are asking for support to continue that software program and to provide further "hands-on" assistance to agencies. Finally, we must ensure that our e-commerce activity is operating in a secure environment and we are requesting funds to help confirm that as we attempt to expand the program.

Don't judge the importance of these programs by the brevity of these short explanations. Each one impacts the way you and OSC conducts its business, and we hope to improve our service to you with funding for these efforts.

Good luck to all as the 2007 Legislative Session begins.

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## Master agreement signed for American Express

The Office of the State Controller has negotiated a master agreement with American Express Travel Related Services Company, Inc., that will allow state and local agencies participating in North Carolina 's credit and debit card program to accept the American Express card.

Rollout of the American Express card program is anticipated to come in February. Negotiations are currently underway with Discover Financial Services, LLC. If a master agreement can be reached, agencies could begin accepting the Discover card by as early as this spring.

"The ability of state agencies and local units of government to accept proprietary cards like American Express when conducting official government business would be of great benefit, to both the agencies and the citizens," said State Controller Robert Powell. "Providing citizens with more payment options will help advance the goals and objectives of the Statewide E-Commerce Program."

"Like in the private arena where not all merchants accept proprietary cards, not all agencies will elect to accept the proprietary cards as well," said David Reavis, the State's E-Commerce Manager. "The main reason is that there is a one-day delay in receiving funds for proprietary card transactions, as compared to a Visa or MasterCard transaction."

Since the year 2000, OSC has had a Master Services Agreement with SunTrust Merchant Services which allows eligible state agencies, universities, community colleges, and local units of governments to accept credit cards at lower rates than they would be likely to get individually. During FY 2005-06, 3.6 million card transactions totaling \$435 million were processed under the master agreement. There are currently 92 participants in the STMS master agreement.

The master services agreement with STMS allows for participating agencies to accept credit and debit cards issued by both Visa and MasterCard, without the participant having to execute any additional agreements. However, the master agreement does not provide for the acceptance of proprietary cards, such as American Express or Discover, unless the State or the agencies were to enter into agreements directly with the proprietary card companies.

In response to the interest of several agencies, the State Controller in December issued an E-Commerce policy that addressed how agencies could elect, on an optional basis, to accept proprietary cards. The policy also allowed the State Controller to negotiate master agreements with the various proprietary card companies, in order to obtain more favorable discount rates.

The Office of the State Controller has scheduled an E-Commerce Summit for May 7 at the McKimmon Center to update agencies on the electronic commerce opportunities that are available. More details will be coming as the program is developed.

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# More than 300 attend financial update seminar

More than 300 representatives of state agencies, universities, community colleges and other organizations attended the Fiscal Officer Update Seminar organized by the Office of the State Controller on December 14.

State Controller Robert Powell opened the seminar with an update of recent OSC initiatives, including the BEACON payroll/personnel project, efforts to restore North Carolina's Aaa bond rating by Moody's Investor Services and e-commerce expansion.

John Barfield of OSC presented a General Fund update, noting that the fund balance of the General Fund, on a GAAP basis, more than doubled to \$1.93 billion at June 30, 2006. Barfield also discussed the State's change in methodology for reporting individual income taxes, which resulted in substantially higher revenues in fiscal year 2006 and a restatement of the beginning fund balance.

Vance Holloman, Deputy State Treasurer, provided a bond rating update, including a discussion of why ratings are important and how North Carolina's ratings compare to its peer group.



Wesley Ray, Assistant State Controller, began a session on the State's retiree health care obligations and introduced Marvin Stokes of Aon Consulting, who gave an overview of the State's just-released actuarial valuation on retiree health care. Stokes said Aon's work indicated the actuarial accrued liability as of December 31, 2005, for retiree health care is \$23.9 billion and the annual required contribution is \$2.4 billion.

