SOUTH CAROLINA
DEPARTMENT OF TRANSPORTATION
COLUMBIA, SOUTH CAROLINA

FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

State of South Carolina

Office of the State Auditor

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October 17, 2005

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Transportation Commission
South Carolina Department of Transportation
Columbia, South Carolina

This report on the audit of the basic financial statements of the South Carolina Department of Transportation and the accompanying schedule of expenditures of federal awards as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, for the fiscal year ended June 30, 2005, was issued by Scott McElveen, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/cwc

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

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SCOTT McELVEEN L.L.P.

Independent Auditors' Report

Mr. Thomas L. Wagner Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying financial statements of the governmental activities, the major fund and the aggregate remaining fund information of the South Carolina Department of Transportation (the "Department") as of and for the year ended June 30, 2005, which collectively comprise the Department's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Connector 2000 Association, Inc. (the "Association"), a component unit of the Department. The financial statements of the Association as of and for the year ended December 31, 2004 were audited by other auditors whose report dated March 4, 2005 thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for that component unit, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1 to the financial statements, the Department's financial statements are intended to present the financial position and changes in financial position of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the Department, an agency of the State, and its discretely presented component unit. They do not purport to and do not present the financial position of the State of South Carolina as of June 30, 2005, and changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America, and do not include other agencies, divisions, or component units of the State of South Carolina.

In our opinion, and based on the aforementioned report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, major fund and aggregate remaining fund information of the Department as of June 30, 2005, and its component unit as of December 31, 2004, and the respective changes in financial position thereof for the year then ended June 30, 2005 and the respective changes in financial position of its component unit for the year then ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

CERTIFIED PUBLIC ACCOUNTANTS

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As discussed in Note 21 to the financial statements, the Department made certain adjustments related to its prior year financial statements as of July 1, 2004.

In accordance with *Government Auditing Standards,* we have also issued our report dated October 3, 2005, on our consideration of the Department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and schedule of revenues, expenditures and changes in fund balance – budget and actual – general fund, as listed in the accompanying table of contents, are not a required part of the basic financial statements but supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the Department. The supplementary information and schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Scott McElveen, L.L.P.

Columbia, South Carolina
October 3, 2005

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the South Carolina Department of Transportation (the "Department"), we provide this *Management's Discussion and Analysis* of the Department's financial statements for the fiscal year ended June 30, 2005 as a narrative overview and analysis. We encourage readers to consider this information in conjunction with the Department's financial statements, which follow.

Included in these financial statements is the discretely reported information of one component unit, *Connector 2000 Association, Inc.*, which operates the Southern Connector toll road in Greenville County under a license agreement with the Department. Component units are legally separate organizations for which the elected/appointed officials of the primary entity are financially accountable. The Department's inclusion of the Association as a component unit is done for the purpose of communicating information about its component unit as required by generally accepted accounting principles. It is not intended to create the perception that the Department has a legal or financial responsibility for the Association. The Association's financial statements are independently audited and a separate annual report with the auditor's opinion dated March 4, 2005 has been issued. We refer readers to that report for more detailed information.

FINANCIAL HIGHLIGHTS

DEPARTMENT-WIDE

Net Assets - The assets of the Department exceeded its liabilities at fiscal year ending June 30, 2005 by **$10.4** billion (presented as "net assets"). Of this amount, **$235.6 million** was reported as "unrestricted net assets". Unrestricted net assets represent the amount available to be used to meet the Department's ongoing obligations to citizens and creditors. The Department's component unit, Connector 2000 Association, Inc. reported a ***net deficit*** of **$68.8** million as of December 31, 2004, the close of its fiscal year.

Changes in Net Assets - The Department's total net assets increased by **$648.0** million (a **6.6%** increase) in fiscal year 2005. All of the activities of the Department are considered governmental activities in the Department-wide financial statements. The Department's component unit net deficit increased by **$18.1** million, **$14.9** million of which was interest expense.

Capital Assets – Capital Assets, net of depreciation, which include infrastructure, were approximately **$11.0** billion at June 30, 2005 for the Department. Capital additions for the year, including **$214.3** million donated from the South Carolina Transportation Infrastructure Bank, totaled **$773.1** million. The carrying value of capital assets removed from the records this year was **$2.6** million. Capital assets of the component unit, net of depreciation, were approximately **$173.2** million at December 31, 2004. The Association classified the capital costs **($192.5** million) of constructing the Southern Connector toll road, including construction period interest, as a license agreement with the Department. The carrying value (net of amortization) of the license agreement was **$173.0** million at December 31, 2004.The Department, as legal owner of the toll highway, has recorded a like amount in its records as infrastructure. See the Capital Assets section of this management's discussion and analysis for more information about the accounting treatment of capital assets.

Long-term Debt - The Department's total long-term debt obligations increased by **$122.8** million **(13.5%)** during the current fiscal year to **$1,034.3** million. This change is attributable to a net increase in bonds payable of **$115.5** million, a net increase in the amount due to the South Carolina State Infrastructure Bank of **$6.8** million, and other increases of **$0.5** million.

FUND ACTIVITY

Governmental Funds - Fund Balances - As of the close of fiscal year 2005, the Department's governmental funds reported a combined ending fund balance of **$409.2 million**, an increase of **$245.9** million in comparison with the prior year. Of this total amount, **$249.9** million represents the "unreserved fund balance" which is available for spending at the Department's discretion on future road and bridge construction and maintenance or other necessary activities.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements include three sections: 1) department-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves. These sections are described below:

Department-Wide Financial Statements

The *Department-Wide Financial Statements* provide a broad overview of the Department's operations in a manner similar to a private-sector business. The statements provide both short-term and long-term information about the Department's financial position, which assists in assessing the Department's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid. The department-wide financial statements include two statements:

The *Statement of Net Assets* presents all of the Department's assets and liabilities with the difference between the two reported as "net assets". Over time, increases or decreases in the Department's net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The *Statement of Activities* presents information showing how the Department's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Department.

Both of the above financial statements have separate columns for two different types of programs or activities. These two types of activities are:

Governmental Activities – The activities in this column are mostly supported by motor fuel taxes and intergovernmental revenues (federal grants). All services normally associated with the Department fall into this category.

Business Type Activities – This is the discretely presented component unit, Connector 2000 Association, Inc., for which the Department is considered financially accountable, but it has many independent qualities as well. The Association is a nonprofit corporation for which the Department, from a legal standpoint, has no legal or financial responsibility.

The department-wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department, like other state agencies, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Department can be divided into two categories, governmental funds and fiduciary funds. The discretely presented component unit, Connector 2000 Association, Inc., is considered a proprietary fund. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are:

Governmental Funds – Most of the basic services provided by the Department are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the Department-wide financial statements. However, unlike the Department-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Department's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Department.

Because the focus of governmental funds is narrower than that of the Department-wide financial statements, it is useful to compare the information presented in governmental funds with similar information presented for governmental activities in the Department-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the Departmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Department has two governmental funds which are presented in separate columns in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances. The Department's governmental funds are – the General Fund, consisting of funds appropriated from the State General Fund for public transportation, and the Special Revenue Fund, which records expenditures of revenues that are restricted to specific programs or projects.

The basic governmental funds financial statements can be found immediately following the government-wide statements.

Fiduciary Funds – These funds are used to account for resources held for the benefit of parties outside the Department. Fiduciary funds are not reflected in the Department-wide financial statements because the resources of these funds are not available to support the Department's own programs. Fiduciary funds financial statements use the accrual basis of accounting. The Department's fiduciary funds are the County Transportation Program Fund, the Right of Ways Fund, and the Special Deposits Fund.

The basic fiduciary funds financial statements can be found immediately following the Governmental funds financial statements.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the Department-wide and the fund financial statements. The notes to the financial statements can be found immediately following proprietary fund financial statements.

Required Supplementary Information and Combining Statement

The basic financial statements are followed by a section of required supplementary information. In the Department's case, this section includes a budgetary comparison schedule for the *general fund*, which includes comparisons of original budget to final budget to actual outflow (expenditures) on a budgetary basis. Also included is a combining statement of changes in assets and liabilities – agency funds.

DEPARTMENT-WIDE FINANCIAL ANALYSIS

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Department's assets (all classified as governmental activities) exceeded liabilities by **$10.4** billion at the close of business on June 30, 2005 (See **Table A-1** for a summary of net assets for fiscal years 2004-2005 and 2003-2004). The largest portion of the Department's net assets **(96.3%)** reflects its investment in infrastructure and other capital assets such as land, buildings, and equipment less any related debt used to acquire those assets that is still outstanding. The Department uses these capital assets to fulfill its primary mission to provide a safe and efficient transportation system for the state of South Carolina. Consequentially, these assets are not available for future spending. Although the Department's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Table A-1

SCDOT Net Assets
(expressed in millions)

	Governmental Activities	
	2004 (as restated - Note 21)	2005
Current Assets	$ 424.0	$ 423.9
Capital Assets	10,387.3	11,030.7
Other Assets	11.7	160.1
Total Assets	**10,823.0**	**11,614.7**
Current Liabilities	214.4	238.3
Non-current Liabilities	851.2	971.0
Total Liabilities	**1,065.6**	**1,209.3**
Net Assets:		
Invested in Capital Assets, Net of Related Debt	9,497.8	10,018.9
Restricted	1.2	150.9
Unrestricted	258.4	235.6
Total Net Assets	**9,757.4**	**10,405.4**
Total Liabilities & Net Assets	**$ 10,823.0**	**$ 11,614.7**

At June 30, 2005, a portion of the Department's net assets (**$150.9** million) represents resources that are subject to external restrictions on how they may be used. The remaining balance of net assets (**2.3% or $235.6 million**) is unrestricted and may be used to meet the Department's ongoing obligations to citizens and creditors. Internally imposed designations of resources are not presented as restricted net assets. At the end of the current fiscal year, the Department is able to report positive balances in all three categories of net assets.

Changes in Net Assets

The Department's net assets increased by **$648.0** million, or 6.6%. Approximately **$214.3** million of this increase came from the donation of infrastructure capital assets to the Department by the South Carolina Transportation Infrastructure Bank, a sister state agency established to finance major transportation projects. The balance of the increase in net assets can be attributed to an increase in self-constructed infrastructure assets net of accumulated depreciation. As stated earlier, the primary purpose of the Department is to build and maintain these infrastructure assets.

In 2005, the Department's program revenues exceeded expenses by **$147.1**. A breakdown of the **$1.5** billion in gross revenues reveals that motor fuel taxes represented **36%,** while **49.0%** resulted from Federal highway allocations and grants, **14.4%** represented contributions of infrastructure from the State Infrastructure Bank, and **3.1%** of revenues came from various sources including toll revenues, motor vehicle fees and interest income.

Table A-2 presents a breakdown of these revenues and expenses for fiscal year 2004-2005 with comparative figures for the prior year.

Table A-2

SCDOT Changes in Net Assets
(Expressed in Millions)

	Governmental Activities			
Revenues:	2004 (as restated - Note 21)	% of Revenue	2005	% of Revenue
Program Revenues:				
Capital Grants and Contributions	$ 882.3	54%	$ 830.5	54%
Operating Grants and Contributions	95.4	6%	110.6	6%
Charges for Services	24.5	3%	37.3	3%
General Revenues:				
Motor Fuel Taxes	488.6	36%	497.4	36%
State Appropriations	-	0%	0.1	0%
Investment Earnings	0.8	1%	8.4	1%
Total Revenues	**1,491.6**	**100%**	**1,484.3**	**100%**
Expenses:				
Public Transportation	771.1		831.4	
Total Expenses	**771.1**		**831.4**	
Increase in Net Assets Before Transfers	720.5		652.9	
Transfers to State General Fund	4.9		4.9	
Changes in Net Assets	**715.6**		**648.0**	
Net Assets, Beginning of Year, as restated	9,041.8		9,757.4	
Net Assets, End of Year	**$ 9,757.4**		**$ 10,405.4**	

FINANCIAL ANALYSIS OF THE DEPARTMENT'S INDIVIDUAL FUNDS

As noted earlier, the Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the Department's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of the current fiscal year, the Department's governmental funds reported ending fund balances of **$409.2** million, an increase of **$120.9** million in comparison with the prior year. **61.1%** of these total fund balances or **$249.9** million constitute unreserved fund balances, which are available for spending in the coming year. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed, 1) bond proceeds received for capital projects and other projects (**$140.9** million), 2) to pay the State Infrastructure Bank (**$10.0** million), 3) for long-term receivables **($7.6** million), and 4) to purchase right-of way (**$771** thousand).

GENERAL FUND BUDGETARY HIGHLIGHTS

Not all revenues and expenditures of the Department's *state highway fund* are budgeted and, therefore, a legal operating budget is not adopted for this fund. Budgetary analysis is not provided for the state highway fund.

All of the activity in the Department's *general fund,* which represents less than .008% of total revenues ($101 thousand), is funded by annual appropriations for public transportation by the General Assembly. The appropriation as enacted becomes the legal operating budget for the general fund. The difference between the original budget and the final amended budget is immaterial.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Department's investment in capital assets for its governmental activities as of June 30, 2005, amounts to **$13.2 billion**, less accumulated depreciation of **$2.2 billion**, leaving a net book value of **$11.0** billion. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets **($10.9** billion, net) are items that are normally stationary in nature and can be preserved for a significantly longer period then most capital assets. In the case of the Department, infrastructure assets are classified into **three networks**: <u>roads</u>, <u>bridges</u> and <u>right of ways</u>. Cost or estimated cost of infrastructure and related depreciation were recorded retroactively back to the year 1914. The Department has chosen to depreciate Infrastructure assets (excluding right of ways). **Table A-3** summarizes capital assets at June 30, 2005 and June 30, 2004.

Table A-3

SCDOT Capital Assets
(expressed in millions)

	Primary Government	
	2004 (as restated - Note 21)	2005
Land	$ 5.6	$5.6
Buildings and Improvements	59.6	59.9
Furniture and Equipment	196.1	194.5
Infrastructure		
Right of Way	1,066.3	1,132.1
Roads	6,747.8	6,923.8
Bridges	1,080.7	1,112.8
Construction in Progress	3,264.7	3,748.1
Total Cost	$ 12,420.8	$13,176.8
Less Accumulated Depreciation	2,033.5	2,146.2
Net Capital Assets	**$ 10,387.3**	**$11,030.6**

The total increase in the Department's investment in capital assets for the current fiscal year was about **$6.2%** in terms of net book value. However, actual expenditures to purchase or construct capital assets were **$774.3** million for the year. **$214.3** million in infrastructure assets were constructed by and donated to the Department by the South Carolina Infrastructure State Bank. Depreciation charges for the year totaled **$128.4** million.

Debt Administration

The authority of the Department to incur debt is described in Sections 57-11-210 of the South Carolina Code and continued and amended by Section 11-27-30 thereof, authorizing the issuance of general obligation State Highway Bonds for highway construction and related purposes backed by the full faith and credit of the state. State Highway Bonds are additionally secured by a pledge of so much of the revenues as may be made applicable by the General Assembly for state highway purposes from gasoline and fuel oil taxes and motor vehicle license fees.

The Department's total bonded debt increased by **$115.5** million during the current fiscal year, to **$725.4** million. The net increase is primarily attributed to (1) the issue on April 1, 2005, of **$146.5** million in State Highway Bonds, Series 2005A; (2) the net decrease on unamortized deferred loss on Refunding of **$1.6** million; (3) the net increase in unamortized bond premiums of **$0.3** million; less (4) scheduled bond payments of **$32.9** million. Other long-term debt includes **$286.5** million due to the SC Infrastructure State Bank and various local governments for financial assistance on transportation projects managed by those entities and accrued compensated absences of **$22.1** million (net increase for the year of **$0.7** million). Due within one year for all long-term debt is **$63.3** million.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

During the period 1998-2005 the state experienced significant increases in Federal highway funding primarily due to changes in federal allocation formulas. Federal highway funding is typically authorized in six (6) year increments because of the long-range nature of highway construction commitments. The funding legislation for the six-year period 1997-2003 (Federal fiscal year's ended September 30), the Transportation Equity Act for the 21st Century (TEA-21), expired on September 30, 2003 and was temporarily extended several times.

President Bush signed a new Federal authorization bill for the 2004-2009 Federal fiscal years into law on August 10, 2005. The Safe, Accountable, Flexible and Efficient Transportation Act of 2003 (SAFETEA) increased core federal programs by approximately 20% during this six-year period. These projected increases plus a provision that would guarantee that states would receive at least 91.5 (FY2006/07) and 92.0 (FY2008/09) cents of each dollar in federal fuel taxes collected within their boundaries will result in a net increase of 20% to 25% for South Carolina by 2009.

