SOUTH CAROLINA
DEPARTMENT OF TRANSPORTATION
COLUMBIA, SOUTH CAROLINA

FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORTS

YEAR ENDED JUNE 30, 2007

State of South Carolina

Office of the State Auditor

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October 15, 2007

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, 2007, 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,

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/cwc

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

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SCOTT + McELVEEN LLP

Independent Auditors' Report

Mr. Richard H. Gilbert, Jr., CPA,
Deputy 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, 2007, 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 discretely presented component unit of the Department. The financial statements of the Association as of and for the year ended December 31, 2006 were audited by other auditors whose report dated July 3, 2007, thereon has been furnished to us, and our opinions, insofar as they relate to the amounts included for that component unit, are 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 fairly the financial position of the State of South Carolina as of June 30, 2007, 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, 2007, and the respective changes in financial position thereof for the year then ended, and the financial position of its component unit as of December 31, 2006, and the changes in financial position thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2007 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 required supplementary information, as listed in the accompanying table of contents, are not a required part of the basic financial statements but are 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 1, 2007

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, 2007 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 July 3, 2007, 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, 2007 by **$11.1** billion (presented as "net assets"). Of this amount, **$218.6 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 **$108.4** million as of December 31, 2006, the close of its fiscal year.

Changes in Net Assets - The Department's total net assets increased by **$288.6** million (a 2.6**%** increase) in fiscal year 2007. The major component of the net asset increase is **$107.9** million in donations of construction in progress from the South Carolina Transportation Infrastructure Bank. The remaining increase resulted in general revenues exceeding the governmental activities deficit by **$180.7** million. 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 **$19.9** million, **$16.5** million of which was interest expense.

Capital Assets – Capital Assets, net of depreciation, which include infrastructure, were approximately **$11.8** billion at June 30, 2007 for the Department. Capital additions for the year, including **$107.9** million donated from the South Carolina Transportation Infrastructure Bank, totaled **$388.7** million. The carrying value of capital assets removed from the records this year was **$1.4** million. Capital assets of the component unit, net of depreciation, were approximately **$162.6** million at December 31, 2006. 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 **$162.5** million at December 31, 2006. 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 decreased by **$37.9** million (3.8%) during the current fiscal year to **$990** million. This change is attributable a net decrease in bonds payable of **$36** million, a net decrease in the amount due the South Carolina State Transportation Infrastructure Bank of **$2.8** million and other increases of **$0.9** million.

FUND ACTIVITY

Governmental Funds - Fund Balances - As of the close of fiscal year 2007, the Department's governmental funds reported a combined ending fund balance of **$252.8 million**, an increase of **$6.1** million in comparison with the prior year. Revenues exceeded expenditures by **$4.2** million. Overall agency expenditures were down **21%** and federal grants, which are a direct reimbursement of eligible expenditures, are down **27%**; however, revenues from motor fuel taxes are up **13%** and debt interest and principal expenditures are up **12%**. Of this total amount, **$223.0** 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 S*tatement 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 S*tatement 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 fund 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 Fund – Most of the basic services provided by the Department are financed through governmental fund. The governmental fund is 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 the governmental fund 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 one governmental fund which includes the Earmarked, Restricted, and General Funds.

The basic governmental fund 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 fund 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. This section includes a budgetary comparison schedule for the *governmental fund*, which includes comparisons of original budget to final budget to actual outflow (expenditures) on a non-GAAP 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 **$11.1** billion at the close of business on June 30, 2007 (See **Table A-1** for a summary of net assets for fiscal years 2006-2007 and 2005-2006). The largest portion of the Department's net assets **(97.8%)** 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 are 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	
	2006	2007
Current Assets	$ 346.4	$ 374.0
Capital Assets	11,610.7	11,855.1
Other Assets	96.9	18.2
Total Assets	**12,054.0**	**12,247.3**
Current Liabilities	272.8	219.5
Non-current Liabilities	953.2	910.9
Total Liabilities	**1,226.0**	**1,130.4**
Net Assets:		
Invested in Capital Assets, Net of Related Debt	10,604.8	10,888.3
Restricted	88.4	10.0
Unrestricted	134.8	218.6
Total Net Assets	**10,828.0**	**11,116.9**
Total Liabilities & Net Assets	**$ 12,054.0**	**$ 12,247.3**

At June 30, 2007, the Department's net assets do not include resources that are subject to external restrictions on how they may be used. The remaining balance of net assets **(19% or $218.6 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 **$288.6** million, or 2.6%. Approximately **$107.9** 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 2007, the Department's program expenditures exceeded revenues by **$289.2** million. A breakdown of the **$1.28** billion in gross revenues reveals that motor fuel taxes, **$556.3** represented 43.1**%,** while federal highway allocations and grants of **$665.6** represented 51.9%, and 5**%** of revenues came from various sources including toll revenues, motor vehicle fees, charges for services, and interest income.

Table A-2 presents a breakdown of these revenues and expenses for fiscal year 2006-2007 with comparative figures for the prior year.

Table A-2

SCDOT Changes in Net Assets
(Expressed in Millions)

	Governmental Activities			
Revenues:	2006	% of Revenue	2007	% of Revenue
Program Revenues:				
Capital Grants and Contributions	$ 732.1	52%	$ 566.4	44%
Operating Grants and Contributions	104.3	7%	99.2	8%
Charges for Services	87.2	6%	24.9	2%
General Revenues:				
Motor Fuel Taxes	490.1	34%	556.3	44%
State Appropriations	1.5	0%	9.7	1%
Investment Earnings	6.4	1%	11.8	1%
Total Revenues	**1,421.6**	**100%**	**1,268.3**	**100%**
Expenses:				
Public Transportation	986.6		979.7	
Total Expenses	**986.6**		**979.7**	
Changes in Net Assets	**435.0**		**288.6**	
Net Assets, Beginning of Year	10,393.1		10,828.1	
Net Assets, End of Year	**$ 10,828.1**		**$ 11,116.7**	

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 Fund

The focus of the Department's governmental fund 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 state highway fund reported ending fund balance of **$252.8** million, an increase of **$6.1** million in comparison with the prior year. The increase is due to revenues exceeding expenditures by **$4.2** million and proceeds of **$1.9** million from the sale of capital assets. 89**%** of these total fund balances or **$223** 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) to pay the South Carolina Infrastructure Bank (**$10** million), (2) for inventories and pre-paid expenses (**$12.3** million), (3) for long-term receivables (**$6.7** million) and (4) purchase right-of way (**$771** thousand).