Additional sessions included a State Management and Budget Update by Charles Perusse, Deputy State Budget Officer; an economic and budget update and a legislative update by David Crofts and Marilyn Chism of

the Fiscal Research Division of the General Assembly; a discussion of the North Carolina Education Lottery by lottery director Thomas Shaheen; a presentation by Dr. Frank Perry, Education Director of the State Ethics Commission; and updates from the various sections of OSC.

The seminar concluded with a presentation by Gerry Fisher of the Office of State Personnel on enhancing personal performance and controlling quality control and two optional breakout sessions on professional ethics and conduct and cash management.

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## CAFR shows positive fund balance for first times in years

North Carolina ended the fiscal year with a positive fund balance for the first time in five years, according to the Comprehensive Annual Financial Report released December 19.

The report indicates that the State's General Fund had a fund balance of \$1.925 billion as of June 30, 2006, with an unreserved balance of \$1.77 billion. The balances are calculated on the basis of generally accepted accounting principles, or GAAP.

The Comprehensive Annual Financial Report, or CAFR, is prepared each year by the Office of the State Controller and audited by the Office of the State Auditor. The report, which outlines North Carolina's financial condition, has received a "clean" opinion from auditors, indicating that it fairly represents the financial position of the State.

"The positive fund balance is certainly good news for North Carolina," said State Controller Robert Powell. "It has taken a great deal of effort by both the executive and legislative branches of government to pull us out of the financial crisis that we have faced for the last several years."

Powell said the State's improved financial condition was due both to increased revenue collections as the economy

recovered and to accounting changes made by North Carolina in the way it treats income taxes.

This year's CAFR also includes the first few months of operations by the North Carolina Education Lottery, which began in April. The "Popular Report," an executive summary of the CAFR showing highlights of the State's finances, also is available.

Both documents are available on the Office of the State Controller website at:

[http://www.ncosc.net/financial/06\\_cafr/index.html](http://www.ncosc.net/financial/06_cafr/index.html).

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## *Health plan study shows OPEB unfunded liability at \$23.8 billion*

Health benefits for retirees under North Carolina's retirement system have created an unfunded liability of \$23.8 billion, an actuarial study for the State Health Plan indicates.

The study says the State, as of December 31, 2005, is facing expected health care costs for retirees of \$23.9 billion, essentially what the State "owes" today for future retiree health-care costs. Only about \$139 million has been set aside in advance for those costs, so the unfunded liability amounts to \$23.8 billion. The benefits, provided through the State Health Plan, were earned through past service by North Carolina state employees and teachers who are now retired or already vested in the retirement system.

### **Training Opportunities**

Accounts Payable Overview	February 6-8
Procurement Card	February 13
Fixed Assets Basics	February 15
DSS Basics	February 22
Budget Management	February 22
Agency System Management	February 27-28
Internal Controls Using the COSO Framework	March 1
Statewide Foreign Nationals Immigration and Tax Compliance Symposium	March 21
GASB Update and Other Topics	April 26
E-Commerce Summit	May 7

**For full details, scheduling and registration, see the CPE Seminars section of the OSC web page: [www.ncosc.net](http://www.ncosc.net)**

The study indicates that the plan would begin operating on an actuarially sound basis if contributions to support retiree health benefits were increased. The study estimates that an annual required contribution of \$2.4 billion is actuarially required to support the retiree medical benefits of the State Health Plan. As indicated in the study, this contribution amount is valid for only two years and subject to change by subsequent studies.

The State Retirement System provides monthly pension payments using a pension fund that now represents 106 percent of future obligations. Investment income from that pension fund helps reduce the costs of pension payments to the State. A similar, and separate, fund was created for retiree health benefits two years ago, but has a balance of only \$139 million.

Retiree health claims are paid by the State Health Plan and financed by premiums set by the General Assembly. These premiums are paid to the State Health Plan by state agencies, universities, community

colleges and the local education authorities. Historically, premiums finance claim payments on a pay-as-you-go basis. The study indicates that during 2005 claims paid for retirees totaled \$539 million.