State motor fuel user fees, however, are projected to increase in fiscal year 2005-2006 by only a modest 2%, which would barely match the inflation rate. State leaders have not granted an increase in state fuel user fee rates since 1987. During the legislative session ended in June 2005, however, the legislature, from other sources, increased annual funding for construction and maintenance by about $34 million each (an approximate increase of 13% in non-federal revenues) phased in over the next three to five years. Revenues must grow with two factors – inflation and traffic volume – in order to maintain the status quo. Overall, state revenues continue to fall short of these benchmarks. With the influx of these new state revenues and through an aggressive and sophisticated cash management program, the Department is making a concerted effort to address some of the critical maintenance needs. Additional funding, however, will be needed to prevent further significant deterioration of the state's highway system, which will lead to greater costs to repair and renovate in the future.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Department's finances for all of the Department's taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Department's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

South Carolina Department of Transportation
Office of Financial Management
955 Park Street, Suite 304
Columbia, South Carolina 29202-0191

The Department's component unit, Connector 2000 Association, Inc., issues its own separately audited financial statements. These statements may be obtained by directly contacting Southern Connector at Post Office Box 408, Piedmont, South Carolina 29673 or by telephone at (864) 527-2150.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF NET ASSETS
JUNE 30, 2005

	Primary Entity Governmental Activities	Component Unit
ASSETS		
Current assets:		
Cash and cash equivalents	$ 148,179,528	$ 682,006
Restricted assets:		
Cash and cash equivalents	-	790,859
Receivables:		
Federal government	163,667,991	-
State agencies	81,950,999	-
Local governments	7,017,177	-
Other entities	7,365,458	-
Investments	-	202,945
Investments - Restricted	-	1,240,266
Accrued interest receivable	1,471,257	24,657
Prepaid expenses	5,984,849	51,251
Inventories	5,189,375	89,997
Total current assets	420,826,634	3,081,981
Non-current assets:		
Restricted assets:		
Cash and cash equivalents	150,901,718	-
Investments	-	16,772,509
Accrued interest receivable	-	473,287
Total restricted assets	150,901,718	17,245,796
Receivables, net of current portion:		
Local governments	6,534,795	
Other entities	1,044,515	
Other assets	770,675	
Capital assets, net of accumulated depreciation	11,030,658,291	173,220,585
Bond issuance costs, net of accumulated amortization	808,968	4,267,175
Total non-current assets	11,190,718,962	194,733,556
TOTAL ASSETS	$ 11,611,545,596	$ 197,815,537

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF NET ASSETS (CONTINUED)
JUNE 30, 2005

LIABILITIES AND NET ASSETS	Primary Entity Governmental Activities	Component Unit
Liabilities:		
Current liabilities:		
Liabilities payable from restricted assets:		
Requisitions payable	$ -	$ 11,565
Accrued interest payable	-	1,765,750
Total	-	1,777,315
Bonds payable	25,765,244	-
Accrued interest payable	8,515,531	-
Accounts payable	113,377,072	49,316
Accounts payable - state agencies	4,462,710	
Intergovernmental payable:		
Due to State agency	21,929,752	225,000
Due to local government	100,000	-
Federal Aid Payable	9,164,906	
Contract retainages payable	2,170,120	-
Accrued payroll and related liabilities	16,869,872	-
Due to Agency Fund - County Transportation Program	12,386,548	-
Capital leases payable	113,578	-
Accrued compensated absences	15,408,880	-
Deferred revenue	17,166,463	123,659
Total current liabilities	247,430,676	2,175,290
Noncurrent liabilities:		
Bonds payable, including unamortized premium and net of current portion and unamortized discounts and deferred loss on refunding of bonds	699,669,092	264,444,140
Intergovernmental payable:		
Due to State agency, net of current portion	264,153,810	-
Due to local government, net of current portion	300,000	-
Capital leases payable, net of current portion	115,859	-
Accrued compensated absences, net of current portion	6,719,863	-
Total noncurrent liabilities	970,958,624	264,444,140
TOTAL LIABILITIES	1,218,389,300	266,619,430
Net assets:		
Invested in capital assets, net of related debt (deficit)	10,018,910,956	(29,673,841)
Restricted:		
Debt service	-	253,923
Bond proceeds for capital projects and other purposes	140,901,718	11,452
State Infrastructure Bank - agreement	10,000,000	-
Unrestricted:		
Balance (deficit)	223,343,622	(39,395,427)
TOTAL NET ASSETS (DEFICIT)	10,393,156,296	(68,803,893)
TOTAL LIABILITIES AND NET ASSETS	$ 11,611,545,596	$ 197,815,537

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005

		Program Revenues			Net (Expenses) Revenues and Changes in Net Assets	
Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Component Unit
Primary entity:						
Public Transportation	$ 831,430,362	$ 34,234,246	$ 110,605,835	$ 821,401,362	$ 134,811,081	$ -
Component unit:						
Toll operations	$ 22,870,298	$ 3,769,428	$ -	$ -		(19,100,870)
Totals					134,811,081	(19,100,870)
General revenues:						
State appropriations					100,990	
Taxes and fees					497,392,254	
Interest/investment income					8,384,827	1,017,596
Total general revenues					505,878,071	1,017,596
Transfers:						
Transfers to General Fund of the State					(4,940,205)	
Changes in net assets					635,748,947	(18,083,274)
Net assets - Beginning, as restated					9,757,407,349	(50,720,619)
Net assets - Ending					$ 10,393,156,296	$ (68,803,893)

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2005

ASSETS	General Fund	State Highway Fund	Totals
Current assets:			
Cash and cash equivalents	$ -	$ 148,179,528	$ 148,179,528
Receivables:			
Federal government		163,667,991	163,667,991
State agencies		81,950,999	81,950,999
Local governments		7,017,177	7,017,177
Other		7,365,458	7,365,458
Accrued interest receivable		1,471,257	1,471,257
Prepaid expenses		5,984,849	5,984,849
Inventories		5,189,375	5,189,375
Total current assets	-	420,826,634	420,826,634
Non-current assets:			
Restricted assets:			
Cash and cash equivalents		150,901,718	150,901,718
Total restricted assets		150,901,718	150,901,718
Receivables, net of current portion			
Local governments		6,534,795	6,534,795
Other		1,044,514	1,044,514
Other assets		770,675	770,675
Total non-current assets		159,251,702	159,251,702
TOTAL ASSETS	-	580,078,336	580,078,336
LIABILITIES AND FUND BALANCE			
Liabilities:			
Current liabilities:			
Accounts payable	-	113,377,072	113,377,072
Intergovernmental payables:			
Due to State agencies		4,462,710	4,462,710
Federal aid payable		9,164,906	9,164,906
Contract retainages payable		2,170,120	2,170,120
Accrued payroll and related liabilities		16,869,872	16,869,872
Due to Agency Fund - County Transportation Program		12,386,548	12,386,548
Deferred revenue		86,875,674	86,875,674
Accrued interest payable		298,813	298,813
TOTAL LIABILITIES	-	245,605,715	245,605,715
Fund Balance:			
Reserved:			
Long-term receivables		7,579,310	7,579,310
Other assets		770,675	770,675
Bond proceeds for capital projects and other purposes		140,901,718	140,901,718
State Infrastructure Bank - agreement		10,000,000	10,000,000
Unreserved		175,220,918	175,220,918
TOTAL FUND BALANCES		334,472,621	334,472,621
TOTAL LIABILITIES AND FUND BALANCES	$ -	$ 580,078,336	$ 580,078,336

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

BALANCE SHEETS - GOVERNMENTAL FUNDS (CONTINUED)
JUNE 30, 2005

RECONCILIATION TO THE STATEMENT OF NET ASSETS:

FUND BALANCES - GOVERNMENTAL FUNDS		$ 334,472,621
Amounts reported for governmental activities in the statement of net assets are different because:		
Assets are capitalized and depreciated or amortized in the statement of net assets and are charged to expenditures in the governmental funds:		
Capital assets, net of accumulated depreciation	11,030,658,291	
Bond issuance costs, net of accumulated amortization	808,968	11,031,467,259
Deferred revenues are recognized on an accrual basis in the statement of net assets and on the modified accrual basis in the governmental funds:		
Participation agreements, net of allowance for bad debts	69,709,212	69,709,212
Liabilities are not due and payable in the current period, therefore, are not reported in the governmental funds:		
Bonds payable including unamortized premium and discounts and net of unamortized deferred loss on refunding of bonds	(725,434,336)	
Intergovernmental payable:		
Due to State agency	(286,083,562)	
Due to local government	(400,000)	
Capital leases payable	(229,437)	
Accrued compensated absences	(22,128,743)	
Accrued interest payable	(8,216,718)	(1,042,492,796)
NET ASSETS - GOVERNMENTAL ACTIVITIES		$ 10,393,156,296

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	General Fund	State Highway Fund	Totals
REVENUES:			
Taxes and fees		$ 433,501,830	$ 433,501,830
Restricted taxes		63,890,423	63,890,423
State appropriations	$ 100,990	-	100,990
Federal grants		718,989,191	718,989,191
Reimbursements from Agency Fund - County Transportation Program		2,313,562	2,313,562
Interest/investment income		8,384,827	8,384,827
Sales of goods and fees for services		4,402,261	4,402,261
Participation agreement/project revenues		17,311,844	17,311,844
Other revenues		1,659,390	1,659,390
TOTAL REVENUES	100,990	1,250,453,328	1,250,554,318
EXPENDITURES:			
Current:			
General administration		36,261,845	36,261,845
Engineering		39,987,343	39,987,343
Toll facilities		3,125,452	3,125,452
Public transportation	100,990	23,342,112	23,443,102
Highway maintenance		468,336,402	468,336,402
Capital outlay:			
Right of ways land		31,161,464	31,161,464
Construction in progress		-	
Infrastructure - road and bridge network		513,137,443	513,137,443
Buildings and improvements		3,716,427	3,716,427
Equipment and furniture		6,759,978	6,759,978
Vehicles		4,136,739	4,136,739
Debt service:			
Principal		48,348,162	48,348,162
Interest		32,382,690	32,382,690
Other		464,647	464,647
Allocations to other entities:			
State agency		24,356,765	24,356,765
Agency Fund - County Transportation Program		73,390,424	73,390,424
TOTAL EXPENDITURES	100,990	1,308,907,893	1,309,008,883
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	-	(58,454,565)	(58,454,565)
OTHER FINANCING SOURCES (USES):			
Proceeds from Refunding bonds issued		146,495,000	146,495,000
Premium on bonds issued		293,915	293,915
Proceeds from intergovernmental payable - State agency (contibution payable)		28,597,550	28,597,550
Proceeds from sale of capital assets		3,357,907	3,357,907
Payment to Escrow Agent - Bond Refunding		(6,746,575)	(6,746,575)
Remitted to General Fund of the State		(4,940,205)	(4,940,205)
TOTAL OTHER FINANCING SOURCES (USES)	-	167,057,592	167,057,592
NET CHANGE IN FUND BALANCES		108,603,027	108,603,027
FUND BALANCES, beginning of year, as restated		225,869,594	225,869,594
FUND BALANCES, end of year	$ -	$ 334,472,621	$ 334,472,621

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2005

RECONCILIATION TO THE STATEMENT OF ACTIVITIES:

NET CHANGE IN FUND BALANCES - GOVERNMENTAL FUNDS	$	108,603,027
Amounts reported for governmental activities in the statement of activities are different because:		
Costs of capital assets are reported as expenditures in the governmental fund and are reported as capital asset additions in the statement of net assets		530,314,501
Costs of donated capital assets for right of ways land and infrastructure - road and bridge network are reported in the statement of activities and are not reported in the governmental fund		214,326,318
Depreciation of capital assets is reported as expenses in the statement of activities		(128,381,970)
Participation agreement revenues are reported on a modified accrual basis in the governmental funds and on an accrual basis in the statement of activities		7,238,877
Cost of issuance of bonds are reported as expenditures in the governmental fund and are reported as assets in the statement of net assets		464,647
Amortization of the costs of issuance is reported as expenses in the statement of activities		(28,641)
Cost of deferred losses on refunding of bonds are reported as expenditures in the govenrmental fund and are reported as a reduction of liabilities in the statement of net assets		246,575
Amortization of deferred losses on refunding of bonds is reported as expenses in the statement of activities		(1,859,493)
Increase in accrued interest payable is reported as an addition to expenses in statement of activities		(1,065,211)
Proceeds from bond financing are reported as other financing sources in the governmental fund and are reported as an increase in liabilities in the statement of net assets		(146,495,000)
Premiums on bonds issued are reported as revenues in the governmental fund and are reported as an increase in liabilities in the statement of net assets		(293,915)
Amortization of premium on bonds is reported as a reduction of expenses in the statement of activities		42,034
Repayments of long-term debt are reported as expenditures and as other financing uses in governmental fund and are reported as a reduction of liabilities in the statement of net assets:		
Bonds payable		32,865,000
Intergovernmental payable:		
Due to State agency		21,748,906
Due to local government		100,000
Capital leases		134,256
Increase in accrued compensated absences is reported as expenses in the statement of activities		(719,755)
Costs less accumulated depreciation of capital assets disposed of are reported as expenses in the statement of activities		(1,491,209)
INCREASE IN NET ASSETS - GOVERNMENTAL ACTIVITIES		635,748,947

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2005

	Agency Funds
ASSETS:	
Cash and cash equivalents	$ 97,532,313
Accrued interest receivable	627,417
Due from State Highway Fund	12,386,548
Total assets	110,546,278
LIABILITIES:	
Accounts payable	13,961,458
Deposits for right of ways	328,182
Special deposits and bonds	786,561
Funds held for all counties	95,470,077
Total liabilities	$ 110,546,278

See accompanying Notes to Financial Statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Reporting Entity

The South Carolina Department of Transportation (the Department) was established pursuant to Section 57-1-20 of the Code of Laws of South Carolina as an administrative agency of the government of South Carolina (The State), comprised of a Division of Mass Transit; a Division of Construction, Engineering and Planning; and a Division of Finance and Administration. The Department is responsible for the planning, construction, maintenance and operation of the highway system of the State of South Carolina and the coordination of statewide mass transit activities.

The Department is governed by the South Carolina Transportation Commission, which is comprised of seven members, six of whom are elected by the Legislative Delegations of each of the State's Transportation Districts. These Transportation Districts coincide with the State's Congressional Districts. One at-large member is appointed by the Governor and, upon confirmation by the South Carolina Senate, serves as Chairman of the Commission. The Commission serves as a general policy-making body for the various functions and purposes of the Department as prescribed by law. The Commission defines policies that are to be administered by the Director.

The core of a financial reporting entity is normally the primary government, which has a separately elected governing body. The Department is reported as part of the primary government of the State. An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. The Department is identified herein as such a primary entity. As required by generally accepted accounting principles, the financial reporting entity includes both the primary entity and all of its component units. Component units are legally separate organizations for which the elected officials of the primary entity are financially accountable. In turn, component units may have component units. The Department has determined it has one component unit, the Connector 2000 Association, Inc. (the Association).

A primary government or entity is financially accountable if it appoints a voting majority of the organization's governing body, <u>and</u> (1) it is able to impose its will on that organization <u>or</u> (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is <u>fiscally dependent</u> on it even if it does not appoint a voting majority of the board. An organization is fiscally dependent on the primary entity that holds one or more of the following powers:

(1) Determines its budget without another government having the authority to approve and modify that budget;
(2) Levies taxes or set rates or charges without approval by another government; or,
(3) Issues bonded debt without approval by another government.

Based on the above described fiscal dependency criteria, the Department has determined it is not a component of another entity and the Association is a component unit of the Department under Statement 14 of the Governmental Accounting Standards Board. This financial reporting entity includes only the Department (a primary entity) and its component unit.

The Association is considered a component unit of the Department because the Department initially fixed the toll rates for the Southern Connector in Greenville County, South Carolina and, after consultation with the Association, has the right (but not the obligation) to revise the toll rates from time to time to rates which are not less than 90% and not more than 120% of the optimum toll rates as estimated by an independent traffic consultant retained by the Association. Rates set by the Department must satisfy the applicable revenue covenants contained in the Association's financing documents. Also, the Association is governed by a Board of Directors approved by the Department.

The Association is a South Carolina nonprofit corporation organized as a "public benefit corporation" under the South Carolina Nonprofit Corporation Act of 1994. The Articles of Incorporation of the Association were originally filed with the South Carolina Secretary of State on January 12, 1996 and were amended by a filing on March 5, 1997. The Internal Revenue Service has issued a letter dated October 20, 1997 determining that the Association is an exempt organization that is not a private foundation under Section 501l(3) of the Internal Revenue Code. The Association was formed to finance, acquire, construct and operate turnpikes, highway projects and other transportation facilities pursuant to Section 57-3-200 of the Code of Laws of South Carolina.

The Department's inclusion of the Association as a component unit is done for the purpose of communicating information about its component unit as required by generally accepted accounting principles (GAAP) and the Association's relationship with the Department. It is not intended to create the perception that the Department and the Association are one legal entity. From a legal standpoint, the State and the Department have only a contractual relationship with the Association. This contractual relationship came about as a result of the Association's submittal of the successful proposal to construct and operate the Southern Connector. In addition, the Supreme Court of South Carolina has held that the State of South Carolina and the Department are not a joint owner in the Association, and, accordingly, have no legal or financial responsibility for the Association.

Although the Association was formed in 1996, its first financial activity occurred in February 1998. At that time, the Association entered into a license agreement (the License Agreement) with the Department that grants the Association rights and obligations to finance, acquire, construct and operate an approximately 16 mile fully controlled access toll highway (the Southern Connector) and to construct the South Carolina Highway 153 Extension (the SC 153 Extension) (collectively, the Projects). Toll road revenue bonds were issued on February 11, 1998 to finance the construction of the Southern Connector. Governmental accounting standards require that the reporting entity's financial statements include the year-end statements of the component unit which falls within the reporting entity's fiscal year.

For the purpose of applying GAAP to its activities, the Association's management has determined that the Association is a governmental entity. The Governmental Accounting Standards Board (GASB), which has jurisdiction over accounting and financial reporting standards applicable to governmental entities, and the Financial Accounting Standards Board (FASB), which has jurisdiction over such standards applicable to nongovernmental entities, have agreed on a definition of a governmental entity that is to be used when determining whether governmental GAAP is applicable. Since (a) the Association is a public benefit corporation, (b) the members of the Association's Board of Directors must be approved by the Department and (c) upon dissolution of the Association, all of the Association's net assets will revert to the Department, the Association meets the criteria set forth in the definition of a governmental entity. Accordingly, the accompanying financial statements of the Association have been prepared in accordance with GAAP applicable to governmental unit proprietary funds.