GOVERNMENTAL FUND BUDGETARY HIGHLIGHTS

The South Carolina Appropriations Act as enacted becomes the legal operating budget for the department. The Department's legally adopted budget is presented at the program level including the restricted, earmarked, and general funds appropriated as is included in Other Budgeted Funds for the State. Legal level of authority exists at the program level and any revisions to the budget over and above the amount totally appropriated must be approved by the State Budget and Control Board.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Department's investment in capital assets for its governmental activities as of June 30, 2007, amounts to **$14.3 billion**, less accumulated depreciation of **$2.4 billion**, leaving a net book value of **$11.9** billion. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets 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**: roads, bridges and right of ways. 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, 2007 and June 30, 2006.

Table A-3

SCDOT Capital Assets
(expressed in millions)

	Primary Government	
	2006	2007
Land	$ 3.7	$ 3.7
Buildings and Improvements	61.3	67.3
Furniture and Equipment	199.6	200.9
Infrastructure		
Right of Way	1,181.0	1,198.2
Roads	7,011.3	7,127.6
Bridges	1,673.4	1,728.4
Construction in Progress	3,744.2	3,922.4
Total Cost	$ 13,874.5	$ 14,248.5
Less Accumulated Depreciation	2,263.8	2,393.5
Net Capital Assets	**$ 11,610.7**	**$ 11,855.0**

The total increase in the Department's investment in capital assets for the current fiscal year was about **2.15%** in terms of net book value. However, actual expenditures to purchase or construct capital assets were **$388.7** million for the year. **$107.9** 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 **$142.9** million. Refer to note 6 in the financial statements for additional information on capital assets.

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 decreased by **$36.0** million during the current fiscal year, to **$663.5** million. The net decrease is primarily attributed (1) the payment of principal on outstanding debt of **$36.0** million, (2) the net increase in unamortized bond premiums of **$55** thousand; (3) net decrease on unamortized deferred loss on refunding of **$48** thousand. Other long-term debt includes **$303.2** million due to the SC Infrastructure Bank and various local governments for financial assistance on transportation projects managed by those entities and accrued compensated absences of **$23** million (net increase for the year of **$1.1** million). Due within one year for all long-term debt is **$79.2** million. Refer to notes 7, 8 and 9 of the financial statements for additional information on debt administration.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

During the period 1998-2006 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 are projected to grow nominally in fiscal year 2007-2008. 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 maintenance by about $34 million (an approximate increase of 13% in non-federal revenues) phased in over the next three to five years. Even with this increase, construction costs continue to out pace the growth in revenues. Since 1999 construction cost have risen 63%. Various legislative increases, such retirement, insurance contribution, and personal services also tap into the limited Department resources with no additional increase in the revenues.

In fiscal year 2006-2007, the Department took measurers to reduce the drain on future financial resources by curtailing the construction of new road projects. The focus shifted to maintenance of the current system and replacement of bridges. However, revenues must grow by $1 billion a year for the next ten years in order for the Department to completely address the needs for maintenance and rehabilitation of the highway system. This will begin to take the Department's resurfacing and repair cycle from an average of 75 years currently to 15 years, which is the life of the pavement. Overall, state revenues continue to fall short of these benchmarks. New revenues sources and an aggressive cash management program will assist the Department in 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.

During the 2006-2007 Legislative session, restructuring legislation was passed for the Department of Transportation. Act 114 established a Secretary of Transportation, a Governor Appointee, in lieu of an Executive Director and established qualifications for Commissioners. The Secretary is to administer the day to day operations of the Department and carry out the policies of the commission. The Secretary is responsible for routine operation and maintenance except for request for resurfacing, installation of new traffic signals, curb cuts on primary routes, construction of bike lanes, and construction projects under $10 million. These duties along with developing a statewide long range plan; utilizing prescribed criteria to develop a priority list of projects; developing the Statewide Transportation Improvement Plan (STIP); utilizing prescribed criteria to develop a priority list of projects financed with state funds; awarding federal enhancement grants, and approving the Department's budget belong to the Commission.

The seven member Commission is comprised of six members elected by the members of the South Carolina General Assembly based on the State's congressional districts and one at large member being appointed by the Governor. Each nominee must be screened by a Joint Transportation Review Committee and found qualified to fill the post of Commissioner.

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
Director Finance and Administration
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, 2007

(In Thousands)

	Primary Entity Governmental Activities	Component Unit
ASSETS		
Current assets:		
Cash and cash equivalents	$ 197,543	$ 703
Invested securities lending collateral	23	-
Restricted assets:		
Cash and cash equivalents	-	1,501
Investments - Restricted	-	1,017
Receivables:		
Federal government	94,427	-
State agencies	56,126	-
Local governments	8,541	-
Other entities- net of allowances	3,785	-
Investments	-	321
Accrued interest receivable	1,316	4
Prepaid items	6,769	38
Inventories	5,511	89
Total current assets	374,041	3,673
Non-current assets:		
Restricted assets:		
Cash and cash equivalents	10,000	567
Investments	-	15,878
Accrued interest receivable	-	1
Total restricted assets	10,000	16,446
Receivables, net of current portion:		
Local governments	6,430	-
Other entities	279	-
Other assets	771	-
Non-depreciable capital assets	5,124,462	-
Capital assets, net of accumulated depreciation	6,730,660	109
Interest in license agreement, net of accumulated amortizatioon	-	162,542
Bond issuance costs, net of accumulated amortization	711	3,989
Total non-current assets	11,873,313	183,086
TOTAL ASSETS	$ 12,247,354	$ 186,759

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF NET ASSETS (CONTINUED)
JUNE 30, 2007

(In Thousands)

LIABILITIES AND NET ASSETS	Primary Entity Governmental Activities	Component Unit
Liabilities:		
Current liabilities:		
Liabilities payable from restricted assets:		
Accrued interest	$ -	$ 1,765
Total	-	1,765
Bonds payable	41,437	-
Accrued interest payable	8,410	273
Accounts payable	80,078	241
Intergovernmental payable:		
Due to State agency	34,453	3,453
Due to local government	100	-
Contract retainages payable	1,988	-
Accrued payroll and related liabilities	17,996	-
Due to Agency Fund - County Transportation Program	5,856	-
Capital leases payable	17	-
Accrued compensated absences	15,311	-
Deferred revenue	13,918	-
Securities lending collateral	23	-
Total current liabilities	219,587	5,732
Noncurrent liabilities:		
Bonds payable, including unamortized premium and net of current portion and unamortized discounts and deferred loss on refunding of bonds	622,145	289,457
Intergovernmental payable:		
Due to State agency, net of current portion	280,923	-
Due to local government, net of current portion	100	-
Accrued compensated absences, net of current portion	7,716	-
Total noncurrent liabilities	910,884	289,457
TOTAL LIABILITIES	1,130,471	295,189
Net assets:		
Invested in capital assets, net of related debt (deficit)	10,888,283	(40,829)
Restricted:		
Debt service	-	199
Bond proceeds for capital projects and other purposes	-	9
State Infrastructure Agreement	10,000	-
Unrestricted:		
Balance (deficit)	218,600	(67,809)
TOTAL NET ASSETS (DEFICIT)	11,116,883	(108,430)
TOTAL LIABILITIES AND NET ASSETS	$ 12,247,354	$ 186,759