In an effort to manage the liability for retiree health benefits, the General Assembly this year increased the service requirements for future retirees to receive health care benefits. Since these changes were effective October 1, 2006, they had no effect on the new study, but they are expected to reduce long-range health obligations in the future.

The legislative changes provide that employees hired after October 1, 2006, will have to work 20 years to receive free health care. Employees with 10 but less than 20 years of service must pay 50 percent of the premium. Employees with less than 10 years of service receive no retiree health benefits. Prior to this legislation, free health insurance was offered to retirees who had at least five years of state service.

The study was prepared for the State Health Plan which administers health programs for public school teachers, state employees and retirees. The study was made because changes in national accounting standards require North Carolina

to include its liability for post employment benefits, like retiree health care, in its financial disclosures beginning in 2007.

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## Internal control task force adopts framework that defines system

The Statewide Internal Control Task Force has endorsed a proposed internal control framework for North Carolina that defines an effective system of controls for state government.

The Statewide Internal Control Framework, which was adapted from the model developed by the Committee of Sponsoring Organizations of the Treadway Commission, is intended to provide definitive, high-level guidance on internal controls in state government. It establishes a single definition of internal control and details the elements which a sound system of internal control should possess.

Internal control has often meant radically different things to different people. Common understandings of internal control have centered on the routine actions surrounding certain transactions meant to ensure correctness and reduce the risk of loss. While those actions are examples of specific internal controls, a more comprehensive definition is required.

The Task Force defined internal control “as an integral process, effected by an entity's governing body, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with applicable laws and regulations.”

The framework document also defines the five interrelated elements of internal control as: control environment, risk assessment, control activities, information and communications, and compliance monitoring.

It is essential that these elements connect all of the business processes of an organization and must be in place and properly functioning for an effective system of internal control to flourish. State government strives to achieve the internal control objectives of efficient and effective operations, sound financial reporting and compliance with laws and regulations. These five elements are the meanings of achieving reasonable assurance that those objectives are met.

The Task Force, which includes representatives from all branches of government and the university system, is continuing to work on a detailed system of internal control.

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## OSC joining consolidation effort on IT basic services

BEACON, an effort to consolidate and standardize business operations statewide, is not the only consolidation program North Carolina is undertaking.

The Office of the State Controller, which has been leading the BEACON effort, is joining a statewide consolidation program led by Information Technology Services to provide basic technology services across agency lines.

The first phase of the IT consolidation program, which involved five agencies, is nearly completed. OSC will join other agencies in the next segment of the phase-in. The consolidation includes local area networks, data centers and server operations, the service desk, desktop management services and security support and consulting.

“One of the objectives of Senate Bill 991 (which restructured North Carolina 's IT operations) was to find economies of scale,” said Assistant State Controller Julie Batchelor, who heads the Financial Services Division. “Bulk purchasing across agency lines was one step taken by ITS toward achieving those efficiencies. Consolidating basic IT services is another step in that direction by ITS .”

The consolidation effort is intended to give ITS responsibility for networks, servers, mainframes and desktop operations in hopes that agencies could then concentrate on the applications and processes that are unique to their operations.

Under the consolidation effort, agency employees who provide the affected technology services would be transferred to ITS control, although they would continue to work in OSC. Calls for assistance with IT problems involving PC's , printers and other devices would be directed to the ITS service desk, rather than OSC's service desk, as is done now.

"We will continue to be responsible for our unique applications, but ITS will become responsible for the basic IT infrastructure under consolidation," Batchelor said.

The consolidation project is now in the assessment phase, as ITS and OSC define exactly what tasks are performed by OSC employees and which of those tasks will come under ITS responsibility.

"In large agencies, you develop a certain amount of specialization," Batchelor said. "In a small agency like ours, however, people wear a lot of hats. Our employees perform a wide variety of functions beyond those identified under consolidation. That is going to be a challenge as we decide how to accomplish IT consolidation.

"(IT) employees at OSC provide a very high level of customer service," she said. "I think that's a challenge ahead as well. We want to be sure that the consolidation provides the highly responsive customer service that is in place today."

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