The financial statements of a component unit are blended in as though it were part of the primary entity if it is, in substance, part of its operations. Since the Association is not a part of the operations of the Department, the Association's financial activity is presented discretely outside of the Department's primary entity financial statements. A complete copy of the Association's financial statements can be obtained from Connector 2000 Association, Inc., PO Box 408, Piedmont, South Carolina 29673.

The Department is granted an annual appropriation for mass transit operating purposes as authorized by the South Carolina General Assembly. The appropriation as enacted becomes the legal operating budget for the Department. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The laws of the State and the policies and procedures specified by the State for State agencies and institutions are applicable to the activities of the Department. Generally, all State departments, agencies, and colleges are included in the State's reporting entity, which is the primary government of the State of South Carolina. These entities are financially accountable to and fiscally dependent on the State. Although the Department operates somewhat autonomously, it lacks full powers. In addition, the Governor and/or the General Assembly appoints all of its board members and budgets a significant portion of its funds.

The reporting entity is part of the State of South Carolina primary government unit and is included in the Comprehensive Annual Financial Report of the State of South Carolina. The accompanying financial statements present the financial position and the results of operations of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the Department and its component unit and do not include any other funds or component units of the State of South Carolina.

Department-Wide And Fund Financial Statements

The financial statements of the Department and its component unit are presented in accordance with accounting principles generally accepted in the United States of America applicable to state and local governmental units. The GASB is the accepted standard-setting body in the United States of America for establishing governmental accounting and financial reporting principles. In accordance with GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, the Association elected to apply only those standards issued by the Financial Accounting Standards Board on or before November 30, 1989.

Department-Wide Financial Statements

The Department-wide financial statements are prepared on the accrual basis of accounting and include a "Statement of Net Assets" which discloses the financial position of the Department; and a "Statement of Activities", which demonstrates the degree to which the direct expenses by function of the Department's programs are offset by program revenues.

Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Other items not properly included among program revenues are reported instead as general revenues.

The Department-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government.

Fund Financial Statements

The Department uses funds to report its financial position and results of operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

Governmental Funds:

Governmental funds are those through which most governmental functions typically are financed and are used to account for all or most of a government's general activities, including the collection and disbursement of earmarked monies. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; and, the difference between the assets and liabilities is fund balance.

General Fund – The General Fund accounts for all activities except those required to be accounted for in another fund. For the Department, the general fund consists of funds appropriated from the State General Fund for public transportation.

State Highway Fund – The State Highway Fund generally records the expenditure of revenues that are restricted to specific programs or projects. This special revenue fund accounts for Federal grant program revenues, taxes levied with statutorily defined distributions, and other resources restricted as to purpose. Charges for and costs of operations of vehicles and other equipment utilized for road and bridge network projects are reported in this fund. The State Highway Fund was established pursuant to Section 57-11-20 of the Code of Laws of South Carolina. This Fund accounts for, among others, gasoline tax, including the 2.66 cents per gallon that is allocated to the County Transportation Program Agency Fund; and, other special imposts upon highway users for the construction and maintenance of highways and bridges and for other operations of the Department;

and, 20% of motor vehicle license fees as provided by Section 56-3-910 of the South Carolina Code of Laws. This fund also accounts for revenue from the sales of goods and services and from participation agreements between the Department and other entities for the sharing of costs of construction projects. Revenues from participation agreement and other project contracts are recognized as earned based on the percentage of completion method. The unearned portion is reflected as deferred revenue in the liability section of the financial statements of the Department until earned.

Fiduciary Funds:

Fiduciary funds are used to account for assets held by the Department in a trustee capacity or as an agent for individuals, private organizations, other governmental units and/or other funds. The Department uses agency funds which are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The agency funds used by the Department include the following:

- The County Transportation Program Fund was established pursuant to Section 12-28-2740 of the South Carolina Code of Laws to provide for the receipts from distribution and use of the 2.66 cents per gallon gasoline tax collected by the South Carolina Department of Revenue and remitted to the Department. In addition to the gasoline tax, the Department is required to transfer $9,500,000 annually from the State Highway Fund to the Program. Each county has a county transportation committee that is appointed by the county legislative delegation to administer the use of these funds. Based on the legally prescribed allocation formula, these monies are either paid directly to the counties for infrastructure projects that are administered by the counties or to vendors on behalf of the counties for expenditures incurred on projects that the county transportation committees have contracted the Department to administer.

- The Right of Ways Fund is used to account for payments for the purchase of right of ways land which has been contested by the property owner. In those cases, the property owner is paid 75% of the offer and 25% of the offer is transferred to the county clerk of court. Current year's activity represents receipt of funds from various clerks of court and disbursement to property owners upon settlement of contested cases.

- The Special Deposits Fund is used to account for various funds that are collected from other governments or agencies and outside parties. These funds are held until resolution of various matters, such as anti-trust violations, oversize and overweight charges and other similar items that occur.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The Department-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. "Measurable" means that the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to pay obligations of the current period. For this purpose, the government considers major sources of revenues to be available if they are collected within one year of the end of the current fiscal year. Major sources of revenue reported in compliance with policy are taxes, federal grants, and participation agreements. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Financial resources of fiduciary funds are reported using the economic resources measurement focus and the accrual basis of accounting.

The Association generally follows the authoritative guidance in GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Fund and Governmental Entities That Use*

Proprietary Fund Accounting, to distinguish operating from non-operating revenues and expenses. Thus, the principal operating revenues of the Association are toll revenues received from patrons.

The Association also recognizes as operating revenues fees received from a sponsor of the Southern Connector who participated in, and shares costs of advertising and promoting the toll road. Operating expenses of the Association consist of the costs of operating the Southern Connector, including administrative expenses, toll road management fees, contractual maintenance fees paid to the Department, and depreciation of equipment. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Non-operating revenues and expenses include interest earned on cash equivalents and investments. The Association's amortization of its intangible interest in the License Agreement with the Department is reported as a non-operating expense. The Association has no plans to renew or extend the License Agreement upon its earliest expiration date. The Master Indenture of Trust and supplements (the Trust Agreement) related to the Series 1998A, 1998B,and 1998C Bonds require that the Association adopt governmental GAAP. The Trust Agreement also requires that certain funds and accounts be established and maintained. The Association consolidates these funds and accounts of the purpose of enterprise fund presentation in its external financial statements.

Revenues – Exchange and Non-Exchange Transactions

Revenues resulting from exchange transactions, in which each party gives and receives essentially equal value, are recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenues are recorded in the fiscal year in which the resources are measurable and become available.

Non-exchange transactions, in which the Department receives value without directly giving value in return, include grants and donations. On an accrual basis, revenue from grants and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted; matching requirements, in which the Department must provide local resources to be used for a specific purpose; and expenditure requirements, in which the resources are provided to the Department on a reimbursement basis. On a modified accrual basis, revenue from non-exchange transactions must be available before it can be recognized.

Budget Policy

All of the activity in the Department's general fund is funded by annual appropriations for public transportation by the General Assembly. The appropriation as enacted becomes the legal operating budget for the general fund. The budget is prepared on the GAAP basis. A budget versus actual comparison for the State highway fund is not presented as required supplementary information since all revenues and expenditures of this fund are not budgeted.

Cash and Cash Equivalents

The amounts shown in the financial statements as "cash and cash equivalents" of the Department represent petty cash, cash on hand with the State Treasurer, and cash invested in various instruments by the State Treasurer as part of the State's internal cash management pool.

Most State agencies, including the Department, participate in the State's internal cash management pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Information pertaining to carrying amounts, fair value, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. The Department records and reports its deposits in the general deposit account at cost, and records and reports its deposits in the special deposit accounts at fair value. Investments held by the pool are

recorded at fair value. Interest earned by the Department's special deposit accounts is posted to the Department's account at the end of each month and is retained. Interest/investment earnings are allocated based on the percentage of the Department's accumulated daily income receivable to the income receivable of the pool. Reported income includes interest earnings at the stated rate, realized gains/losses and unrealized gains/losses arising from changes in the fair value of investments in the pool. Realized gains and losses are allocated daily and are included in the accumulated income receivable. Unrealized gains and losses are allocated at year-end based on the percentage ownership in the pool.

Some State Treasurer accounts are not included in the State's internal cash management pool because of restrictions on the use of the funds. For those accounts, cash equivalents include investments in short-term highly liquid securities having an initial maturity of three months or less at the time of acquisition. At year-end, the Department held no short-term investments.

The Association considers all investments with maturities of three months or less when purchased to be cash equivalents. The amounts shown in the financial statements as "cash and cash equivalents" of the Association represent cash on deposit in banks and funds invested in open-end money market mutual funds.

Investments – Component Unit

The Trust Agreement requires that all bond proceeds received by the Association be held in trust to be expended in accordance with the indenture guidelines. All monies held in trust that are not insured by the Federal Deposit Insurance Corporation (FDIC) must be secured by and/or invested in investment securities as defined in the Trust Agreement. Investment securities include, but are not limited to, direct obligations of, or obligations guaranteed by, the United States of America or an agency thereof. The Association accounts for its investments at fair value quoted at market price or the best available estimate thereof.

Capital Assets – Primary Entity

Capitalized assets include land, improvements to land, easements, right-of-ways, buildings, building improvements, vehicles, equipment, furniture, and infrastructure, and all other tangible or intangible assets that are used in operations and have initial useful lives extending beyond a single reporting period. Capital assets also include assets purchased with Federal funds in which the Federal government retains a reversionary interest.

Capital assets are recorded at cost at the date of acquisition or fair market value at the date of donation in the case of gift. Assets contributed by another state agency are recorded at the acquisition cost of that agency. The Department follows capitalization guidelines established by the State of South Carolina. Major additions, renovations, and other improvements which provide new uses, or extend the useful life of an existing capital asset, are capitalized. Routine repairs and maintenance are charged to operations in the year in which the expense is incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. A full year of depreciation is taken in the year the asset is placed in service and no depreciation is taken in the year of disposition.

A summary of the Department's capitalization and useful life by asset category is as follows:

Asset Category	Capitalization	Useful Life (Years)
Land	All, regardless of cost	N/A
Non-depreciable land improvements	All, regardless of cost	N/A
Depreciable land improvements	Any costing more than $100,000	30
Infrastructure:	Any costing more than $500,000	
Roads		75
Bridges		50
Buildings and building improvements	Any costing more than $100,000	30
Vehicles	Any costing more than $5,000	5 – 12
Equipment and furniture	Any costing more than $5,000	5 – 12

Capital Asset – Component Unit

All capital assets, including intangible interest in the License Agreement with the Department, are stated at cost. The Association has adopted the asset capitalization policies recommended by the State of South Carolina Office of Comptroller General.

Pursuant to this policy, equipment with costs greater than $5,000 and intangible assets with costs in excess of $100,000 are capitalized. Equipment depreciation is computed using the straight-line method over the equipment's estimated useful life of five years. A full year of depreciation is taken in the year an asset is placed in service. The Association's interest in its License Agreement with the Department is amortized over the term of the License Agreement, which ends in year 2038. When capital assets are disposed of, the cost and accumulated depreciation is removed and the resulting gain or loss is included in operations.

Interest Capitalization – Component Unit

In accordance with FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants,* the Association capitalized the interest costs incurred during the construction of the Southern Connector. The amount of interest capitalized for assets constructed with tax-exempt borrowings consisted of interest cost of the borrowings, including amortization of the original issue discount, less interest earned on the related interest-bearing investments acquired with proceeds of the related tax-exempt borrowings, incurred prior to commencement of toll road operations.

Receivables

All of the receivables are reported net of any allowances for uncollectible amounts and any discounts, if applicable. The Department's receivables consist of amounts due from the Federal government, State agencies, local governments, and other entities and individuals.

Some of the receivables are evidenced by notes and contracts. The notes and contracts are related to costs shared by other entities in construction projects. No allowance for uncollectible amounts was provided for based on management's evaluation of the collectability of the receivable balances at June 30, 2005.

Prepaid Expenses

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses in the accompanying financial statements. Expenditures for prepaid expenses are accounted for using the consumption method of accounting.

Inventories

The Department maintains inventories for its use and resale to other state agencies, local governments, and other entities. All inventories are valued at cost using the weighted average method. Expenditures for inventory are accounted for using the consumption method of accounting.

Other Assets

Other assets consist of right of ways land the Department had to purchase for economic reasons that was not allocable to project construction costs. These purchases are held until they are disposed of and are reflected in the accompanying financial statements at the original cost to the Department. Expenditures for this land are accounted for using the consumption method of accounting in which the purchase is recorded as an expenditure when disposed of. Gains or losses on the disposition of right-of-ways land are included in the other revenues category in the fund financial statements. Right of ways land transferred to county and municipal governments for no consideration are recorded as allocations to other entities – county and municipal governments in the fund financial statements.

Interfund Receivables/Payables

Long-term interfund loans are classified as "advance to" or "advance from" particular funds. Short-term amounts are classified as "due to" or "due from" the particular funds. No interest is charged on the advances to or due from amounts. Short-term amounts are generally repaid within 60 days. There were no advances outstanding as of June 30, 2005.

Bonds Payable, Bond Discounts, Bond Premiums, Bond Issuance Costs and Deferred Loss on Refundings of Bonds

The Department reports bonds payable in the governmental activities in the Department-wide financial statements. The Department defers and amortizes bond discounts and bond premiums over the term of the bonds using the bonds outstanding method, which results in amortization being computed using the percentage of bonds retired to the original amount of bonds issued. Costs incurred in connection with the bond issues are deferred and amortized on the straight-line method over the lives of the related issues. For current refundings and advance refundings of bonds resulting in the defeasance of debt, the difference between the reacquisition price and the net carrying amount of the old debt is also deferred and amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter. The Department reports bonds payable net of the applicable bond premium or discount and the deferred losses on refundings. Unamortized issuance costs are reported as deferred charges.

For the Association, bond issuance costs, discounts and underwriters' fees on all bonds are deferred and amortized over the terms of the bonds. Bond discounts are amortized using the bonds outstanding method, which approximates the effective interest method. Bond issuance costs and underwriters' fees are amortized using the straight-line method. Bond discounts are presented as a reduction of the face amount of the related revenue bonds payable whereas bond issuance costs and underwriters' fees are recorded as other assets.

Rebatable Arbitrage

Arbitrage involves the investment of proceeds from the sale of tax-exempt securities in a taxable investment that yields a higher rate, resulting in income in excess of interest costs. Federal law requires entities to rebate to the government such income on tax-exempt debt if the yield from those earnings exceeds the effective yield on the related tax-exempt debt issued. Governmental

units may avoid the requirement to rebate the "excess" earnings to the federal government under certain circumstances, if they issue no more than $5 million in total of all such debt in a calendar year and if they meet specified targets for expending of the proceeds and interest earnings thereon. For this purpose, tax-exempt indebtedness includes bonds and certain capital leases and installment purchases. The federal government only requires arbitrage be calculated, reported and paid every five years or at maturity of the debt, whichever is earlier. However, the potential liability is calculated annually for financial reporting purposes. The Department has no arbitrage liability for the year ended June 30, 2005.

The Association records the arbitrage liability using the revenue reduction method, whereby the rebate is recorded as a reduction of interest revenue. At December 31, 2004, no such liability had been incurred.

Interest in License Agreement with the Department

The Association's license agreement with the Department grants to the Association various rights and obligations pertaining to the financing, acquisition, construction and operation of the Southern Connector and construction of the SC 153 Extension. The terms of the license agreement provide that the Association finance and construct the Southern Connector and construct the SC 153 Extension with financing provided by the Department. However, the Department at all times retained fee simple title to the Southern Connector and to the SC 153 Extension, to all real property and improvements thereon, and to all rights of way acquired during construction. The Southern Connector was opened for traffic on February 27, 2001 and began collecting tolls on March 14, 2001. On July 22, 2001, the Southern Connector attained substantial completion. On December 22, 2003, the Southern Connector attained final completion. Beginning one year after the date of final completion, the Association is required to pay monthly license fees to the Department.

The Association's interest in the license agreement constitutes an intangible asset relating to the Southern Connector that began generating revenues upon commencement of operations. In order to account for its interest in the license agreement, the Association capitalized all costs of acquisition and construction of the Southern Connector, including interest expense incurred during the construction period. Upon commencement of operations, the Association began amortizing its interest in the License Agreement on a straight-line basis over the remaining term of the License Agreement through 2038.

Restricted Assets – Component Unit

Certain proceeds of the Association's Revenue Bonds are restricted by applicable bond covenants for construction, payment of operating and other expenses, or are set aside as reserves to ensure repayment of the bonds. Certain other assets are accumulated and restricted on a monthly basis in accordance with the trust agreement for the purposes of paying debt interest payments, due on a semiannual basis, and principal payments, due on an annual basis, and for the purpose of maintaining reserve funds at the required levels. The trust agreement provisions govern payments from the restricted accounts. Limited types of expenses may be funded from these restricted accounts. The funds and accounts are established as follows:

The Construction Fund was established for purposes of holding bond proceeds and investment earnings, which are used to pay the costs of constructing the Southern Connector.