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2007

(In Thousands)

		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	$ 942,749	$ 24,869	$ 99,216	$ 566,411	$ (252,253)	$ -
Unallocated Interest Expense	36,992	-	-	-	(36,992)	-
Total primary entity	$ 979,741	$ 24,869	$ 99,216	$ 566,411	$ (289,245)	$ -
Component unit:						
Toll operations	$ 25,994	$ 5,085	$ -	$ -	-	(20,909)
Totals					(289,245)	(20,909)
General revenues:						
State appropriations-unrestricted					9,781	-
Motor fuel taxes					556,352	-
Interest/Investment Income					11,806	956
Total general revenues					577,939	956
Changes in net assets					288,694	(19,953)
Net assets - Beginning					10,828,189	(88,477)
Net assets - Ending					$ 11,116,883	$ (108,430)

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

BALANCE SHEET - GOVERNMENTAL FUND
JUNE 30, 2007

(In Thousands)

ASSETS	
Current assets:	
Cash and cash equivalents	$ 197,543
Invested securities lending collateral	22,708
Receivables:	
Federal government	94,427
State agencies	56,126
Local governments	8,541
Other	3,785
Accrued interest receivable	1,316
Prepaid items	6,769
Inventories	5,511
Total current assets	396,726
Non-current assets:	
Restricted assets:	
Cash and cash equivalents	10,000
Total restricted assets	10,000
Receivables, net of current portion	
Local governments	6,430
Other	279
Other assets	771
Total non-current assets	17,480
TOTAL ASSETS	$ 414,206
LIABILITIES AND FUND BALANCE	
Liabilities:	
Current liabilities:	
Accounts payable	$ 80,078
Intergovernmental payables:	
Due to State agencies	12,135
Contract retainages payable	1,988
Accrued payroll and related liabilities	17,996
Due to Agency Fund - County Transportation Program	5,856
Deferred revenue	20,627
Securities lending collateral	22,708
TOTAL LIABILITIES	161,388
Fund Balance:	
Reserved:	
Inventories and prepaid items	12,280
Long-term receivables	6,709
Other assets	771
State Infrastructure Bank agreement	10,000
Unreserved	223,058
TOTAL FUND BALANCES	252,818
TOTAL LIABILITIES AND FUND BALANCES	$ 414,206

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

BALANCE SHEET- GOVERNMENTAL FUND (CONTINUED)
JUNE 30, 2007

(In Thousands)

RECONCILIATION OF THE BALANCE SHEET TO THE STATEMENT OF NET ASSETS:

FUND BALANCE - GOVERNMENTAL FUND		$ 252,818
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 fund:		
Capital assets, net of accumulated depreciation	11,855,122	
Bond issuance costs, net of accumulated amortization	711	11,855,833
Deferred revenues are recognized on an accrual basis in the statement of net assets and on the modified accrual basis in the governmental fund:		
Participation agreements, net of allowance for bad debts	6,709	6,709
Liabilities are not due and payable in the current period, therefore, are not reported in the governmental fund:		
Bonds payable including unamortized premium and discounts and net of unamortized deferred loss on refunding of bonds	(663,582)	
Intergovernmental payable:		
Due to State agency	(303,241)	
Due to local government	(200)	
Capital leases payable	(17)	
Accrued compensated absences	(23,027)	
Accrued interest payable	(8,410)	(998,477)
NET ASSETS - GOVERNMENTAL ACTIVITIES		$ 11,116,883

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUND
FOR THE YEAR ENDED JUNE 30, 2007

(In Thousands)

REVENUES:	
Motor fuel taxes	$ 556,352
State appropriations	9,781
Federal grants	557,489
Interest/investment income	11,806
Sales of goods and fees for services	9,830
Participation agreement/project revenues	6,825
Other revenues	6,221
Proceeds from intergovernmental payable -	
State agency (contribution payable)	19,305
TOTAL REVENUES	1,177,609
EXPENDITURES:	
Current:	
General administration	42,710
Engineering	40,135
Toll facilities	3,557
Public transportation	18,816
Highway maintenance	588,896
Capital outlay:	
Rights of way land	13,311
Construction in progress	
Infrastructure - road and bridge network	255,386
Other	1,462
Equipment and furniture	6,284
Vehicles	4,148
Debt service:	
Principal	58,398
Interest	37,468
Allocations to other entities:	
State agency	25,670
Agency Fund - County Transportation Program	77,100
TOTAL EXPENDITURES	1,173,341
EXCESS OF EXPENDITURES OVER REVENUES	4,268
OTHER FINANCING SOURCES (USES):	
Proceeds from sale of capital assets	1,902
TOTAL OTHER FINANCING SOURCES (USES)	1,902
NET CHANGE IN FUND BALANCES	6,170
FUND BALANCES, beginning of year	246,648
FUND BALANCES, end of year	$ 252,818

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUND (CONTINUED) FOR THE YEAR ENDED JUNE 30, 2007

(In Thousands)

RECONCILIATION OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NET CHANGE IN FUND BALANCES - GOVERNMENTAL FUND TO THE STATEMENT OF ACTIVITIES:

INCREASE IN FUND BALANCE - GOVERNMENTAL FUND	$ 6,170
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	280,783
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	107,947
Depreciation of capital assets is reported as expenses in the statement of activities	(142,966)
Deferred revenues are reported on a modified accrual basis in the governmental fund and on accrual basis in the statement of activities	(268)
Amortization of the costs of issuance is reported as expenses in the statement of activities	(49)
Amortization of deferred losses on refunding of bonds is reported as expenses in the statement of activities	(48)
Decrease in accrued interest payable is reported as an expense in statement of activities	476
Proceeds from intergovernmental debt financing are reported as revenues in the governmental fund, and are reported as an increase in liabilities in the statement of net assets	(19,305)
Amortization of premium on bonds is reported as a reduction of expenses in the statement of activities	55
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	36,080
Intergovernmental payable:	
Due to State agency	22,119
Due to local government	100
Capital leases	99
Decreases (increases) in accrued compensated absences is reported as expense in the statement of activities	(1,131)
Costs less accumulated depreciation of capital assets disposed of are reported as expenses in the statement of activities	(1,368)
INCREASE IN NET ASSETS - GOVERNMENTAL ACTIVITIES	$ 288,694

See accompanying Notes to Financial Statements.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2007

(In Thousands)

		Agency Funds
ASSETS:		
Cash and cash equivalents	$	108,032
Accrued interest receivable		1,397
Due from State Highway Fund		5,856
Total assets		115,285
LIABILITIES:		
Accounts payable		11,592
Deposits for rights of way		332
Special deposits and bonds		2,506
Funds held for all counties		100,855
Total liabilities	$	115,285

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, or entities that if excluded would make the financial statements misleading or incomplete. 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, and (1) it is able to impose its will on that organization or (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 fiscally dependent 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 501 (c)(3) of the Internal Revenue Code of 1996, as amended (the Code). The Association was formed to assist the South Carolina Department of Transportation in the financing, acquisition, construction, and operation of 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. The Association's year end is December 31, and all financial information included in this report is for the year ended December 31, 2006.

For the purpose of applying GAAP to its activities, the Association's management has determined that the Association should be treated as 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 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 of the State. Although the Department operates somewhat autonomously, it lacks full powers. In addition, the Governor and/or the General Assembly appoint 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. The presentation of the Department's financial position and Statement of Revenues, Expenditures, and Changes in Fund Balance, differs from the State of South Carolina's Comprehensive Annual Financial Report primarily due to adjusting certain transactions that exist between the Department and the South Carolina Transportation Infrastructure Bank.

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 not to apply those standards and interpretations issued by the Financial Accounting Standards Board after 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 Fund:

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.

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. 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 agreements 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. The Department's appropriation from the State's General Fund is also included in this fund. All of the Department's activities are included in this one fund because this is how the Department is presented in the State's financial statements.

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 or for non-exchange transactions, when all eligibility requirements have been met, 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, except for principal and interest on general debt, 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 and depreciation of equipment. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Non-operating revenues include interest earned on cash equivalents and investments. Non-operating expenses include amortization (a) of its intangible interest in the License Agreement with the Department, and (b) underwriters' fees. In addition, interest expense on the Association's debt, license fees to the Department, and maintenance expenses to the Department are reported as non-operating expenses.

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 or authorized; 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 contingent upon the federal authority to claim the funds. 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 governmental fund, Other Budgeted Funds by the State of South Carolina, is by annual appropriations for public transportation by the General Assembly. The appropriation as enacted becomes the legal operating budget for the State Highway Fund. Please refer to the information contained in Required Supplementary Information for the budget to actual and notes regarding the governmental fund.

The Association's Board of Directors adopts an annual non-appropriated operating budget. The Board of Directors also approves any amendments to the budget during the year. The budget is prepared using the modified accrual (non GAAP) basis for Revenue Fund (as defined in the Trust Agreement) expenses. Expenses are recognized in the period in which they are paid rather than the period in which they are incurred for budgetary control purposes. Depreciation and amortization are not recognized as expenses, but capital outlays are recognized as expenses for budgetary control purposes. The expenses are reclassified for the purpose of preparing basic financial statements in accordance with governmental GAAP. Since the Association's activities are accounted for in a proprietary fund, a budget-to-actual comparison is not presented in the accompanying basic financial statements.

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 hand, deposits 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 (Note 2). 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. Infrastructure assets acquired prior to fiscal years ended after June 30, 1980 are reported at cost beginning with fiscal year 1917. 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 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 between four and 10 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 (see Note 6 for further details). 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.

All of the Association's receivables are reported net of any allowances for uncollectible amount and any discounts.

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, 2007.

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. The current and non-current portions of bonds payable are recorded as liabilities in the accompanying Statements of Net 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. An arbitrage liability at June 30, 2007 of $4 thousand exists, due to the fact the Richland County Transportation Committee did not expend all of a $2.2 million bond proceed issued against the Department's bonding capacity within the stated spend down time. This liability is to be paid by the Richland County Transportation Committee and will not be a liability of the Department.

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, 2006, 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, 2006, 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, 2006.

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, 2006 the Rebate Fund was inactive.

Deferred Revenue

Deferred revenue in the government-wide financial statements 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.

Deferred revenue in the fund financial statements represents the long-term portion of receivables that will not be collected within one year of the balance sheet date and advance payments for construction projects.

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, 2007. 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, 2006, 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, 2006, 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:

(In Thousands)

Financial Statements			Footnotes		
Primary Entity:					
Unrestricted current assets:					
Cash and cash equivalents	$	197,543	Cash on hand	$	-
Restricted noncurrent assets:			Deposits held by State		
Cash and cash equivalents		10,000	Treasurer		315,575
Fiduciary - Agency Funds					
Cash and cash equivalents		108,032			
Total Primary Entity		315,575			315,575
Component Unit					
Unrestricted current assets:					
Cash and cash equivalents		703			
Investments		321			
Restricted current assets:					
Cash and cash equivalents		1,501	Bank Deposits		1,024
Investments		1,017			
Restricted noncurrent assets:					
Cash		567			
Investments		15,878	Investments		18,963
Total component unit		19,987			19,987
TOTAL	$	335,562		$	335,562

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. The State's investment policy by law authorizes investments that vary by fund, but generally include 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, certain corporate bonds, and commercial paper.

Custodial credit risk for investments is the risk that in the event of a failure of the counterparty to a transaction, the State will not be able to recover the value of investments or collateral securities that are in possession of an outside party. All of the State Treasurer's investments are fully insured or collateralized. More 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 an unrealized loss of $830 thousand for the governmental funds and $493.2 thousand for the fiduciary funds as of June 30, 2007 arising from changes in the fair value. The interest/investment income includes a gain of $1.08 million for the year ended June 30, 2007.

Securities Lending Program

By law , the State Treasurer may lend securities from its investment portfolios on a collateralized basis to third parties, primarily financial institutions, with a simultaneous agreement to return the collateral for the same securities in the future. The State may lend United States government securities, corporate bonds, other securities and equities for collateral in the form of cash or other securities. The contracts with the State's custodians requires them to indemnify the State if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the State for income distributions by the securities' issuers while the securities are on loan.

The weighted average maturity of the State's collateral investments generally matched the maturity of the securities loans during the fiscal year ended at June 20, 2007. At June 30, 2007, the State had no credit risk exposure to borrowers because the amounts the State owed the borrowers exceeded the amounts the borrowers owed the State. Either the State or the borrower can terminate all securities loans on demand. There are no restrictions on the amount of the loans that can be made. For the fiscal year ended June 30, 2007, the State experienced no losses on its securities lending transactions because of borrower defaults.