The Revenue Fund was established to hold all revenues from toll road operations. The trust agreement provides that all revenues from the operation of the Southern Connector shall be delivered by the Association to the Trustee immediately upon receipt by, or on behalf of, the Association and shall be deposited by the Trustee into the Revenue Fund. The Trustee is obligated to transfer money on a monthly basis from the Revenue Fund to the other various funds established under the Trust Agreement in the priority listed below:

1. Operating costs budgeted by the Association for the next succeeding month shall be distributed to the Association.
2. There shall be transferred to the Rebate Fund amounts which equal the amount required to be on deposit therein.
3. The Trustee shall transfer to the Senior Bonds Debt Service Account amounts which, when added to other amounts in the Senior Bonds Debt Service Account, and available for such purposes, will provide for accumulation, in substantially equal monthly installments, of the amounts required to pay the sum of:
    a. Any interest to become due and payable on each series of outstanding Senior Bonds on the next interest payment date (within the next six months) for such Series; and
    b. Any principal installments to become due and payable on any series of outstanding Senior Bonds on or before the next date (within the next twelve months) on which such principal installment is payable
4. If the Senior Bonds Debt Service Reserve Account contains less than the Senior Bonds Debt Service Reserve Account requirement, the Trustee shall transfer into the Senior Bonds Debt Service Reserve Account an amount equal to 1/24 of the Senior bonds Debt Service Account requirement or the amount to attain the Senior Bonds Debt service Reserve Account requirement, whichever is less. The transfers shall continue until the Senior Bonds Debt Service Reserve Account contains the Senior Bonds Debt Service Account requirement.
5. The Trustee shall transfer to the Subordinate Bonds Debt Service Account amounts which, when added to other amounts in the Subordinate Bonds Debt Service Account, and available for such purposes, will provide for accumulation, in substantially equal monthly installments, of the amounts required to pay the sum of:
    a. Any interest to become due and payable on each series of outstanding Subordinate Bonds (within the next six months) on the next interest payment date for such Series; and,
    b. Any principal installments to become due and payable on any series of outstanding Subordinate Bonds on or before the next date (within the next twelve months) on which such principal installment is payable.
6. If the Subordinate Bonds Debt Service Reserve Account contains less than the Subordinate Bonds Debt Service Reserve Account Requirement, the Trustee shall transfer into the Subordinate Debt Service Reserve Account an amount equal to 1/60 of the Subordinate Bonds Debt service Reserve Account Requirement or the amount needed to attain the Subordinate Bonds Debt Service Reserve Account Requirement, whichever is less. All transfers shall continue until the Subordinate Bonds Debt Service Reserve Account contains the necessary requirement.
7. After the date of Final Completion of the Southern Connector Project, the Trustee shall deposit into the Renewal and Replacement Fund the amounts included in the annual budget of the Association, which are required pursuant to the Renewal and Replacement Plan then in effect under the License Agreement.
8. The Trustee shall pay to the Department amounts certified by an Authorized Association Representative as being due the Department for (i.) the maintenance costs reimbursable to the Department under the License Agreement, together with any accruals from prior periods and interest owed thereon under the License Agreement, and (ii.) any reimbursement to the Department for condemnation awards for rights of way for the Southern Connector Project in excess of the amounts reserved therefore on the Completion Date.
9. The Trustee shall pay amounts certified by an Authorized Association Representative as being due the Department for the License Fee owing to the Department under the License Agreement, together with any accruals from prior periods and any interest owed thereon under the License Agreement.
10. Money remaining in the Revenue Fund shall be used by the Trustee to make or provide for all deposits, payments, or transfers certified by an Authorized Association Representative as being required by any agreement or other instrument creating or evidencing any obligation or the Association which is not a Senior Bond or Subordinate Bond, at the time and in the amount provided for in such instrument.

11. The Trustee shall transfer any money remaining in the Revenue Fund at the end of any fiscal year to the Program Fund.

The Debt Service Fund, consisting of the Senior Bonds Debt Service Account and the Subordinate Bonds Debt Service Account, was established as a sinking fund for the payment of interest and principal on the revenue bonds.

The Debt Service Reserve Fund consisting of the Senior Bonds Debt Service Reserve Account and the Subordinate Bonds Debt Service Reserve Account, was established for the purpose of paying bond interest and maturing principal in the event that monies held in the Debt Service Fund and other funds would be insufficient for such purposes.

The Renewal and Replacement Fund was established for the purpose of holding monies in reserve to pay the costs of reconstruction, renewal, repair and replacement of the Southern Connector. At December 31, 2004, this account was inactive.

The Program Fund consisting of the Retained Balance and the General Account was established to hold monies in reserve to pay debt service if monies in other accounts are insufficient for such purpose and the pay other fees and costs as defined in the Trust Agreement. The Program Fund General Account was initially funded in 2002 from monies remaining in the Revenue Fund at December 31, 2001. The Program Fund Retained Balance Account was inactive at December 31, 2004.

The Rebate Fund was established for the purpose of holding and paying arbitrage investment earnings to the United States Treasury as a result of investing tax exempt bond proceeds at rates of return exceeding the maximum amount that is permitted under the applicable tax code. At December 31, 2004 the Rebate Fund was inactive.

Deferred Revenue

Deferred revenue consists of advance payments for construction projects which have not been earned. Revenues are recognized in the period in which the project expenditures are made.

Compensated Absences

Generally, all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's work week are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for accrued sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances which commenced on or before June 30, 2005. The Department calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded as a liability.

The Association grants its regular full time employees 10 vacation days and 10 holidays per year. Employees receive no sick days but are allowed to use vacation or holiday time when sick. All vacation and holiday time must be taken in the year earned. Therefore, at year end there are no accumulating vacation or holiday benefits, thus there is no liability that must be recorded. At December 31, 2004, no liability or expense was recorded in the financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts of assets, liabilities, revenues and expenses/expenditures and affect disclosure of contingent assets and liabilities at the balance sheet date of the financial statements and the reported amounts of revenues and expenses/expenditures during the reporting period. Accordingly, actual results could differ from those estimates.

Net Assets

Net assets are classified and presented in three components:

Invested in capital assets, net of related debt – Consists of capital assets including restricted capital assets, net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted – Consists of assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.

Unrestricted – All other assets that do not meet the definition of "restricted" or "invested in capital assets".

When both restricted and unrestricted resources are available for use, the policy is to use restricted resources first, then unrestricted resources as they are needed.

The Association's net deficit at December 31, 2004, resulted from shortfalls since commencement of operations due to lower than expected traffic counts and toll revenue. The Association anticipates that future development along the Southern Connector corridor will encourage increased traffic, which in turn, will generate toll revenues that will reduce the deficit.

NOTE 2. DEPOSITS AND INVESTMENTS:

The following schedule reconciles deposits and investments within the footnotes to the amounts in the financial statements:

Financial Statements		Footnotes	
Primary Entity:			
Unrestricted current assets:			
Cash and cash equivalents	$ 148,179,528	Cash on hand	$ 250
Restricted noncurrent assets:		Deposits held by State	
Cash and cash equivalents	150,901,718	Treasurer	396,613,309
Fiduciary - Agency Funds			
Cash and cash equivalents	97,532,313		
Total Primary Entity	396,613,559		396,613,559
Component Unit			
Unrestricted current assets:			
Cash and cash equivalents	682,006		
Investments	202,945		
Restricted current assets:			
Cash and cash equivalents	790,859	Bank Deposits	886,035
Investments	1,240,266		
Restricted noncurrent assets:			
Investments	16,772,509	Investments	18,802,550
Total component unit	19,688,585		19,688,585
TOTAL	$ 416,302,144		$ 416,302,144

PRIMARY ENTITY:

Deposits Held by State Treasurer

The deposits of the Department held by the State Treasurer are under the control of the State Treasurer who, by law, has sole authority for investing State funds. State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days.

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agent in the State's name. Information pertaining to carrying amounts, fair value, credit and other risks as required by Governmental Accounting Standards Board Statement No. 40, *Deposits and Investments - Risk Disclosures*, of the State Treasurer's investments are disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

Cash and cash equivalents reported include unrealized appreciation of $1,877,749 for the governmental funds and $563,583 for the fiduciary funds as of June 30, 2005 arising from changes in the fair value. The interest/investment income includes a gain of $968,219 realized for the year ended June 30, 2005.

Deposits at fair value at June 30, 2005 held by the State Treasurer include $140,613,848 of unexpended funds from bond issues which are to be used for projects in progress and other purposes.

COMPONENT UNIT:

Deposits

The Association's Trust Agreement requires that all bank deposits that are not insured by the Federal Deposit Insurance Corporation be collateralized by investment securities. The types of investment securities that may be used as collateral are: obligations of or guaranteed by the United States of America or certain of its agencies, repurchase agreements with underlying securities that are obligations of or guaranteed by the United States of America or certain of its agencies, certain obligations of or guaranteed by any State within the territorial United States of America, agreements that provide for the forward delivery of any securities previously described, investments in money market mutual funds rated "AAAm", "Aam", "AAAmG" or better, unsecured investments agreements with any bank or financial institution the unsecured debt or counter-party rating of which is "investment grade" rated as of the date of acquisition; and any other obligation which, at the date of acquisition, is rated by a rating agency in one of the two highest rating categories for long-term obligations or in the highest rating category for short-term obligations.

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements,* requires entities to categorize their bank deposits to give an indication of the level of risk assumed at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that an entity will not be able to recover deposits if the depository financial institution fails to recover the value of collateral securities that are in the possession of an outside party if the counter-party to the deposit transaction fails. There are three categories of deposit credit risk as follows:

(1) Insured or collateralized with securities held by the Association or by its agent in the Association's name
(2) Collateralized with securities held by the pledging financial institution's trust department or agent in the Association's name and
(3) Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the Association's name.

The Association's bank balances and carrying amounts at December 31, 2004 were as follows:

	Risk Category 1	Risk Category 2	Risk Category 3	Bank Balance	Carrying Amount
Insured Deposits	$ 568,243		$ 319,784	$ 888,027	$ 886,035

The Association had deposits of approximately $320,000 that were uninsured and uncollateralized at December 31, 2004.

None of the deposits above were on deposit with the South Carolina State Treasurer.

Investments

Pursuant to requirements of GASB Statement No. 3, the Association's investments in repurchase agreements were categorized to give an indication of the level of risk assumed by the Association at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that an entity will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counter-party to the investment transaction fails. There are three categories of investment risk which are as follows:

(1) Insured or registered, or securities held by the Association or by its agent in the Association's name,
(2) Uninsured and unregistered, with securities held by the counter-party's trust department or agent in the Association's name, and
(3) Uninsured and unregistered, with securities held by the counter-party, or by its trust department or agent, but not in the Association's name, including the portion of the carrying amount of any repurchase agreement that exceeds the market value of the underlying securities.

The Association's investments in open-end money market mutual funds were not required to be categorized since the investments were not evidenced by securities that exist in physical or book entry form.

The Association's investments at December 31, 2004 by investment risk categories are as follows:

	Risk Category 1	Risk Category 2	Risk Category 3	Carrying Value	Market Value
Repurchase Agreements		$ 17,292,761		$ 17,292,761	$ 17,292,761
US Treasury Note		718,931		718,931	702,638
Total Investments		$ 18,011,692		18,011,692	17,995,399
Not Categorized:					
Open-end Money Market Mutual Funds				790,858	790,858
				$ 18,802,550	$ 18,786,257

The investment types listed above include all investment types in which monies were held during the year ended December 31, 2004. None of the above investments were on deposit with the South Carolina State Treasurer.

See Notes 1 and 8 for additional information about restrictions on investments and balances of the various trust funds at December 31, 2004.

NOTE 3. STATE APPROPRIATIONS:

The original appropriation is the Department's base budget amount as presented in the General Fund column of Section 53, Part IA of the 2004-2005 Appropriation Act.

STATE APPROPRIATIONS	
Original appropriation	$ 100,990
State budget reductions:	-
Total Appropriation	$ 100,990

NOTE 4. RECEIVABLES:

Primary Entity:

The following schedule summarizes receivables at June 30, 2005, which include various notes, contracts and other accounts receivable.

Due From / Description	Current Portion	Long-term Portion (A)	Totals
Intergovernmental:			
Federal Government:			
Amounts due Under various grant programs and reimbursable contracts	163,667,991		163,667,991
	163,667,991		163,667,991
State Agencies:			
South Carolina Department of Motor Vehicles			
Sales of good and services	1,120		1,120
South Carolina Department of Revenue			
Gasoline and special fuels taxes	81,948,138		81,948,138
South Carolina Department of Public Safety			
Sales of good and services	621		621
University of South Carolina - Aiken			
Sales of goods and services	1,120		1,120
	81,950,999		81,950,999
Local Governments:			
Long-term contracts for construction projects	855,057	6,534,795	7,389,852
Participation agreements	4,979,905		4,979,905
Construction projects	1,182,215		1,182,215
	7,017,177	6,534,795	13,551,972
Other			
Long-term contracts for construction projects	861,735	1,044,514	1,906,249
Participation agreements	3,647,594		3,647,594
Sales of goods and services	2,856,129		2,856,129
	7,365,458	1,044,514	8,409,972
Total Receivables	260,001,625	7,579,309	267,580,934

(A) Due to long-term nature of this portion of the receivables, the entire amount has been offset as a reservation of fund balances as not being currently available.

The balances due under long-term contracts for construction projects from local governments and other entities represent loans to those entities for their share of the costs of construction projects.

The balances due under participation agreements from local governments and other entities represent advances by the Department for construction costs in excess of collections on joint-venture construction projects.

Component Unit:

At December 31, 2004, the Association's receivable was comprised of interest in the amount of $497,994.

NOTE 5. INVENTORIES:

The following schedule summarizes inventories at June 30, 2005:

Sign Shops	$	2,902,526
Repair Shops		1,139,917
Supply Depot		1,146,932
	$	5,189,375

NOTE 6. CAPITAL ASSETS:

PRIMARY ENTITY:

The following schedule summarizes changes in capital assets of the Department for the year ended June 30, 2005:

	Beginning Balances as Restated June 30, 2004	Increases	Decreases	Ending Balances June 30, 2005
Capital assets not being depreciated:				
Land and improvements	$ 5,566,732	$ -	$ -	$ 5,566,732
Right of ways land	1,066,282,891	65,892,570	54,638	1,132,120,823
Construction in progress:				
Infrastructure - road and bridge network	3,253,615,015	692,732,656	211,987,576	3,734,360,095
Other	11,096,057	3,716,427	1,069,167	13,743,317
Total capital assets not being depreciated	4,336,560,695	762,341,653	213,111,381	4,885,790,967
Other capital assets:				
Infrastructure - road and bridge network	7,828,506,179	211,987,576	3,924,020	8,036,569,735
Buildings and improvements	59,589,749	1,069,167	784,338	59,874,578
Equipment and furniture	107,881,093	6,759,978	7,103,054	107,538,017
Vehicles	88,216,054	4,136,739	5,309,221	87,043,572
Total other capital assets	8,084,193,075	223,953,460	17,120,633	8,291,025,902
Less accumulated depreciation for:				
Infrastructure - road and bridge network	1,870,634,268	113,039,073	3,544,404	1,980,128,937
Buildings and improvements	20,794,478	1,932,033	182,016	22,544,495
Equipment and furniture	77,262,286	7,251,712	6,814,118	77,699,880
Vehicles	64,769,634	6,159,152	5,143,520	65,785,266
Total accumulated depreciation	2,033,460,666	128,381,970	15,684,058	2,146,158,578
Other capital assets, net	6,050,732,409	95,571,490	1,436,575	6,144,867,324
Total capital assets for governmental activities, net	$ 10,387,293,104	$ 857,913,143	$ 214,547,956	$ 11,030,658,291

The following schedule summarizes additions to capital assets and their funding sources for the year ended June 30, 2005:

Additions:		
Increases per above:		
Capital assets not being depreciated	$	762,341,653
Other capital assets		223,953,460
Less, transfers from construction in progress:		
capital assets not being depreciated		(213,056,743)
Total additions	$	773,238,370
Funding Sources:		
Governmenetal funds	$	558,912,052
Donated captial assets:		
South Carolina transportation Intrastructure Bank		214,326,318
Total funding Sources	$	773,238,370

Included in the Department's capital assets as of June 30, 2005 is $192,472,174 that was paid for by the Association for the Southern Connector. This same amount has been capitalized by the Association as the capital asset - Interest in License Agreement with the Department. Accumulated depreciation on these assets was $19,452,929 at June 30, 2005. Depreciation expense on these assets for the year ended June 30, 2005 was $5,243,008.

At June 30, 2005, the estimated total costs of Department projects in progress to construct, acquire and maintain various capitalized assets amounted to approximately $23,240,000 for facilities capital projects and approximately $4,637,715,000 for infrastructure projects including capital and non-capital. The estimated costs to complete the facilities capital projects amounted to approximately $9,740,000 and the infrastructure projects amounted to approximately $999,908,000 at June 30, 2005. The outstanding contractual obligations attributable to the facilities capital projects were approximately $6,099,000 and to the infrastructure projects were approximately $607,241,000. The estimated time frame for completion of these projects is several years. The costs of the projects in progress and future projects will be funded from taxes and fees, federal grants, bond proceeds and other revenues of the Department. The amounts for infrastructure projects exclude those infrastructure project costs funded by the South Carolina Transportation Infrastructure Bank.

COMPONENT UNIT:

The following schedule summarizes changes in capital assets of the Association for the year ended December 31, 2004:

	Balance December 31, 2003	Increases	Decreases	Balance December 31, 2004
Capital assets:				
Interest in License Agreement with SCDOT	192,472,174	-	-	192,472,174
Equipment	546,643	46,279	(3,325)	589,597
Subtotal - Capital Assets	193,018,817	46,279	(3,325)	193,061,771
Less accumulated depreciation/ Amortization:				
Interest in License Agreement	14,209,921	5,243,008	-	19,452,929
Equipment	278,466	112,451	(2,660)	388,257
Subtotal-Accum. Deprec/Amortization	14,488,387	5,355,459	(2,660)	19,841,186
Totals-Net	$ 178,530,430	$ (5,309,180)	$ (665)	$ 173,220,585

For the year ended December 31, 2004, depreciation and amortization expense related to capital assets was $5,355,459.

The Association had no construction commitments outstanding at December 31, 2004.