The State receives primarily cash as collateral for its loaned securities. The market value of the required collateral must meet or exceed 102.0% of the market value of the securities loaned, providing a margin against a decline in the market value of the collateral. During the fiscal year ended June 30, 2007, the State met the 102.0% requirement. The State cannot pledge or sell collateral securities unless the borrower defaults. The lending agent, on behalf of the State, invests cash collateral received. Accordingly, at June 30, 2007, the State recorded these investments of cash collateral as assets in the CAFR. Corresponding liability amounts also have been recorded because the State must return the cash collateral to the borrower upon expiration of the loan. Amounts included in the accompanying statement of net assets and balance sheet – governmental fund is the Department's proportionate share of the invested securities lending collateral.

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.

Custodial credit risk for deposits is the risk, that in the event of a bank failure, the Association's deposits might not be recovered. The Association does not have a formal deposit policy for custodial credit risk but follows the guidelines outlined in the Association's trust agreement. As of December 31, 2006 approximately $449 thousand of the Association's bank balances of approximately $1.050 million, with a carrying value of $1.025 million, were uninsured and uncollateralized.

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

Investments

The Association does not have a formal policy for limiting the investment maturities that would help manage its exposure to fair value losses from increasing interest rates. Custodial credit risk for investments is the risk that in the event of a bank failure, the government will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Association does not have a formal written policy for custodial credit risk but follows the guidelines outlined in the trust agreement. As of December 31, 2006, none of the Association's investments were exposed to custodial credit risk. Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Association does not have a formal investment policy for credit risk but follows the guidelines outlined in the Association's Trust Agreement. The Association places no limit on the amount the Association may invest in any one issuer. Investments issued by or explicitly guaranteed by the U. S. Government and investments in mutual funds, external investment pools and other pooled investments are exempt from concentration of credit risk disclosures. All of the Association's investments in repurchase agreements are with Lehman Brothers.

As of December 31, 2006, the Association had the following investments as defined by GASB:

(In Thousands)

Investment Type	Credit Rating	Fair Value	Percentage of Total Investment	Weighted Average maturity (In Years)
Open Ended Treasury Money Market Funds	AAAM, Aaa, NR	$ 2,068	10.9%	0.003
US Treasury Note	N/A	718	3.8%	0.986
Repurchase Agreements	N/A	16,177	85.3%	11.000
Total Investments		$ 18,963		9.420

The investment types listed above include all investment types in which monies were held during the year ended December 31, 2006. None of the above investments were on deposit with the South Carolina State Treasurer.

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 2006-2007 Appropriation Act.

(In Thousands)

STATE APPROPRIATIONS	
Original appropriation	$ 1,101
Earmark Supplemental Appropriations	8,680
Total Appropriation	$ 9,781

NOTE 4. RECEIVABLES:

Primary Entity:

The following schedule summarizes receivables at June 30, 2007, which include various notes, contracts and other accounts receivable.

(In Thousands)

Due From / Description	Current Portion	Long-term Portion (A)	Totals
Intergovernmental:			
Federal Government:			
Amounts due under various grant programs and reimbursable contracts	$ 94,427	$ -	$ 94,427
	94,427	-	94,427
State Agencies:			
South Carolina Department of Motor Vehicles License Fees	3,690	-	3,690
South Carolina State Infrastructure Bank Reimbursement	798	-	798
South Carolina Department of Revenue Gasoline and special fuels taxes	47,445	-	47,445
Various Agencies: Sales of good and services	4,193	-	4,193
	56,126	-	56,126
Local Governments:			
Long-term contracts for construction projects	1,242	6,430	7,672
Participation agreements	7,299	-	7,299
	8,541	6,430	14,971
Other:			
Long-term contracts for construction projects	756	279	1,035
Participation agreements	1,634	-	1,634
Sales of goods and services	5,792	-	5,792
Less: allowance for doubtful accounts	(4,397)	-	(4,397)
	3,785	279	4,064
Total Receivables	$ 162,879	$ 6,709	$ 169,588

(A) Due to long-term nature of this portion of the receivables, the entire amount has been offset as a as deferred revenues in the governmental fund as they are not currently available. Receivables are shown net of allowances.

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, 2006, the Association's receivable was comprised of interest in the amount of $4.1 thousand.

NOTE 5. INVENTORIES:

The following schedule summarizes inventories at June 30, 2007:

(In Thousands)

Sign Shops	$	3,207
Repair Shops		887
Supply Depot		1,417
	$	5,511

NOTE 6. CAPITAL ASSETS:

PRIMARY ENTITY:

The following schedule summarizes changes in capital assets of the Department for the year ended June 30, 2007:

(In Thousands)

	Beginning Balances June 30, 2006	Increases	Decreases	Ending Balances June 30, 2007
Capital assets not being depreciated:				
Land and improvements	$ 3,721	$ -	$ -	$ 3,721
Right of ways land	1,181,003	17,302	10	1,198,295
Construction in progress:				
Infrastructure - road and bridge network	3,725,667	359,342	176,610	3,908,399
Other	18,577	1,462	5,992	14,047
Total capital assets not being depreciated	4,928,968	378,106	182,612	5,124,462
Other capital assets:				
Infrastructure - road and bridge network	8,684,669	176,610	5,245	8,856,034
Buildings and improvements	61,305	5,992	-	67,297
Equipment and furniture	108,592	6,284	3,994	110,882
Vehicles	89,527	4,339	5,332	88,534
Other Asset	1,500	-	-	1,500
Total other capital assets	8,945,593	193,225	14,571	9,124,247
Less accumulated depreciation for:				
Infrastructure - road and bridge network	2,093,581	127,797	4,086	2,217,292
Buildings and improvements	24,047	2,193	-	26,240
Equipment and furniture	78,182	7,182	3,848	81,516
Vehicles	68,024	5,794	5,279	68,539
Total accumulated depreciation	2,263,834	142,966	13,213	2,393,587
Other capital assets, net	6,681,759	50,259	1,358	6,730,660
Total capital assets for governmental activities, net	$ 11,610,727	$ 428,365	$ 183,970	$ 11,855,122

The following schedule summarizes additions to capital assets and their funding sources for the year ended June 30, 2007:

(In Thousands)		
Additions:		
Increases per above:		
Capital assets not being depreciated	$	378,106
Other capital assets		193,225
Less, transfers from construction in progress:		
capital assets not being depreciated		(182,602)
Total additions	$	388,729
Funding Sources:		
Governmental funds	$	280,782
Donated capital assets:		
South Carolina Transportation Intrastructure Bank		107,947
Total funding Sources	$	388,729

Included in the Department's capital assets as of June 30, 2007 is $192.47 million 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 $29.94 million at June 30, 2007. Depreciation expense on these assets for the year ended June 30, 2007 was $5.25 million.