NOTE 7. CHANGES IN LONG-TERM OBLIGATIONS:

The following schedule summarizes changes in long-term obligations of the Department for the year ended June 30, 2005:

	Beginning Balances June 30, 2004	Increases	Decreases	Ending Balances June 30, 2005	Due Within One Year
General obligation					
bonds payable	$ 613,005,000	$ 146,495,000	$ 32,865,000	$ 726,635,000	$ 27,610,000
Unamortized discounts, premiums	637,614	293,915	42,034	889,495	54,507
Unamortized deferred loss					
on refunding of bonds	(3,703,077)	$ (246,575)	1,859,493	(2,090,159)	1,899,263
Total Bonds Payable	609,939,537	146,542,340	31,047,541	725,434,336	25,765,244
Intergovernmental Payable					
Due to State agency	279,234,917	28,597,551	21,748,906	286,083,562	21,929,752
Due to Local Governments	500,000	-	100,000	400,000	100,000
Capital Leases payable	363,693	-	134,256	229,437	113,578
Accrued Compensated					
absences	21,408,988	16,245,586	15,525,831	22,128,743	15,408,880
Total Governmental Activities	$ 911,447,135	$ 191,385,477	$ 68,556,534	$ 1,034,276,078	$ 63,317,454

The following schedule summarizes principal and interest expenditures/expenses attributable to long-term obligations of the Department for year ended June 30, 2005:

	Principal	Interest	Totals
Bonds Payable	$ 32,865,000	$ 28,517,981	$ 61,382,981
Contributions Payable	21,748,906	3,851,094	25,600,000
Notes Payable	100,000	-	100,000
Capital Leases	134,256	13,615	147,871
Total Expenditures	$ 54,848,162	$ 32,382,690	$ 87,230,852
Adjustments to Department-wide statements			
Change in interest accrual - bonds payable		1,065,211	
Total Interest Expense		$ 33,447,901	

The principal amount includes $6.5 million to defease previously issued bonds.

NOTE 8. BONDS PAYABLE:

Primary Entity

Sections 57-11-210, et seq. of the South Carolina Code (the "State Highway Bond Act"), as continued and amended by Section 11-27-30 thereof, authorized the issuance of general obligation State Highway Bonds for highway construction and related purposes backed by the full faith, credit, and taxing power of the State. State Highway Bonds are additionally secured by a pledge of so much of the revenues as may be made applicable by the General Assembly for State highway purposes from any and all taxes or licenses imposed upon individuals or vehicles for the privilege of using the public highways of the State. Such taxes include the gasoline tax, the fuel oil tax, the road tax and the motor vehicle license tax described herein.

So long as any State Highway Bonds are outstanding the amount of revenues made applicable thereto by the General Assembly may not be less than the amounts needed to fund the general operations budget of the Department and meet debt service requirements for annual principal and interest payments on such bonds. Section 57-11-240 provides that the debt limit for State Highway Bonds is the maximum annual debt service limitation of approximately $88,950,000 which results from the application of the constitutional limitation imposed by said Paragraph 6(a) of Section 13 of the Article X of the South Carolina Constitution. From time to time, the State Budget and Control Board may authorize the issuance of various amounts of State Highway Bonds for specific types of projects or individual projects and may authorize the total to be issued in one or more series depending on the projections of the timing of project expenditures to be funded from the proceeds.

A listing of the general obligation bonds payable at June 30, 2005 is as follows:

Issue Date	Series	Original Face Amount	Maturity Date	Interest Rates	Ending Principal Balance
8/1/1995	1995	$20,000,000	8/1/2010	3.500-5.400%	$3,400,000
1/1/1996	1996A	30,000,000	2/1/2011	4.125-5.000%	14,535,000
7/1/1996	1996B	45,000,000	7/1/2021	5.625-5.650%	2,600,000
10/1/1997	1997A	30,000,000	10/1/2012	4.500-5.000%	18,930,000
4/1/1998	1998A	17,500,000	4/1/2023	4.500-6.500%	14,595,000
3/1/1999	1999A	200,000,000	5/1/2019	4.500-4.600%	176,000,000
1/1/2001	2001A	2,000,000	1/1/2021	4.500-6.000%	1,760,000
4/1/2001	2001B	350,000,000	4/1/2021	4.750-5.500%	300,685,000
10/1/2003	2003A	2,200,000	10/1/2018	5.00%	2,100,000
6/4/2003	2003B	46,080,000	7/1/2021	2.000-4.000%	45,535,000
4/1/2005	2005A	146,495,000	8/1/2022	3.000-5.000%	146,495,000
					726,635,000
Add, unamortized premium					889,495
Less, unamortized deferred loss on refundings of bonds					(2,090,159)
Total bonds payable					$725,434,336

The following schedule summarizes the debt service requirements, including principal and interest, of bonds payable by the Department to maturity:

	Principal	Interest	Totals
Year ending June 30:			
2006	$ 27,610,000	$ 32,080,089	$ 59,690,089
2007	36,080,000	31,662,260	67,742,260
2008	41,430,000	29,999,048	71,429,048
2009	43,770,000	28,023,191	71,793,191
2010	45,095,000	25,999,354	71,094,354
2011 - 2015	226,275,000	98,716,816	324,991,816
2016 - 2020	237,205,000	45,029,183	282,234,183
2021 -2023	69,170,000	3,461,438	72,631,438
Total debt service for bonds payable	$ 726,635,000	$ 294,971,378	$ 1,021,606,378

On June 1, 2003 the Department issued $46,080,000 in general obligation State Capital Improvement Refunding Bonds, Series 2003B. The purpose of the issuance was for advance refunding of $39,675,000 of the Series 1996B bonds. Proceeds from the new bond issue consisted of the following:

Face amount of bonds	$ 46,080,000
Premium	669,284
Total	$ 46,749,284

Issuance costs of the 2003B bonds consist of the following:

Underwriter's discount	$ 322,560
Other issuance cost	74,169
	396,729
Accumulated Amortization	(45,706)
Balance of unamortized issuance costs	$ 351,023

Amortization of bond issuance costs for the year ended June 30, 2005 was $21,939

The Department deposited $46,340,000 in an escrow account with Banc of America Securities, LLC pursuant to an irrevocable trust agreement for the future retirement of the refunded bonds. The deposited funds were invested in U.S. government securities. The $39,675,000 of Series 1996B bonds are considered to be defeased and the liability for those bonds has been removed from the Department-wide statement of net assets.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amounts of the old debt of $5,708,911. This difference is reported in the accompanying financial statements as a reduction of bonds payable and is being amortized on a straight line basis and will be charged to operations through the fiscal year ending June 30, 2006 since a call premium was pre-funded. The bonds are expected to be redeemed on July 1, 2006. The Department completed the advance refunding to reduce its total debt service payments over the next 18 fiscal years by approximately $2,550,000 and to obtain an economic gain of approximately $2,230,000 (the difference between the present values of the debt service payments on the old debt and the new debt).

The following summarizes the deferred loss on advance refunding of the Series 1996B bonds:

Escrow deposit	$46,340,000

Less:	
Principal amount refunded	(39,675,000)
Accrued interest deposited	(956,089)
Deferred loss on refunding of bonds Payable	5,708,911
Accumulated amortization of deferred loss	(3,857,373)
Balance of unamortized deferred loss	$ 1,851,538

Amortization of the deferred loss on refundings of bonds payable for the year ended June 30, 2005 was $1,851,539.

On April 1, 2005 the Department issued $146,495,000 in general obligation State Capital Improvement Bonds, Series 2005A, of which $6,495,000 was used to advance refund $6,500,000 of the Series 1995 Bonds. Proceeds from the new bond issue consisted of the following:

Face amount of bonds	$ 146,495,000
Premium	293,915
Total	$ 146,788,915

Issuance costs of the 2005A bonds consist of the following:

Underwriter's discount	$ 310,754
Other issuance cost	153,893
	464,647
Accumulated Amortization	(6,702)
Balance of unamortized issuance costs	$ 457,945

Amortization of bond issuance costs for the year ended June 30, 2005 was $6,702

The Department deposited $6,746,575 in an escrow account with Bank of New York Trust Company, N.A. pursuant to an irrevocable trust agreement for the future retirement of the refunded bonds. The deposited funds were invested in U.S. government securities. The $6,500,000 of Series 1995 bonds are considered to be defeased and the liability for those bonds has been removed from the Department-wide statement of net assets.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amounts of the old debt $246,575. This difference is reported in the accompanying financial statements as a reduction of bonds payable and is being amortized on a straight line basis and will be charged to operations through the fiscal year ending June 30, 2010 since a call premium was pre-funded. The bonds are expected to be redeemed on August 1, 2009. The Department completed the advance refunding to reduce its total debt service payments over the next 5 fiscal years by approximately $272,187 and to obtain an economic gain of approximately $255,257 (the difference between the present values of the debt service payments on the old debt and the new debt).

The following summarizes the deferred loss on advance refunding of the Series 2005A bonds:

Escrow deposit	$ 6,746,575
Less:	
Principal amount refunded	(6,500,000)
Deferred loss on refunding of bonds Payable	246,575
Accumulated amortization of deferred loss	(7,954)
Balance of unamortized deferred loss	$ 238,621

Amortization of the deferred loss on refundings of bonds payable for the year ended June 30, 2005 was $7,954.

The Series 1995 State Highway Bonds maturing on or after August 1, 2006, are subject to redemption, at the option of the State, in whole or in part at any time in any order of maturity to be determined by the State, on and after August 1, 2005, at the Redemption Prices expressed as a percentage of the principal amount of each Series 1995 State Highway Bond, or portion thereof, to be redeemed, as set forth below, plus accrued interest to the date for redemption:

Redemption Dates	Redemption Price
August 1, 2005 through July 31, 2005	102%
August 1, 2006 through July 31, 2006	101%
August 1, 2007 and thereafter	100%

These bonds were refunded in part and the $6,495,000 was defeased and removed from the financial statements of the Department.

The Series 1996A General Obligation State Highway Bonds maturing on and after February 1, 2007, are subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on and after February 1, 2006, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed as set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
February 1, 2006 through January 31, 2007	102%
February 1, 2007 through January 31, 2008	101%
February 1, 2008 and thereafter	100%

The Series 1996B State Highway Bonds are not subject to redemption prior to maturity. The Series 1997A State Highway Bonds maturing on and after October 1, 2008, are subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on or after October 1, 2007, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
October 1, 2007 through September 30, 2008	102%
October 1, 2008 through September 30, 2009	101%
October 1, 2009 and thereafter	100%

The Series 1998A State Highway Bonds maturing on and after April 1, 2009, are subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on or after April 1, 2008, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
April 1, 2008 through March 31, 2009	102%
April 1, 2009 through March 31, 2010	101%
April 1, 2010 and thereafter	100%

The Series 1999A General Obligation State Highway Bonds maturing on and after May 1, 2010 are subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on and after May 1, 2009, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
May 1, 2009 through April 30, 2010	102%
May 1, 2010 through April 30, 2011	101%
May 1, 2011 and thereafter	100%

The Series 2001A General Obligations State Highway Bonds maturing on and after January 1, 2012, shall be subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on and after January 1, 2011, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
January 1, 2011 through December 31, 2011	101%
January 1, 2012 and thereafter	100%

The Series 2001B State Highway Bonds maturing on and after April 1, 2009, are subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on or after April 1, 2008, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
April 1, 2008 through March 31, 2009	102%
April 1, 2009 through March 31, 2010	101%
April 1, 2010 and thereafter	100%

The Series 2003A State Highway Bonds maturing on and after October 1, 2014, are subject to redemption, in whole or in part at any time in any order of maturity to be determined by the State, on or after October 1, 2013, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
October 1, 2013 and thereafter	100%

The Series 2003B State Capital Improvement Refunding Bonds are not subject to redemption prior to maturity.

The Series 2005A State Highway Bonds maturing on and after August 1, 2016, are subject to redemption, in whole or in part at any time in any order of maturity to be determined by the State, on or after August 1, 2015 at par plus accrued interest to the date fixed for redemption:

Redemption Dates	Redemption Price
October 1, 2015 and thereafter	100%

Component Unit

The Association issued three series of tax-exempt toll road revenue bonds pursuant to a Master Indenture of Trust and a First Supplemental Indenture of Trust, both dated February 1, 1998. All of the bonds were issued on February 11, 1998. The bonds are special limited obligations of the Association that are not, and shall never, constitute an indebtedness of the State of South Carolina, the Department, or any agency, department or political subdivisions of the State of South Carolina, including the County of Greenville, South Carolina and the City of Greenville, South Carolina. Following is a brief description of each bond issue:

Series 1998A: Series 1998A Senior Current Interest Toll Road Revenue Bonds which were dated 2/11/98 - $66,200,000 original principal amount at issuance; interest payable semi-annually on January 1 and July 1 at rates of 5.250% and 5.375%; $21,400,000 of bonds mature January, 2023; $44,800,000 of bonds mature January, 2038. There was an original issue discount on the Series 1998A bonds at issuance of $2,693,952.

Series 1998B: Series 1998B Senior Capital Appreciation Toll Road Revenue Bonds, which were dated 2/11/98 - $87,385,622 original principal amount at issuance; interest accretes at various rates ranging from 5.30% to 5.85%; $438,100,000 of bonds mature serially from January 2008 to January 2038.

Series 1998C: Series 1998C Subordinate Capital Appreciation Toll Road Revenue Bonds which were dated 2/11/98 - $46,592,058 original principal amount at issuance; interest accretes at various rates ranging from 6.15% to 6.30%; $241,800,000 of bonds mature serially from January 2008 to January 2038.

The following schedule summarizes changes in bonds payable by the Association for the year ended December 31, 2004:

	Beginning Balances December 31, 2003	Increases	Decreases	Ending Balances December 31, 2004
Senior Bonds				
Series 1998A	$ 66,200,000	$ -	$ -	$ 66,200,000
Original Issue Discount on 1998A	(2,218,962)	80,280		(2,138,682
Subtatal Series 1998A	63,981,038	80,280	-	64,061,318
Series 1998B	122,101,517	7,136,925	-	129,238,442
Subordinate Bonds				
Series 1998C	66,958,343	4,186,037	-	71,144,380
Totals	$ 253,040,898	$ 11,403,242	$ -	$ 264,444,140

Additions to bonds payable represent the amortization of original issue discount on the Series 1998A Senior Current Interest Toll Revenue Bonds, and accretions on the Series 1998B and 1998C Capital Appreciation Bonds. At December 31, 2004, no principal payments on bonds were due within one year. Interest cost expensed during the year ended December 31, 2004 totaled $14,940,897.

The following schedule summarizes debt service requirements of the Association to maturity:

	Principal	Interest	Totals
Year ending December 31:			
2005	$ -	$ 3,531,500	$ 3,531,500
2006	-	3,531,500	3,531,500
2007	-	3,531,500	3,531,500
2008	6,200,000	3,507,875	9,707,875
2009-2013	42,500,000	16,775,500	59,275,500
2014-2018	67,200,000	15,213,625	82,413,625
2019-2023	99,600,000	13,210,750	112,810,750
2024-2028	135,800,000	10,604,876	146,404,876
2029-2033	177,500,000	7,148,751	184,648,751
2034-2038	217,300,000	2,660,625	219,960,625
Totals	$ 746,100,000	$ 79,716,502	$ 825,816,502

The terms of the Trust Agreement require the establishment of seven bank accounts (called "funds" in the indenture documents). The proceeds of the bonds were allocated among and deposited into certain of these accounts. The monies deposited into these accounts are invested according to the terms of Trust Agreement. Authorized payments of construction costs, debt service, arbitrage rebates and operating costs and renewal and replacement costs may only be paid from certain accounts as specified in the Trust Agreement. Payment of debt service of the bonds is secured by the Trust Estate, which includes all monies deposited into these various funds, excluding amounts in the rebate account and in the renewal and replacement account. The Trust Estate also includes the Association's interest in revenues as defined in the Trust Agreement, the Association's interest in the license agreement with the Department, and any other property pledged as security for the bonds.

The accounts established by the Trust Agreement and the balances therein at December 31, 2004 were as follows:

Fund	Amount December 31, 2004
Construction	$ 11,423
Revenue	38,304
Debt Service	2,019,673
Debt Service Reserve	16,772,509
Renewal and Replacement	-
Program	-
Rebate	-
Total	$ 18,841,909

During the year ended December 31, 2004, payments from the various accounts were made in accordance with the terms of the bond indenture.

The Trust Agreement contains certain other bond covenants including, but not limited to, the following:

- The Association is prohibited from taking any action or omitting to take any action that would cause the bonds to lose their tax-exempt status.

- After the Southern Connector is completed and operational, the Association's Engineer must inspect the toll road annually and submit a report documenting the physical condition of the toll road, offering advice, recommendations and a cost estimate as to the proper operation of the toll road during the ensuing fiscal year, offering advice and recommendations regarding the insurance to be carried, and stating the amount to be deposited into the Renewal and Replacement Fund for the next fiscal year.

- Prior to the end of each fiscal year, the Association is required to file an annual budget for the next fiscal year with the Trustee.

- Beginning on the first day of the second full fiscal year immediately following the later of (i) the final completion date of the Southern Connector, and (ii) the last date through which interest on any of the bonds is to be paid from proceeds of the bonds, the tolls charged by the Association shall equal or exceed the greater of (a) 1.25 times the aggregate debt service on all outstanding Senior Bonds due in that fiscal year, and (b) the amount required to fund all transfers to the Senior Bonds Debt Service Reserve Fund as defined in the Trust Agreement and to equal not less than 1.10 times the aggregate debt service on all outstanding bonds due in that fiscal year. The Trust Agreement also specifies actions to be taken if the Association determines that revenues may be inadequate to meet this covenant.

- The Association monitors the covenants for compliance throughout the year. The Association believes it was in compliance with its bond covenants throughout 2004.

NOTE 9. Intergovernmental Payable – Due to State Agency – Primary Entity

The Department entered into various intergovernmental agreements with the South Carolina Transportation Infrastructure Bank (the Bank) and various local governments to provide financial assistance for highway and transportation facilities projects. Details of the agreements follow in which the Department has a financial obligation.