At June 30, 2007, the estimated total costs of Department projects in progress to construct, acquire and maintain various capitalized assets amounted to approximately $21.46 million for facilities capital projects and approximately $5.32 billion for infrastructure projects including capital and non-capital. The estimated costs to complete the facilities capital projects amounted to approximately $7.41 million and the infrastructure projects amounted to approximately $927.05 million at June 30, 2007. The outstanding contractual obligations attributable to the facilities capital projects were approximately $1.2 million and to the infrastructure projects were approximately $406.28 million. 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, 2006:

(In Thousands)

	Balance December 31, 2005	Increases	Decreases	Balance December 31, 2006
Capital assets:				
Interest in License Agreement with SCDOT	$ 192,472	$ 8	$ -	$ 192,480
Equipment	586	46	(5)	627
Subtotal - Capital Assets	193,058	54	(5)	193,107
Less accumulated depreciation/				
Amortization:				
Interest in License Agreement	24,696	5,243	-	29,939
Equipment	496	26	(5)	517
Subtotal-Accum. Deprec/Amortization	25,192	5,269	(5)	30,456
Totals-Net	$ 167,866	$ (5,215)	$ -	$ 162,651

For the year ended December 31, 2006 depreciation and amortization expense related to capital assets was $5.629 million.

The Association had no construction commitments outstanding at December 31, 2006.

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, 2007:

(In Thousands)

	Beginning Balances June 30, 2006	Increases	Decreases	Ending Balances June 30, 2007	Due Within One Year
General obligation					
bonds payable	$ 699,025	$ -	$ 36,080	$ 662,945	$ 41,430
Unamortized discounts, premiums	835	-	55	780	55
Unamortized deferred loss					
on refunding of bonds	(191)	-	(48)	(143)	(48)
Total Bonds Payable	699,669	-	36,087	663,582	41,437
Intergovernmental Payable					
Due to State agency	306,055	19,305	22,119	303,241	22,318
Due to Local Governments	300	-	100	200	100
Capital Leases payable	116	-	99	17	17
Accrued Compensated					
absences	21,897	17,700	16,570	23,027	15,311
Total Governmental Activities	$ 1,028,037	$ 37,005	$ 74,975	$ 990,067	$ 79,183

The Department has an additional amount due to the state agencies of $12,135, which is included in the current portion of due to state agencies in the accompanying statement of net assets.

The following schedule summarizes principal and interest expenditures/expenses attributable to long-term obligations of the Department for year ended June 30, 2007:

	Principal	Interest	Totals
Bonds Payable	$ 36,080	$ 31,657	$ 67,737
Contributions Payable	22,119	5,808	27,927
Notes Payable	100	-	100
Capital Leases	99	3	102
Total Expenditures	$ 58,398	$ 37,468	$ 95,866
Adjustments to Department-wide statements			
Change in interest accrual - bonds payable		(476)	
Total Interest Expense		$ 36,992	

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 $88.9 million 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, 2007 is as follows:

(In Thousands)

Issue Date	Series	Original Face Amount	Maturity Date	Interest Rates	Ending Principal Balance
8/1/1995	1995	$20,000	8/1/2010	3.500-5.400%	$ 1,900
1/1/1996	1996A	30,000	2/1/2011	4.125-5.000%	10,140
10/1/1997	1997A	30,000	10/1/2012	4.500-5.000%	14,930
4/1/1998	1998A	17,500	4/1/2023	4.500-6.500%	13,555
3/1/1999	1999A	200,000	5/1/2019	4.500-4.600%	162,000
1/1/2001	2001A	2,000	1/1/2021	4.500-6.000%	1,620
4/1/2001	2001B	350,000	4/1/2021	4.750-5.500%	273,260
10/1/2003	2003A	2,200	10/1/2018	5.00%	1,880
6/1/2003	2003B	46,080	7/1/2021	2.000-4.000%	44,310
4/1/2005	2005A	146,495	8/1/2022	3.000-5.000%	139,350
					662,945
Add, unamortized premium					780
Less, unamortized deferred loss on refundings of bonds					(143)
Total bonds payable					$ 663,582

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

(In Thousands)

	Principal	Interest	Totals
Year ending June 30:			
2008	$ 41,430	$ 29,976	$ 71,406
2009	43,770	27,996	71,766
2010	45,095	25,961	71,056
2011	46,790	23,822	70,612
2012	43,570	21,654	65,224
2013 - 2017	231,650	77,932	309,582
2018 - 2022	198,200	22,892	221,092
2023	12,440	223	12,663
Total debt service for bonds payable	$ 662,945	$ 230,456	$ 893,401

On June 1, 2003, the Department issued $46.08 million in general obligation State Capital Improvement Refunding Bonds, Series 2003B. The purpose of the issuance was for advance refunding of $39.675 million of the Series 1996B bonds. Proceeds from the new bond issue consisted of the following:

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

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

Underwriter's discount	$ 322.5
Other issuance cost	74.1
	396.6
Accumulated Amortization	(89.5)
Balance of unamortized issuance costs	$ 307.1

Amortization of bond issuance costs for the year ended June 30, 2007 was $21,939.

The Department deposited $46.34 million in an escrow account with Bank 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 million 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 $5.7 million. 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, 2007 since a call premium was pre-funded. The bonds were 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 million and to obtain an economic gain of approximately $2.230 million (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 2003B bonds:

Escrow deposit	$46,340
Less:	
Principal amount refunded	(39,675)
Accrued interest deposited	(956)
Deferred loss on refunding of bonds Payable	5,709
Accumulated amortization of deferred loss	(5,709)
Balance of unamortized deferred loss	$ -

On April 1, 2005, the Department issued $146.4 million in general obligation State Capital Improvement Bonds, Series 2005A, of which $6.495 million was used to advance refund $6.5 million of the Series 1995 Bonds. Proceeds from the new bond issue consisted of the following:

Face amount of bonds	$ 146,495
Premium	294
Total	$ 146,789

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

Underwriter's discount	$ 310
Other issuance cost	154
	464
Accumulated Amortization	(60)
Balance of unamortized issuance costs	$ 404

Amortization of bond issuance costs for the year ended June 30, 2007 was $26.8 thousand.

The Department deposited $6.5 million 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 $6.5 million 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 of $246.5 thousand. 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 thousand and to obtain an economic gain of approximately $255 thousand (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
Less:	
Principal amount refunded	(6,500)
Deferred loss on refunding of bonds Payable	246
Accumulated amortization of deferred loss	(102)
Balance of unamortized deferred loss	$ 144

Amortization of the deferred loss on refundings of bonds payable for the year ended June 30, 2007 was $47 thousand.