Horry County RIDE I Project. The total costs for this project are estimated to be $888 million. Funding consists of (1) a $340 million financial assistance award by the Bank, of which $114 million is being re-paid to the Bank by the Department of Transportation in annual installments of $10 million each for eleven years and $4 million in the twelth year; and an additional $95 million contribution which is being paid to the Bank by the Department in annual installments of $7.6 million including 5% interest per annum for 20 years; (2) a $300 million interest free loan to Horry County; and, (3) a $247,577,664 interest bearing loan to Horry County.

Charleston County Project. The total estimated project costs are $650 million. Funding for the project consists of a $540 million financial assistance award by the Bank and the funding of $110 million of expenditures by the Department and claimed as federal expenditures. In addition, the Department is to contribute $200 million to the Bank at the rate of $8 million per year for 25 years without interest commencing in fiscal year 2003.

The following schedule summarizes changes in contributions payable – State agency (the South Carolina Transportation Infrastructure Bank) for the year ended June 30, 2005 and account balances of each year-end:

Project	Beginning Balance June 30, 2004	Increases	Decreases	Ending Balance June 30, 2005
Horry Ride Project				
Phase I	$ 44,000,000	$ -	$ 10,000,000	$ 34,000,000
Phase II	79,832,468	-	3,748,906	76,083,562
Charleston County Project	155,402,449	28,597,551	8,000,000	176,000,000
Totals	$ 279,234,917	$ 28,597,551	$ 21,748,906	$ 286,083,562

The following schedule summarizes the debt service requirements, including principal and interest, Department of Transportation to maturity:

Year Ending June 30	Principal	Interest	Total
2006	$ 21,929,752	$ 3,670,248	$ 25,600,000
2007	22,119,322	3,480,678	25,600,000
2008	22,318,037	3,281,963	25,600,000
2009	16,526,338	3,073,662	19,600,000
2010	12,744,687	2,855,313	15,600,000
2011-2015	67,385,640	10,614,361	78,000,001
2016-2020	67,059,786	3,340,214	70,400,000
2021-2025	40,000,000	-	40,000,000
2026-2027	16,000,000	-	16,000,000
Totals	$ 286,083,562	$ 30,316,439	$ 316,400,001

NOTE 10. LEASE OBLIGATIONS:

The Department is obligated under various operating and capital leases for the use of office equipment.

The Department entered into various capital leases for the purchase of imaging equipment costing $1,301,232. Principal payments made to date totaled $1,071,795 leaving unpaid balances of $229,437. The leases are secured by the equipment purchases. Interest rates range from 4.36% to 5.34%. Certain of the capital leases provide for renewal options and none of the leases include any purchase options. Total payments on these leases during the fiscal year ended June 30, 2005 totaled $195,678 of which $134,256 was principal, $13,615 was interest and $47,807 was executory costs. The carrying value of the imaging equipment purchased with capital leases at June 30, 2005 was $183,728. Depreciation for the fiscal year 2005 amounted to $132,190 and is included in depreciation expense.

The Department's non-cancelable operating leases expired in 2005. Certain operating leases provide for renewal options for periods at their fair rental value at the time of renewal. In the normal course of business, operating leases are generally renewed or replaced by other leases. Operating leases are generally payable on a monthly basis. The operating lease expenditures in fiscal year

2005 were approximately $5,000. In addition to the non-cancelable operating leases, the Department incurred approximately $438,000 in expenditures applicable to contingent rental agreements that are based on a pay-per-copy arrangement, with no required minimum usage requirements. All operating leases are with external parties.

The following schedule summarizes future commitments for capital leases as of June 30, 2005. The Department had no operating leases at June 30, 2005.

Year Ending June 30,	
2006	170,966
2007	150,096
2008	24,974
Total	346,036
Less:	
Interest	(13,015)
Executory costs	(103,584)
Capital lease obligations, at June 30, 2005	$ 229,437

NOTE 11. INTEREST IN LICENSE AGREEMENT WITH THE DEPARTMENT – COMPONENT UNIT:

On February 11, 1998, the Association entered into a license agreement (the License Agreement) with the Department regarding the construction and operation of the Southern Connector and SC 153 Extension projects (the Projects). The agreement grants the Association the exclusive right (1) to acquire in the name of the Department rights of way and other real property necessary to the development and operation of the Projects, (2) to develop and construct the Projects, (3) to finance the Southern Connector, (4) to operate, repair, renew and replace the Southern Connector in accordance with terms of the agreement, and (5) to collect tolls from the users of the Southern Connector.

In order to finance the Southern Connector, the Association issued three series of toll road revenue bonds pursuant to the Trust Agreement dated February 1, 1998. Interest on the bonds is exempt from federal income tax and from South Carolina income tax. The bonds are special, limited obligations of the Association, payable solely from net revenues and monies held in certain accounts and other property included in the trust estate. The bonds are not, and shall never, constitute an indebtedness of the State of South Carolina, of the Department, or of any agency, department or political subdivision of the State of South Carolina.

The License Agreement specifies that, upon its termination, the Association is to convey to the Department full title to all property and equipment acquired in whole or in part with proceeds of the bonds issued to finance the Southern Connector project. As stated in the License Agreement, the title to all real property and improvements thereon acquired or constructed during the term of the License Agreement is held by the Department. The License Agreement specifies a termination date 50 years after substantial completion of the Southern Connector. However, the License Agreement automatically terminates upon repayment, redemption or defeasance of the bonds and all other project debt. Since the bonds mature January 1, 2038, management considers that date to be the effective termination date of the License Agreement.

In order to fulfill its responsibilities under the License Agreement, the Association entered into an agreement (the Development Agreement) with Interwest Carolina Transportation Group, LLC (the Developer) whereby the Developer agreed to perform the obligations of the Association under the License Agreement with respect to construction of the Southern Connector and has assumed various additional responsibilities with respect to the construction. In order to fulfill its responsibilities under the Development Agreement, the Developer in turn entered into contracts with various subcontractors for the performance of certain obligations. The Developer agreed to complete the construction of the Southern Connector at a guaranteed price of $173,802,263, which includes acquisition of all rights of way, relocation of utilities and railroads, and all design and construction activities including toll plazas, toll collection equipment, operations systems and other costs. The Developer commenced construction on February 27, 1998. On February 23, 2001, the Association received notification from the Department of its acceptance of the roadways and bridges, thereby permitting the Association to commence operations of the South Connector. The Southern Connector was opened to the public on February 27, 2001. At that time, traffic was allowed on the Southern Connector for free for a two-week introductory period. Toll collection operations began on March 14, 2001. Substantial completion was reached on July 22, 2001. Final completion was achieved on December 22, 2003.

The Association will be required to pay a license fee to the SCDOT in the amount of $125,000 per month for a period of 25 years, commencing thirteen months (starting at the end of January 2005) after Final Completion of the Southern Connector and of $1 per month thereafter for the remainder of the term of the License Agreement. Payment of the monthly license fees will commence on the first day of the calendar month following the first anniversary of the Final Completion date of the Southern Connector. Payment of the license fee is ninth in priority according to the flow of funds set forth in Note 1. Item K. So long as any project debt remains outstanding, any license fees not paid when due will be deferred and will accrue interest at a rate of 5% per annum compounded annually.

The SCDOT is responsible for maintaining the Southern Connector (costs of maintenance are to be reimbursed by the Association in eighth priority in the flow of funds) The SCDOT is responsible for setting the toll rates in accordance with the terms of the License Agreement. The SC 153 Extension, the costs of which are not included in the accompanying financial statements, is operated, maintained, renewed, and replaced by the SCDOT as part of the South Carolina Highway System.

The Association's rights under the License Agreement, as described above, constitute an intangible asset that is valued and recorded at an amount equal to the cost of construction of the Southern Connector, including related capitalized interest.

On December 28, 2000, the Association entered into a contract (the "Operations Contract" with Southern Interwest, LLC, (the "Contractor") whereby the Contractor will operate the Southern Connector on behalf of the Association for a fee. Under the Operations Contract, tolls for the use of the Southern Connector were collected the contractor on behalf of the Association. Toll revenues are deposited into the Revenue Fund and applied as described in Note 1 herein. The Contractor was responsible for all work (as defined in the Operations Contract) relating to the operation, repair, maintenance and insurance of the Southern Connector. The Operations Contact had an original expiration date of December 31, 2004 and provided renewal options of successive one-year terms, upon the mutual agreement of the parties. For compensation for the service provided under the Operations Contract, the Association paid the Contractor for certain costs of work as defined in the Operations Contract plus a management fee and a subordinated management fee. The original management fee consisted of a regular monthly fee totaling $200,000 per year and a subordinated management fee of $100,000 per year. The subordinated fee not paid each year when due would be deferred and would accrue interest at a rate of 10% per annum compounded annually.

Effective March 1, 2002, the Association renegotiated the amount of the annual management fee. The annual management fee was reduced to $100,000 (payable in monthly installments) and the subordinated fee of $100,000 was eliminated. Effective December 31, 2002, the Operations Contract was terminated, but later the Association agreed to extend the Contract through February 28, 2003 to assist in the transition to self-management of the toll highway. The Association agreed to compensate the managing agency for the additional effort necessary to complete the transition. There were no management fees paid during 2004.

NOTE 12. PENSION PLANS:

The majority of employees of the Department are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees.

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the Retirement Division, 202 Arbor Lake Drive, Columbia, South Carolina 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee's average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 15 years credited service (five years effective January 1, 2001). Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service (this requirement does not apply if the disability is the result of a job related injury). A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive (TERI) Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any cost of living adjustments granted during the TERI period.

Because participants are considered retired during the TERI period, they do not make SCRS contributions, do not earn service credit, and are ineligible to receive group life insurance benefits or disability retirement benefits. Beginning July 1, 2005, the State legislature passed a law requiring TERI participants to make SCRS contributions.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. Effective July 1, 2004, the employer contribution rate became 10.80 percent, which included a 3.25 percent surcharge to fund retiree health and dental insurance coverage. The Department's actual contributions to the SCRS for the years ended June 30, 2005, 2004 and 2003 were approximately $12,646,000, $11,842,000, and $11,716,000 respectively, and equaled the required contributions of 7.55 percent (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $251,000 in the current fiscal year at the rate of .15 percent of compensation.

The South Carolina Police Officers Retirement System (PORS) is a cost-sharing multiple employer defined benefit public employee retirement system. Generally, all full-time employees whose principal duties are the preservation of public order or the protection or prevention and control of property destruction by fire are required to participate in and contribute to the System as a condition of employment. This plan provides annuity benefits as well as disability and group-life insurance benefits to eligible employees and retirees. In addition, participating employers in the PORS contribute to the accidental death fund which provides annuity benefits to beneficiaries of police officers and firemen killed in the actual performance of their duties. These benefits are independent of any other retirement benefits available to the beneficiary.

Employees covered under PORS are eligible for a monthly pension payable at age 55 with a minimum of five years service or 25 years credited service regardless of age. In addition, employees who have five years of credited service prior to age 55, can retire yet defer receipt of benefits until they reach age 55. A member is vested for a deferred annuity with five years service. The benefit formula for full benefits effective since July 1, 1989, for the PORS is 2.14 percent of the employee's average final salary multiplied by the number of years of credited service. Disability annuity benefits and the group-life insurance benefits for PORS members are similar to those for SCRS participants. Accidental death benefits provide a monthly pension of 50 percent of the member's budgeted compensation at the time of death.

Since July 1, 1988, employees participating in the PORS have been required to contribute 6.5 percent of all compensation. Effective July 1, 2004, the employer contribution rate became 13.55

percent, which, as for the SCRS, included the 3.25 percent surcharge. The Department's actual contributions to the PORS for the years ended June 30, 2005, 2004 and 2003 were approximately $13,200, $11,700, and $10,800 respectively, and equaled the required contributions of 10.3 percent (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $257 and accidental death insurance contributions of approximately $257 in the current fiscal year for PORS participants. The rate for each of these insurance benefits is .20% of compensation.

Article X, Section 16 of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS and PORS are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of compensation).

The systems do not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Department's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Department's liability under the pension plans is limited to the amounts appropriated therefore in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Department recognizes no contingent liability for unfunded costs associated with participation in the plans. At retirement, employees participating in the SCRS or PORS may receive additional service credit for up to 90 days for accumulated unused sick leave.

NOTE 13. POST-EMPLOYMENT AND OTHER EMPLOYEE BENEFITS:

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the Department are eligible to receive these benefits.

The State provides post-employment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

These benefits are provided through annual appropriations by the General Assembly to the Department for its active employees and to the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable sources of the Department for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Approximately 24,000 State retirees met these eligibility requirements at June 30, 2005.

The Department recorded for the years ending June 30, 2005, 2004, and 2003, employer contributions expenditures within the applicable functional expenditure categories for these insurance benefits for active employees of approximately $18,090,000, $17,598,000 and $18,053,000 respectively. As discussed in Note 12, the Department paid for the years ending June 30, 2005, 2004 and 2003 approximately $5,448,000, $5,175,000 and $4,888,000 respectively, applicable to the surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Office of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to Department retirees is not available. By State law, the Department has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from Systems' earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS and PORS benefits.

NOTE 14. DEFERRED COMPENSATION PLANS:

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Department have elected to participate. The multiple-employer plans, created under Internal Revenue Code Section 457, 401(k), and 403(b), are administered by third parties and are not included in the Comprehensive Annual Financial Report of the State of South Carolina. Compensation deferred under the plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

NOTE 15. TRANSACTIONS WITH STATE ENTITIES / RELATED PARTIES:

Primary Entity:

The Department has significant transactions with the State of South Carolina and various State agencies. The Department purchases goods and services from various State agencies. Total purchases from State agencies were approximately $9,013,178 for the year ended June 30, 2005. The Department sells supply items and provides services for various State agencies. Total sales to State agencies were approximately $1,107,719.31 for the year ended June 30, 2005.

The gasoline and special fuels tax is collected by the South Carolina Department of Revenue (DOR) and remitted on a monthly basis. Taxes collected by DOR for the State Highway Fund amounted to $418,666,580 for the year ended June 30, 2005. Gasoline tax revenues collected by DOR for the County Transportation Program Agency Fund amounted to $63,890,424 for the year ended June 30, 2005. $81,948,138 was unremitted and due to the Department by DOR at June 30, 2005.

Section 56-3-910 of the South Carolina Code of Laws provides for 20% of the motor vehicle fees collected by the South Carolina Department of Public Safety (SCDPS), now the Department of Motor Vehicles, are to be credited to the Department beginning with fiscal year 2002. $6,451,088 allocated to the Department for fiscal year 2004.

Services received at no cost from the various offices of the State Budget and Control Board include pension plans administration, insurance plans administration, audit services, personnel management, assistance in the preparation of the State Budget, review and approval of certain budget amendments, procurement services, and other centralized functions.

The Department had financial transactions with various State agencies during the fiscal year. Significant payments were made to divisions of the State Budget and Control Board for retirement plan contributions and health insurance premiums, insurance coverage, office supplies, printing, telephone, and interagency mail. Payments were also made to other agencies for unemployment insurance and workers' compensation coverage. The amounts of expenditures applicable to related party transactions are not readily available.

In addition, the Department transferred the following amounts to the General Fund of the State of South Carolina for its proportionate share of the cost of administration of central state services, other specified support and pay telephone revenue pursuant to the following provisions of the fiscal year 2005 Appropriations Act:

Statewide Cost Allocation Plan (Proviso 53.4)		
Collection of highway revenues	$	3,067,429
Central Service Agencies recoveries		1,872,536
Pay Telephone Revenue (Proviso 72.58)		240
Total	$	4,940,205

$4,940,205 was paid to the State during the year.

The Department provided no material services free of charge to other State agencies during the fiscal year except as noted on the next page. The Department participates in the statewide dual employment program.

Workers' compensation insurance premiums for the fiscal year 2005 of $5,933,157 were paid to the State Accident Fund.

See Note 9 regarding transactions resulting from intergovernmental agreements entered into by the Department, the South Carolina Transportation Infrastructure Bank (the Bank), and other local governments. The Department provided the Bank administrative services and clerical assistance during fiscal year 2005 for which it was paid $161,045. Allocations to other entities - State agency represented amounts paid to the Bank and totaled $24,356,765 for the year ended June 30, 2005 of which $3,452,781 was unpaid at year end. The payments were from gas tax collections and represented an amount not to exceed the one cent per gallon collected in accordance with Section 11-43-160 of the South Carolina Code of Laws for the on-going funding of construction and maintenance of highways. The Department has established an agreement with the Bank to reserve $10,000,000 as guaranty on an Horry County loan payments to the Bank.

A summary of intergovernmental payables to State agencies at June 30, 2005 is as follows:

Due To / Description	
South Carolina State Infrastructure Bank	
1cent per gallon gasoline tax	$ 3,452,781
Purchases of goods and services:	
Clemson University	398,029
State Budget and Control Board	203,322
University of South Carolina	172,770
S. C. Department of Motor Vehicles	65,924
S.C. Department of Revenue	64,394
S.C. Department of Corrections	59,441
S. C. Educational Television	23,608
Employment Security Commission	9,450
Vocational Rehabilitation	7,855
S.C. Department of Public Safety	5,136
Total	$ 4,462,710

Component Unit:

During the year ended December 31, 2003, the Association paid $50,876 for advertising to an advertising agency controlled by a member of the Association's Board of Directors.

NOTE 16. FEDERAL GRANTS:

The Department has grants and reimbursable contracts with the Federal government for the funding of costs related to the programs described in the grants. These funds are subject to audit and/or adjustment by the various funding sources.

As of June 30, 2005, a liability of $9,164,906 was recorded by the department for federal funds due to the Federal Highway Administration.

NOTE 17. RISK MANAGEMENT:

Primary Entity

The Department is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks. Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from that carried in the prior year. Settled claims have not exceeded this coverage in the prior three years. The Department pays insurance premiums to certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits except for deductibles.

Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of State employees for unemployment compensation benefits (Employment Security Commission);
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Office of Insurance Services); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Office of Insurance Services).

Employees elect health coverage through either a health maintenance organization or through the State's self-insured plan. All of the other coverages listed above are through the applicable State self-insured plan except dependent and optional life premiums are remitted to commercial carriers.

The Department and other entities pay premiums to the State's Insurance Reserve Fund (IRF), which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following assets, activities, and/or events:

- Theft of, damage to, or destruction of assets;
- Real property and contents;
- Motor vehicles;
- Data processing equipment
- Business interruptions
- Torts; and,
- Medical malpractice claims against covered employee for nurse.

The IRF is a self-insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of certain property and equipment and auto liability. Reinsurance permits partial recovery of losses from re-insurers, but the IRF remains primarily liable. The ISF's rates are determined actuarially.

State agencies and other entities are the primary participants in the State's Health and Disability Insurance Fund and ISF.

The Department obtains coverage up to $50,000 through a commercial insurer for employee fidelity bond insurance for the Executive Director for losses arising from theft or misappropriation.

Employee fidelity bond coverage is not maintained on the Department's Commission members or its other employees. The Department self-insures itself for any losses because it feels the likelihood of losses are remote.The Department has not transferred the portion of the risk of loss related to insurance policy deductibles and limits for capital assets and fidelity coverages to a State or commercial insurer.

The Department has not reported an estimated claims loss expenditure, and the related liability at June 30, 2005, based on the requirements of GASB Statement No. 10 and No. 30 which state that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30, 2005 and the amount of the loss is reasonably estimable. Liabilities include an amount for incurred but not reported (IBNR) losses when it is probable a claim will be asserted. Claims liabilities when recorded are based on estimates of the ultimate cost of settling known but not paid claims and IBNR claims at June 30 using past experience adjusted for factors that would modify past experience.

In management's opinion, claims losses in excess of insurance coverage are unlikely and, if incurred, would be insignificant to the Department's financial position. Furthermore, there is no evidence of asset impairment or other information to indicate that a loss expenditure and liability should be recorded; and, therefore, no loss accrual has been recorded.

Component Unit

The Association is exposed to various types of risk including loss related to torts; theft of, damage to, and destruction of assets; injuries to construction workers and others; professional

design; and damage to property of others. The Association obtained commercial insurance covering all of its known risks of loss as follows:

Automobile Liability	Professional Design
Worker's Compensation	Crime
Directors and Officers	Force Majeure
Builders Risk	General Liability

No claim settlements have exceeded insurance coverage during the previous three years. There were no significant reductions in insurance coverage during the year ended December 31, 2004.

NOTE 18. OTHER LIABILITIES – COMPONENT UNIT

Accrued Interest Payable

At December 31, 2004, accrued interest payable was $1,765,750, which consisted of the Senior Current Interest Bond (Series 1998A) payment due January 1, 2004. Interest is paid January 1 of each year to holders of the Senior Bonds at rates of 5.25% and 5.375% per annum.

Requisitions Payable and Accrued Early Completion Bonus

Requisitions payable consisted of requisitions for payment of construction costs and services that had been incurred as of December 31, 2004, but were not yet paid. The Association's engineer approves all requisitions prior to payment from the Construction Fund.

NOTE 19. OTHER MATTERS – COMPONENT UNIT

In prior years, the Association was a Development Stage Enterprise focused on construction of the Southern Connector. During the Development Stage, expenses incurred by the Association increased its net deficit, since toll road operations had not begun and no revenues were earned. The road was opened to public traffic in early 2001 and toll collection commenced March 14, 2001.

Since commencing operations, the Southern Connector has experienced significantly lower traffic counts than those projected during the Traffic and Revenue Study performed in 1997 during the planning phase of the Southern Connector Project.

Several factors have contributed to this shortfall. The Southern Connector is the first toll road in Upstate South Carolina. Since citizens in the Greenville, South Carolina vicinity are unaccustomed to using toll roads, they have been resistant to the concept of paying tolls. Furthermore, the Southern Connector was envisioned as a means of fostering development in southern Greenville County, and its corridor runs through a largely undeveloped area, serving as a thruway connecting Interstate 385 with Interstate 85. This lack of development in the area, coupled with the fact that the Southern Connector was opened almost nine months ahead of schedule, means that the demand for the toll road is in its infancy. In addition, current economic conditions have slowed potential new economic development along the Southern Connector.

Due to the factors discussed above, the Association's revenues for 2004 fell short of amounts anticipated, and the Association suffered a decrease in net assets (loss) of $18.1 million for 2004. In addition, the Association used a portion of its debt service reserve fund to help fund a portion of its 2004 interest payments. Unless revenues increase in the coming years, the Association will continue to have to draw monies from its debt service reserve funds.

NOTE 20. CONTINGENCIES AND SUBSEQUENT EVENTS:

PRIMARY ENTITY:

The Department is a defendant in various lawsuits arising from the conduct of its normal business primarily regarding right of ways. Although any litigation has an element of uncertainty, it is management's and legal counsel's opinions that the outcome of any litigation pending or threatened, or the combination thereof, will not have a materially adverse effect on the financial position of the Department. The Department recorded a liability of $2,164,047 at June 30, 2005 in connection with outstanding litigation cases involving construction projects.

The Department is involved in an unresolved legal action concerning the procurement of construction contracts. In the event of an unfavorable outcome, the Departments liability could exceed $10,000,000. The Department believes its positions are meritorious and it is vigorously defending its position.

Through June 30, 2005 the State's Joint Bond Review Committee approved the issuance by the Department not to exceed $926,640,000 in General Obligation State Highway Bonds for projects. As of June 30, 2005, $889,275,000 in bonds have been issued. The Commission authorizes the timing and amounts of the various bond issues to be determined by the Department's staff.

In May, 1997, the State Budget and Control Board authorized the Department to transfer an island consisting of approximately 8,000 acres to the South Carolina Department of Natural Resources (DNR), another State agency upon exhaustion of mitigation banking credits. The acreage was banked to provide an offset for environmentally sensitive lands that are required for future highway projects. An agreement to transfer the land to DNR will be executed when the Department has used up all the mitigation banking credits.

COMPONENT UNIT:

Contingency:

On March 21, 2003, the Trustee sent Notice #2 to the registered owners of the Associations bonds. In such notice, the Trustee informed the bondholders of a dispute concerning the interpretation of Section 505 (1) of the Trust Agreement. As previously communicated to the bondholders, on January 2, 2003, the Trustee made a withdrawal of approximately $72,320 from the Senior Bonds Debt Service Reserve Account in order to pay a portion of an interest payment then due on the Association's Series 1998A Senior Current Interest Bonds. On February 6, 2003, the Trustee notified the Association by letter that there were not sufficient revenues available to replenish the Senior Bonds Debt Service Reserve Account to the level that existed prior to such withdrawal. The Trustee contends that Section 505(1) of the Trust Agreement requires the Association to deliver to the Trustee on or before the last day of each month monies sufficient to replenish the Senior Bonds Debt Service Reserve Account to the Senior Bonds Debt Service Reserve Account requirement.

The Association reminded the Trustee that the indenture is a "lock box" structure in that all of the revenues available to pay the Bonds and replenish the funds and accounts of the indenture are already transferred to the Trustee. The Association contends that the provisions of Section 505(1) merely direct the Trustee as to the disposition of revenues among the various accounts and the ordering of transfers of such revenues. The Trustee and the Association were unable to resolve their differences in the interpretation of such section of the Trust Agreement and the Trustee notified the bondholders that an event of default has occurred under Section 902(3) of the Trust Agreement. The Trustee informed bondholders it intends to forebear from initiating legal actions in connection with the alleged default and solicited their comment and direction. The Trustee and the Association entered into a Tolling Agreement dated as of April 16, 2003, (the "Tolling Agreement") whereby, among other matters, the Trustee and the Association agreed that the above-described event would not be deemed to be an Event of Default under the Trust Agreement during the term of the Tolling Agreement.

In the Tolling Agreement, the Association agrees not to assert any defense it may have based on the lapse of time under the statute of limitations during the term of the Tolling Agreement relating to the above-described events. This original agreement was to expire on April 30, 2004, but the expiration date could be extended upon mutual written agreement of the parties. In April 2004, the Association and the Trustee amended the Tolling Agreement by extending the term of the Tolling Agreement until April 30, 2005. The amendment also provided for the Tolling Agreement to automatically be extended thereafter for additional periods ending April 30^{th} of each year unless either party gives the other at least sixty days advance written notice that the Tolling Agreement shall expire on the next succeeding April 30^{th}.

Subsequent Events:

In compliance with the provisions of the Continuing Disclosure Agreement with Wachovia bank, N. A., "the Trustee", The Association filed Event Notice No. 2005 announcing that the Trustee withdrew funds from the Senior Bonds Debt Service Reserve Account in order to pay a portion of the interest payment due on January 1, 2005.

In January 2005, the Association increased toll rates from $.75 to $1.00 per two-axle vehicle along with corresponding increases to larger multi-axle vehicles in accordance with the requirements of the Trust Agreement. See Note * concerning bond covenants for further information. This change was approved by the Department.

NOTE 21. PRIOR PERIOD RECLASSIFICATIONS/ ADJUSTMENTS:

The Department made corrections involving the application of accounting principles regarding the capitalization of certain infrastructure. A restatement of net assets of $976,341 was made as of July 1, 2004 which represented the difference between $2,188,250 of costs attributable to certain projects that did meet the capitalization limit but were not included in construction in progress – infrastructure, and $3,164,591 of cost attributable to an infrastructure project that did not meet the capitalization limit but was included in the amount capitalized. A restatement of $191,923 was also made to construction in progress - other construction. This restatement included $25,419 that was included in Land & Improvements, and $166,504 incorrectly accounted for at June 30, 2004. Also, the Building and Improvement asset total increased by $209,869 and accumulated depreciation increased by $76,951 due to property transferred from the Department of Public Safety. Other minor restatements were included to adjust the balances for capital assets on July 1, 2004.

The Department also made corrections regarding the recognition of revenue due from the federal highway administration. The department entered into agreements with federal highway to issue bonds to construct federally eligible projects and use the federal dollars to reimburse debt service payments made on the bond issues. The department issued the bonds in 1999 and 2001 and began making the debt services payments from state funds prior to completion of the projects, when these payments should have been made from federal funds. The department calculated the amount of debt service paid from 1999 to 2004 as $124,970,333. The debt service is now being allocated to the projects and federal reimbursement claimed. The department recorded $124,970,333 as a prior period adjustment to its government-wide net assets for the recognition of the receivable and revenue from the federal highway administration.

The effect of the prior period adjustment resulted in an increase in the fund balance of $62,500,000 of the special revenue fund for the amount available to the Department at June 30, 2004. The remaining amount of $62,470,333 is classified as deferred revenue in the special revenue fund due to the fact the amount was not available to meet the current needs of the department at June 20, 2004 or June 30, 2005.

The effects of these restatements on the various account balances as of July 1, 2004 in the Department-wide and fund financial statements are as follows:

Capital Asset Category	Balances, as previously reported	Restatement Amount	Balances, as restated
Capital assets not be depreciated:			
Construction in Progress - Infrastructure Road and Bridge Network	$ 3,254,591,356	$ (976,341)	$ 3,253,615,015
Total Other CIP	11,287,980	(191,923)	11,096,057
Other capital assets:			
Buildings and Improvements	59,379,880	209,869	59,589,749
Vehicles	88,198,536	17,518	88,216,054
Equipment and furniture	107,847,308	33,785	107,881,093
Accumulated depreciation for:			
Buildings and Improvements	20,717,527	76,951	20,794,478
Vehicles	64,752,117	17,517	64,769,634
Equipment and furniture	77,255,530	6,756	77,262,286
Federal Aid Receivable	$ 131,699,169	$ 124,970,333	$ 256,669,502
Net Assets	$ 9,633,445,334	$ 123,962,015	$ 9,757,407,349
Governmental Fund: Fund Balance	$ $163,369,594	62,500,000	225,869,594

South Carolina Department of Transportation

Schedule of Revenues, Expenditures and Changes in Fund Balance
Budget to Actual - General Fund
For the Year Ended June 30, 2005

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
REVENUES:				
State Appropriations	$ 100,990	$ 100,990	$ 100,990	$ -
EXPENDITURES:				
Public Transportation	100,990	100,990	100,990	-
Total Expenditures	100,990	100,990	100,990	-
NET CHANGE IN FUND BALANCE	-	-	-	-
FUND BALANCE - BEGINNING	-	-	-	-
FUND BALANCE - ENDING	$ -	$ -	$ -	$ -

See accompanying independent auditors' report.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION
COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	Assets			
	Cash and Cash Equivalents	Accrued Interest Receivable	Due from State Highway Fund	Total Assets
RIGHT OF WAYS FUND				
Balance at June 30, 2004	$ 328,182	$ -	$ -	$ 328,182
Additions	66,500			66,500
Deductions	(66,500)			(66,500)
Balance at June 30, 2005	328,182	-	-	328,182
ADVANCE RIGHT OF WAY FUND				
Balance at June 30, 2004	5,387,279			5,387,279
Additions	-			
Deductions	-			
Balance at June 30, 2005	5,387,279	-	-	5,387,279
SPECIAL DEPOSITS				
Balance at June 30, 2004	1,077,195			1,077,195
Additions	1,654,702			1,654,702
Deductions	(1,616,777)			(1,616,777)
Balance at June 30, 2005	1,115,120	-	-	1,115,120
COUNTY TRANSPORTATION FUND				
Balance at June 30, 2004	97,900,033	990,023	11,007,210	109,897,266
Additions	93,973,157	627,417	64,142,103	158,742,677
Deductions	(101,171,458)	(990,023)	(62,762,765)	(164,924,246)
Balance at June 30, 2005	90,701,732	627,417	12,386,548	103,715,697
TOTALS - ALL AGENCY FUNDS				
Balance at June 30, 2004	104,692,689	990,023	11,007,210	116,689,922
Additions	95,694,359	627,417	64,142,103	160,463,879
Deletions	(102,854,735)	(990,023)	(62,762,765)	(166,607,523)
Balance at June 30, 2005	$ 97,532,313	$ 627,417	$ 12,386,548	$ 110,546,278

See accompanying independent auditors' report.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION
COMBINING STATEMENT OF CHANGES ASSEST AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	Liabilities				
	Accounts Payable/ Other Liabilities	Deposits for Right of Ways	Special Deposits and Bonds	Funds Held for Counties	Total Liabilities
RIGHT OF WAYS FUND					
Balance at June 30, 2004	$ -	$ 328,182	$ -	$ -	$ 328,182
Additions		66,500			66,500
Deductions		(66,500)			(66,500)
Balance at June 30, 2005	-	328,182	-	-	328,182
ADVANCE RIGHT OF WAY FUND					
Balance at June 30, 2004	5,387,279				5,387,279
Additions	-				-
Deductions	-				-
Balance at June 30, 2005	5,387,279	-	-	-	5,387,279
SPECIAL DEPOSITS					
Balance at June 30, 2004	308,561		768,634		1,077,195
Additions	181,698		1,644,684		1,826,382
Deductions	(161,701)		(1,626,756)		(1,788,457)
Balance at June 30, 2005	328,558	-	786,562	-	1,115,120
COUNTY TRANSPORTATION FUND					
Balance at June 30, 2004	6,628,362			103,268,904	109,897,266
Additions	8,646,249			150,562,334	159,208,583
Deductions	(7,028,991)			(158,361,161)	(165,390,152)
Balance at June 30, 2005	8,245,620	-	-	95,470,077	103,715,697
TOTALS - ALL AGENCY FUNDS					
Balance at June 30, 2004	12,324,202	328,182	768,634	103,268,904	116,689,922
Additions	8,827,947	66,500	1,644,684	150,562,334	161,101,465
Deletions	(7,190,692)	(66,500)	(1,626,756)	(158,361,161)	(167,245,109)
Balance at June 30, 2005	$ 13,961,457	$ 328,182	$ 786,562	$ 95,470,077	$ 110,546,278

See accompanying independent auditors' report.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED JUNE 30, 2005

Federal Grantor / Program Title	Federal CFDA Number	Total Federal Expenditures	Expenditures To Subrecipients
Direct Programs:			
U.S. Department of Transportation			
Highway Planning and Construction	20.205	$ 699,645,046	$ -
Federal Transit - Capital Investment Grants	20.500	8,788,156	8,788,156
Federal Transit - Metropolitan Planning Grants	20.505	317,902	296,868
Fomula Grants for Other Than Urbanized Areas	20.509	5,604,009	5,132,292
State Planning and Research	20.515	295,492	295,492
Capital Assistance Program for Elderly Persons and Persons with Disabilities	20.513	2,911,323	2,785,470
Job Access: Reverse Commute	20.516	118,951	103,946
Total Direct Programs		717,680,879	17,402,224
Indirect Programs:			
Federal Emergency Management Agency			
Passed Through SC Emergency Preparedness			
Public Assistance Grants	83.544	1,308,312	
Totals		$ 718,989,191	$ 17,402,224

Note: The Department used the accrual basis method of accounting in preparing the above schedule. This is the same basis of accounting used by the Department in the preparation of its annual financial statements. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2005

1. Basis of Presentation:

The information in the Schedule of Expenditures of Federal Awards is presented in accordance with the requirements of OMB Circular A-133 *Audits of States, Local Governments, and Non-Profit Organizations* (as amended).