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, 2006	102%
August 1, 2006 through July 31, 2007	101%
August 1, 2007 and thereafter	100%

These bonds were refunded in part and the $6.495 million 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 General Obligation 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 General Obligation 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 General Obligation 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 General Obligation 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 General Obligation 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 the Trust Agreement. 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 - $66.2 million original principal amount at issuance; interest payable semi-annually on January 1 and July 1 at rates of 5.250% and 5.375%; $21.4 million of bonds mature January, 2023; $44.8 million of bonds mature January, 2038. There was an original issue discount on the Series 1998A bonds at issuance of $2.693 million.

Series 1998B: Series 1998B Senior Capital Appreciation Toll Road Revenue Bonds, which were dated 2/11/98 - $87.4 million original principal amount at issuance; interest accretes at various rates ranging from 5.30% to 5.85%; $438.1 million 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 - $46.6 million original principal amount at issuance; interest accretes at various rates ranging from 6.15% to 6.30%; $241.8 million 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, 2006:

(In Thousands)

	Beginning Balances December 31, 2005	Increases	Decreases	Ending Balances December 31, 2006
Senior Bonds				
Series 1998A	$ 66,200	$ -	$ -	$ 66,200
Original Issue Discount on 1998A	(2,058)	80		(1,978)
Subtatal Series 1998A	64,142	80	-	64,222
Series 1998B	136,792	7,996	-	144,788
Subordinate Bonds				
Series 1998C	75,653	4,794	-	80,447
Totals	$ 276,587	$ 12,870	$ -	$ 289,457

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 Senior Capital Appreciation Toll Road Revenue Bonds, and 1998C Subordinate Capital Appreciation Toll Revenue Bonds. At December 31, 2006, no principal payments on bonds were due within one year.

A summary of debt service requirements to maturity for the bonds is as follows as of December 31, 2006:

(In Thousands)

Year ending December 31:	Principal	Interest	Totals
2007	$ -	$ 3,532	$ 3,532
2008	6,200	3,508	9,708
2009	6,700	3,460	10,160
2010	7,300	3,411	10,711
2011	8,100	3,358	11,458
2012-2016	55,400	15,886	71,286
2017-2021	87,700	14,072	101,772
2022-2026	122,000	11,740	133,740
2027-2031	161,600	8,643	170,243
2032-2036	192,000	4,598	196,598
2037-2038	99,100	446	99,546
	746,100	$ 72,654	$ 818,754
Unamortized discounts	(456,643)		
Totals	$ 289,457		

The terms of the Trust Agreement require the establishment of bank accounts as listed below. 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 the 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 funds 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, 2006 were as follows:

(In Thousands)

Fund	**Amount December 31, 2006**
Construction	$ 9
Revenue	169
Debt Service	2,340
Debt Service Reserve	16,446
Total	$ 18,964

During the year ended December 31, 2006, 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. During 2006, the Association notified the trustee that funding of the Renewal and Replacement Fund was seventh in the flow of funds listing of the trust agreement. To the extent that revenues are insufficient to make any such deposits, the amounts to be transferred to the Renewal and Replacement Funds are to be deferred.

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 ("Revenue Covenant"). In addition, before the beginning of each fiscal year, the Association is required to review its financial status in order to estimate and determine whether Net Revenues (as defined) for the current and following fiscal year will be sufficient to comply with the Revenue Covenant. The Trust Agreement also specifies actions (i.e. toll rate study, etc.) to be taken if the Association determines that revenues may be inadequate to meet this covenant. The projected net toll revenues were insufficient to meet the Revenue Covenant. In compliance with its obligations under the Indenture, the Association interviewed several nationally recognized traffic and revenue consultants and hired URS Corporation (the Toll Rate Consultant). The Toll Rate Consultant undertook to study the traffic and toll rates charged by the Association and to advise the Association whether changes to the tolls rates would enable the Association to meet the Revenue Covenant. The Toll Rate Consultant issued three reports on studies it conducted in 2005, 2006, and 2007, each of which concluded that revising the toll rates would not, in the opinion of the Toll Rate Consultant, permit the Association to meet the Revenue Covenant. Each of the reports contained suggested modification to the toll rates and certain Association policies which would, in the opinion of the Toll Rate Consultant, increase net revenues, although by an amount insufficient to meet the Revenue Covenant.

Toll rates for the Southern Connector were set by the Department in the License Agreement. Such rates are automatically increased on five year intervals. The first (and only) rate adjustment occurred January 1, 2005. The 2005 toll rate increase resulted in a decrease in the traffic using the highway. The next toll rate adjustment is scheduled to occur January 1, 2010. The Association has no authority to modify the toll rate schedule previously set by the Department in the License Agreement. The Association can give no assurance that the Department will revise the toll rates as recommended by the Consultant. Furthermore, the Association can give no assurance that, if the toll rates are changed as recommended by the Toll Rate Consultant, that the net toll revenues will increase. Finally, even if the toll rates are modified as recommended by the Toll Rate Consultant, the report does not forecast that sufficient toll revenues will be produced to permit the Association to timely pay all of the principal and interest on the Bonds due during the forecast period.

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

The Association monitors the covenants for compliance throughout the year. The Association believes it was in compliance with its bond covenants throughout 2006.

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 twelfth 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 $247.5 million interest bearing loan to Horry County.

During fiscal year 2006 the Department and the Bank entered into an agreement to extend the original Horry County agreement. This agreement extends an additional $12 million to complete the Horry Ride Projects, $10 million to complete the Lexington project, $10 million to complete the Beaufort project and $62.1 million for the bridge demolition project in Charleston. Annual installments of $10 million begin in 2009 and continue until 2022.

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, 2007 and account balances of each year-end:

(In Thousands)

Project	Beginning Balance June 30, 2006	Increases	Decreases	Ending Balance June 30, 2007
Horry Ride Project				
Phase I	$ 24,000	$ -	$ 10,000	$ 14,000
Phase II	72,154	-	4,119	68,035
Phase I Extension	41,901	19,305	-	61,206
Charleston County Project	168,000	-	8,000	160,000
Totals	$ 306,055	$ 19,305	$ 22,119	$ 303,241

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

Year Ending June 30	Principal	Interest	Total
2008	$ 22,318	$ 3,282	$ 25,600
2009	22,526	3,074	25,600
2010	22,745	2,855	25,600
2011	22,974	2,626	25,600
2012	23,213	2,387	25,600
2013-2017	95,298	7,907	103,205
2018-2022	54,167	1,033	55,200
2023-2027	40,000	-	40,000
Totals	$ 303,241	$ 23,164	$ 326,405

US 17 Beaufort and Colleton Counties. During fiscal year 2007, the Department and the Bank entered into an agreement to fund Phase I widening of US17 through Beaufort and Colleton Counties. Total project cost is estimated to be $100 million. Funding consist of $11 million in federal dollars; $7 million contribution from Beaufort County; and Bank assistance in the form of an $82 million loan being repaid by the Department in annual installments of $4.9 million including 4.44% interest for 30 years commencing in fiscal year 2008.