The financial information shown in the Schedule of Expenditures of Federal Awards reflects amounts recorded by the South Carolina Department of Transportation during its fiscal year July 1, 2004 through June 30, 2005. This information is presented on the accrual basis of accounting.

SCOTT McELVEEN L.L.P.

Report on Compliance and on Internal Control over Financial Reporting and on Compliance and Other Matters based on an Audit of Financial Statements performed in accordance with *Government Auditing Standards*

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the financial statements of the governmental activities, the major fund and the aggregate remaining fund information of the South Carolina Department of Transportation (the "Department") as of and for the year ended June 30, 2005, which collectively comprise the Department's basic financial statements and have issued our report thereon dated October 3, 2005. We did not audit the financial statements of the Connector 2000 Association, Inc. (the "Association"), a component unit of the Department. The financial statements of the Association as of and for the year ended December 31, 2004 were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for that component unit, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted matters involving internal control over financial reporting and its operations that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions discovered during the audit are described in the accompanying schedule of findings and questioned costs as items 2005-1 through 2005-3.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the

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reportable conditions described above, we consider items 2005-1 and 2005-2 to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.*

We have also issued our letter dated October 3, 2005 (attached) that includes other suggestions related to the Department that are not considered to be reportable conditions.

This report is intended solely for the information of the State Auditor, the Governor of the State of South Carolina, commission members and management of the Department and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Scott McElveen, L.L.P.

Columbia, South Carolina
October 3, 2005

SCOTT McELVEEN L.L.P.

Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in accordance with OMB Circular A-133

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

Compliance

We have audited the compliance of South Carolina Department of Transportation (the "Department") with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The Department's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the

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purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2005-1 through 2005-3.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2005-1 and 2005-2 to be material weaknesses.

We have also issued our letter dated October 3, 2005 (attached) that includes other suggestions related to the Department that are not considered to be reportable conditions.

This report is intended solely for the information of the State Auditor, the Governor of the State of South Carolina, commission members and management of the Department, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Scott McElveen, L.L.P.

Columbia, South Carolina
October 3, 2005

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2005

Section I—Summary of Auditor's Results

Financial Statements

1. Type of auditor's report issued: Unqualified Opinion

2. Internal control over financial reporting:
   Material weaknesses identified: _x_ yes ___ no
   Reportable conditions identified not considered to be material weaknesses? _x_ yes ___ no

3. Non-compliance material to the Financial Statements noted? ___ yes _x_ no

Federal Awards

4. Internal control over major programs:
   Material weaknesses identified: _x_ yes ___ no
   Reportable conditions identified not considered to be material weaknesses? _x_ yes ___ no

5. Type of auditor's report on compliance for major programs: Unqualified Opinion

6. Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? _x_ yes ___ no

7. Identification of major programs:

CFDA Number	Name of Federal Program
20.205	Highway Planning and Construction
20.509	Formula Grants For Other Than Urbanized Areas

8. Dollar threshold used to be distinguished between Type A and Type B Programs: $3,000,000

9. Auditee qualified as low-risk auditee? ___ yes _x_ no

Section II–Financial Statement Findings

Reportable Conditions Considered to be Material Weaknesses

2005 – 1 Completeness of Accounting Records:

Condition:

The Department did not record certain federal revenues in its accrual basis financial statements for the fiscal years ended 2000-2004. This resulted in a restatement of the Department's financial statements in fiscal year 2005 of approximately $125 million dollars. However, even though these revenues were required to be recognized under generally accepted accounting principles, the revenues could not be reimbursed to the Department until projects were substantially complete.

Cause:

As the Department could not be reimbursed until substantial completion had been achieved, it did not occur to the Department that the revenues should have been accrued annually.

Effect:

This resulted in a cumulative error of approximately $125 million to the Department's financial statement. This error was an understatement of assets.

Criteria:

Federal and state regulations, good business practices, and Generally Accepted Accounting Principles require the Department to maintain complete and accurate financial accounting records that properly reflect all of its financial activities.

Recommendation:

We recommend that the Department:

- Implement policies and procedures to ensure that their accounting records are complete and accurate.
- Consider periodically meeting with other department heads of the Department to determine that the accounting records are, in fact, complete and accurate.

2005 – 2 Submission of Reimbursable Expenditures

Condition:

We noted the following regarding the Highway Improvement Maintenance Project (HIMP):

- The Department obtained federal reimbursement of the HIMP program at 100% of expenditures, but they should have only recorded 80% as revenue with the remaining 20% being recorded as deferred revenue. Representatives from Federal Highway Administration also concurred with us on the recording deferred revenues.
- The Department does not maintain adequate financial records to support the HIMP program. Certain revenues and receivables are recorded on Department prepared schedules; however, such transactions could not be substantiated with supporting documentation.

Cause:

There appears to be a lack of communication between the Department administering the HIMP program and the accounting department.

Effect:

Current year revenues were overstated by approximately $9.0 million dollars which resulted in an audit adjustment. Also, the lack of future communication with the department that administers the HIMP program could result in possible future misstatements in the Department's financial statements.

Criteria:

Generally Accepted Accounting Principles require:

- that revenue is not to be recognized until it is earned.
- that complete and accurate financial accounting records are maintained which properly reflect all of the Department's financial activities.

Recommendation:

We recommend that the Department:

- Revise Department prepared schedules to reflect each project under the HIMP program as a separate activity.
- Obtain supporting documentation from the department that administers the HIMP program and retain these accounting records.
- Obtain assistance from the department that administers the HIMP program in completing the Department prepared schedules.
- Periodically meet with the department that administers the HIMP program to ensure that the accounting records are complete and accurate.

Section III—Federal Award Findings and Questioned Costs

Major Programs:

2005 - 3 Questioned Cost – Waiver For Subrecipient Reviews and Independent Audits (CFDA 20.509)

Condition:

Our tests of the Department's monitoring procedures of subrecipients for the Formula Grants For Other Than Urbanized Areas (Nonurbanized Area Formula Program) found that an audit report for the Waccamaw Regional Transit Authority financial statements and other reports required by OMB Circular A-133 by an independent accounting firm have not been issued for the year ended June 30, 2004. The Department's federal expenditures include $343,000 paid to this Authority for the year ended June 30, 2005.

Cause:

The Waccamaw Regional Transit Authority had encountered some fraud involving the misappropriation of funds and unallowable costs. The South Carolina Department of Transportation's internal audit department has been reviewing the subrecipient's records. At this time, the South Carolina Department of Transportation's internal auditors have not issued a report based upon their review and applicable findings.

Effect:

Without the Waccamaw Regional Transit Authority obtaining an extension, it would not be in compliance with OMB Circular A-133 reporting deadlines.

Criteria:

A financial and compliance audit is required to be completed within nine months of the end of the subrecipient's audit period unless an extension is requested.

Recommendation:

Subrecipients and the Department should ensure that OMB Circular A-133 audits are performed and reports issued on a timely basis. However, in the event that this deadline cannot be met, subrecipients should obtain an extension from federal agencies. This would ensure that the subrecipients are in compliance with reporting provisions of OMB Circular A-133.

Perspective:

This was the only finding identified during the audit of this program. This finding appears to be an isolated incident.

This finding is also considered to be a reportable condition.

Prior Year Comments:

During the current year audit, we reviewed the status of corrective action taken on the management letter comments reported in our prior year's report on internal control and compliance of the Department dated October 6, 2004, resulting from the audit of the financial statements for the year ended June 30, 2004. We found that adequate corrective action was taken for all of the management letter comments, findings and questioned costs as follows:

- 2004-1 Accounting for Participation Agreements
- 2004-2 Cash Receipts
- 2004-3 County Transportation Committee Transactions
- 2004-4 Questioned Cost –Highway Planning and Constructive Program

The South Carolina Department of Transportation

Letter to Management

June 30, 2005

SCOTT McELVEEN L.L.P.

October 3, 2005

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

In planning and performing our audit of the financial statements of the South Carolina Department of Transportation (the "Department") for the year ended June 30, 2005, we considered the Department's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. During our audit, we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. This letter summarizes our comments and suggestions concerning those matters. This letter does not affect our reports on the financial statements of the Department.

We will review the status of these comments during our next audit engagement. We have already discussed these issues with the management of the Department, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist in implementing the recommendations.

The Department's accounting and finance staff improved significantly over last year in their close-out and financial reporting process. The staff took on the major responsibility of preparing its own financial statements under generally accepted accounting principles ("GAAP") for the second year in a row and was successful for the first time ever in meeting the very demanding reporting deadline of the South Carolina Comptroller General's office. The completion of this complex and large audit would not have been possible without the complete cooperation and assistance of the accounting and finance staff as well as employees from other areas of the Department.

Sincerely,

Scott McElveen, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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Recording of Accrued Interest Expense

Condition:

The Department provided us with an internally prepared accrued interest expense schedule that was not mathematically correct. This schedule supported an entry recorded by management to record accrued interest expense.

Cause:

The schedule was not properly reviewed and footed for accuracy prior to an entry being recorded in the Department's accounting system.

Effect:

An audit adjustment of $1.556 million had to be recorded to adjust the amount of accrued interest expense as of June 30, 2005.

Criteria:

Good accounting practices dictate that all schedules and supporting documentation be reviewed for clerical accuracy prior to posting an entry to the Department's general ledger system.

Recommendation:

We recommend that the Department:

- Implement policies and procedures whereby all supporting schedules are reviewed for completeness and accuracy, including clerical accuracy.
- Refrain from recording items to the general ledger until appropriate review has been completed and approved.

Year-end Closing Process

Condition:

The accounting department overall does a very good job in closing its books and preparing its financial statements. In fact, in the current year, the Department was able to issue draft financial statements by the established deadline for the first time ever, which is a major achievement for such a large and complex state agency. However, this year's closing process was delayed somewhat which resulted in additional time needed for both Department management and the Department's external auditors in completing the audit process.

Cause:

The Department management did not meet its own established deadlines for completing the closing process.

Effect:

The results were delays in producing closing entries, trial balances, schedules, reconciliations, account analyses, and other financial reports needed by management and the auditors. However, even though these delays occurred, the Department was able to issue draft financial statements by the established deadline.

Criteria:

Good business and accounting practices require timely closing procedures to allow for efficient and accurate preparation of the financial statements and other financial reports.

Recommendation:

We believe that the year-end closing process could proceed more quickly and smoothly by developing a logical order for closing procedures and assigning responsibility for completing the procedures to specific Department personnel. The closing procedures should be documented in a checklist that indicates who will perform each procedure and when completion of each procedure is due and is accomplished. The timing of specific procedures could be coordinated with the timing of management's and the Comptroller General's need for the information. The due dates should be monitored and strictly enforced.

Classification of Revenues

Condition:

Federal Emergency Management Agency (FEMA) revenues were classified for financial statement purposes as other revenues. As these amounts are federal revenues, they should have been classified as federal revenues in the Department's financial statements. These amounts were properly classified by the Department in the trial balance.

Cause:

The Department did not formally reconcile the total federal expenditures as noted on the schedule of federal expenditures to the amounts noted in the financial statements.

Effect:

The Department's financial statements did not properly classify the FEMA revenues as federal revenues.

Criteria:

Good accounting practices include the proper classification of revenues.

Recommendation:

We recommend that the Department properly classify all revenues and reconcile the schedule of federal expenditures to the federal revenue amounts in the financial statements.

Require Appropriate Mileage Rate and Expense Report Documentation

Condition:

Travel and entertainment expense documentation disclosed the following matters:

- Several instances were noted whereby documentation was not obtained on individual expense reports to substantiate the appropriate mileage rate to be reimbursed.
- The documentation of a high-level management employee did not contain a proper explanation of travel expenses.
- There was an instance where an employee approved her own expense payment to a third party.

It should be noted that the Department has made strides in reducing its motor pool and will continue to work on decreasing this major expense of the Department.

Cause:

Department employees did not provide evidence substantiating the appropriate mileage rate to be reimbursed on their submitted expense report. In addition, procedures in place for submission of travel and entertainment expense reimbursements and approval of such expenses were not followed.

Effect:

The Department may have reimbursed employees in excess of the established Department reimbursement policies.

Criteria:

The Department should ensure that all employees understand travel policies and procedures.

Recommendation:

We recommend that the Department managers thoroughly review employee expenditure reports to ensure that they include proper documentation and use appropriate mileage rates.

South Carolina
Department of Transportation

CORRECTIVE ACTION PLAN

October 14, 2005

Thomas L. Wagner, Jr. CPA
State Auditor
Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, SC 29201

Dear Mr. Wagner:

The South Carolina Department of Transportation respectfully submits the following Corrective Action Plan for the year ended June 30, 2005.

The Plan outlines actions, taken, or to be taken, to address "reportable conditions considered to be material weaknesses" and "federal award findings and questioned costs" contained in the audit report prepared by Scott McElveen, LLP dated October 3, 2005. Each audit recommendation is repeated prior to our response and numbers as in the audit report.

Also included are our responses to Management Letter recommendations, which were not considered to be "reportable conditions". The Department has seriously addressed each of these matters.

FINDINGS RELATED TO THE FINANCIAL STATEMENTS

Reportable Conditions Considered to be Material Weaknesses

2005-1 Completeness of Accounting Records

Recommendation:

We recommend that the Department implement policies and procedures to ensue that its accounting records are complete and accurate and consider periodically meeting with other department heads of the Department to determine that the accounting records are, in fact, complete and accurate.

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SCDOT Corrective Action:

The Department concurs with the recommendation. The incident noted referenced a new program and process for the Department. Accurate, detailed reports of this program and its effect on financial position have always been prepared and furnished to management since the inception of the program. All transactions concerning this program have now been duly recorded in the accounting records that lead to production of the financial statements. The Department will ensure that accounting personnel are included in discussions of all new programs.

2005-2 Submission of Reimbursable Expenditures

Recommendation:

We recommend that the Department revise Department prepared schedules to reflect each project under the HIMP (Highway Improvement Match Program) program as a separate activity; obtain supporting documentation from the department that administers the program and retain these accounting records; obtain assistance from the department that administers the program in completing the Department prepared schedules; and periodically meet with the department that administers the program to ensure that the accounting records are complete and accurate.

SCDOT Corrective Action:

Accounting is currently working with the Engineering Department, administering the program, to obtain the necessary information to separate the individual projects contained in the Highway Improvement Match Program (HIMP) and obtain copies of all pertinent documentation supporting the program. We will meet periodically to ensure the accounting schedules and information are correct.

FEDERAL AWARD FINDINGS AND QUESTIONSED COSTS

2005-3 Questioned Cost – Waiver For Subrecipient Reviews and Independent Audits (CFDA 20.509)

Recommendation:

Subrecipients and the Department should ensure that OMB Circular A-133 audits are preformed and reports issued on a timely basis. However, in the event that this deadline cannot be met, subrecipients should obtain an extension from federal agencies. This would ensure that the subrecipients are in compliance with reporting provisions of OMB Circular A-133.

SCDOT Response:

The Department concurs with the finding and the statement under the section titled "Perspective", that "this appears to be an isolated incident" because of the fraud uncovered and subsequent dismissal of the independent audit firm which would have completed the A-133 audit. The Department will stress the importance of subrecipients requesting an extension and monitor that such requests are completed on a timely basis.

LETTER TO MANAGEMENT – OPPORTUNITIES FOR STRENGTHENING INTERNAL CONTROLS AND OPERATING EFFICIENCY

Recording of Accrued Interest Expense

Recommendation:

We recommend that the Department:

- Implement policies and procedures whereby all supporting schedules are reviewed for completeness and accuracy, including clerical accuracy.
- Refrain from recording items to the general ledger until appropriate review has been completed and approve.

SCDOT Response:

The Accounting Division will continue to monitor all supporting schedules and will ensure that a management employee will verify the schedules for accuracy and completeness prior to recording transactions.

Year End Closing Process

Recommendation:

We believe the year-end closing process could proceed more quickly and smoothly by developing a logical order for closing procedures and assigning responsibility for completing the procedure to specific Department personnel. The closing procedures should be documented in a checklist that indicates who will perform each procedure and when completion of each procedure is due and is accomplished. The timing of specific procedures could be coordinated with the timing of management's and the Comptroller General 's need for the information. The due dates should be monitored and strictly enforced.

SCDOT Response:

The Department does maintain a checklist of closing procedures and responsibilities. It is updated with due dates, completion dates, and responsible party. The Department is proud that it shortened the closing time by approximately seven days, earlier that ever before. We would also like to point out the statement in the "Effect" portion of the auditors comment that state deadlines were met. However, there were additional entries to be made as corrections were noted throughout the audit process. We will review our processes and procedures to provide as timely as possible complete and correct financial information.

Classification of Revenues

Recommendation:

We recommend that the Department properly classify all revenues and reconcile the schedule of federal expenditures to the federal revenue amounts in the financial statements.

SCDOT Response:

The revenues received from the Federal Emergency Management Agency were properly classified in the accounting records as federal revenues. The system producing the financial statements incorrectly included this amount as other revenue. This has been corrected and the schedule reconciled to the federal revenue in the financial statements.

Require Appropriate Mileage Rate and Expense Report Documentation

Recommendation:

We recommend that the Department managers thoroughly review employee expenditure reports to ensure that they include proper documentation and use appropriate mileage rates.

SCDOT Response:

There are policies in place that require prior approval for use of a personal vehicle as well as a statement that no state car was available for the travel. The Department is encouraging the use of the personal vehicle to eliminate the need for a large fleet. We will ensure that all appropriate statements and approvals are included with the travel reimbursement form. Approval of the travel reimbursement by the office manager or director is the required attest to the validity and purpose of the travel. Travel is monitored very closely by the Department.

If we can provide additional information, please don't hesitate to contact us.

Sincerely,

Robert W. Wilkes, Jr. CPA
Director of Financial Management

CC: Scott McElveen, LLP