NOTE 10. LEASE OBLIGATIONS:

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

The Department entered into various capital leases for the purchase of imaging equipment costing $1.301 million. Principal payments made to date totaled $1.284 million leaving unpaid balances of $17 thousand. 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, 2007 totaled $149,844 of which $98,946 was principal, $3,090 was interest and $47,808 was executory costs. The carrying value of the imaging equipment purchased with capital leases at June 30, 2007 was $0.

The Department incurred approximately $412,354 in expenditures applicable to contingent rental agreements that are based on a pay-per-copy arrangement, with no required minimum usage requirements. All contingent rental agreements are with external parties.

The following schedule summarizes future commitments for capital leases as of June 30, 2007. The Department had no operating leases at June 30, 2007.

(In Thousands)

Year Ending June 30,		
2008	$	25
Total		25
Less:		
Interest		-
Executory costs		(8)
Capital lease obligations, at June 30, 2007	$	17

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 the SC 153 Extension and has assumed various additional responsibilities. 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 $173.8 million, 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. 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). At December 31, 2006, the Association has unpaid SCDOT deferred maintenance and related interest of $452,816 and $47,733 respectively. The Department is responsible for setting the toll rates in accordance with the terms of the License Agreement. The SC 153 Extension 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.

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. Beginning July 1, 2005, the employees' participation percent in the SCRS increased .25% to a total 6.25%. Effective July 1, 2006, the employer contribution rate became 11.40%, which included a 3.35% surcharge to fund retiree health and dental insurance coverage. The Department's actual contributions to the SCRS for the years ended June 30, 2007, 2006 and 2005 were approximately $13.8 million, $12.8 million, and $12.6 million respectively, and equaled the required contributions of 8.05% (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $255 thousand 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, 2006, the employer contribution rate became 13.65%, which, as for the SCRS, included the 3.35% surcharge. The Department's actual contributions to the PORS for the years ended June 30, 2007, 2006 and 2005 were approximately $30 thousand,

$30 thousand, and $13 thousand 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 $581 and accidental death insurance contributions of approximately $581 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, 2007.

The Department recorded for the years ending June 30, 2007, 2006, and 2005 employer contributions expenditures within the applicable functional expenditure categories for these insurance benefits for active employees of approximately $18.5 million, $18.6 million and $18.0 million respectively. As discussed in Note 12, the Department paid for the years ending June 30, 2007, 2006 and 2005 approximately $5.70 million, $5.53 million and $5.44 million 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 $13.8 million for the year ended June 30, 2007. The Department sells supply items and provides services for various State agencies. Total sales to State agencies were approximately $19,308 for the year ended June 30, 2007.

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 $456.5 million for the year ended June 30, 2007. Gasoline tax revenues collected by DOR for the County Transportation Program Agency Fund amounted to $67.8 million for the year ended June 30, 2007. $47.4 million was unremitted and due to the Department by DOR at June 30, 2007.

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 2006 Appropriations Act. This amount is recorded as an expense/expenditure in the accompanying statement of activities and the statement of revenues, expenditures, and changes in fund balance.

(In Thousands)

Statewide Cost Allocation Plan (Proviso 53.4)		
Collection of highway revenues	$	1,022
Central Service Agencies recoveries	$	624
Total	$	1,646

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 2007 of $9.1 million were paid to the State Accident Fund.

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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 2007 for which it was paid $174 thousand. Allocations to other entities - State agency represented amounts paid to the Bank and totaled $25.67 million for the year ended June 30, 2007 of which $1.5 million 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 Horry County loan payments to the Bank.

A summary of intergovernmental payables to State agencies at June 30, 2007 is as follows:

(In Thousands)

Due To / Description		
South Carolina State Infrastructure Bank		
1 cent per gallon gasoline tax, reimbursement of cost, and license fees	$	6,844
Fees and Licenses:		
South Carolina State Infrastructure Bank		4,166
Purchases of goods and services:		
Clemson University		288
S. C. Department of Motor Vehicles		177
Department of Public Safety		164
County Transportation Program		160
State Budget and Control Board		149
S.C. Department of Corrections		103
Department of Natural Resources		48
S.C. Department of Revenue		24
Parks, Recreation & Tourism		6
Vocational Rehabilitation		4
Forestry Commission		2
Total	$	12,135

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.

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 participant 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 overages to a State or commercial insurer.

The Department has not reported an estimated claims loss expenditure, and the related liability at June 30, 2007, 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, 2007 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, 2006.

NOTE 18. OTHER MATTERS – COMPONENT UNIT

The sole corporate purpose of the Association is to design, finance, acquire, construct and operate the Southern Connector. At the time the Bonds were issued, Wilber Smith Associates prepared a Traffic and Revenue Study (the "Original Study") to estimate the future utilization of the road and toll revenues for the Association. The actual traffic on the highway and toll revenues received by the Association has been substantially less than projected in the Original Study. Currently, the Association is not receiving sufficient toll revenues to pay debt service on the Senior Bonds. The shortfall has been covered by withdrawals from the Senior Bonds Debt Service Reserve Account maintained by the Trustee under the Indenture. In compliance with the provisions of the continuing disclosure requirements, the Association has filed the required "Event Notice" for each withdrawal from the Senior Debt Service Reserve Account used to pay a portion of the interest payments in 2006 and 2005. In addition, interest has accreted on the Capital Appreciation Bonds, which are currently not payable. Due to the factors noted above, the Association has experienced an increase of $19.95 million for 2006 in the Association's net deficit to a total of $108.4 million as of December 21, 2006.

Debt service on the bonds will increase sharply starting in January 2008 as principal begins to mature. The Association engaged a traffic and revenue consultant to prepare a series of toll rate studies to advise the Association regarding the toll rates necessary to maximize toll revenue from the Southern Connector. Even if the recommendation of the consultant are effected, however, unless the traffic and revenues increase by amounts greater than projected in the consultant's reports, management of the Association estimates that within the next five years the reserve funds maintained by the Trustee will be depleted and toll revenues will be insufficient to pay principal and interest on the bonds in full. Management of the Association is investigating the possibility of restructuring its long term indebtedness; however, there can be no assurance that nay restructuring will be successful.

NOTE 19. 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 is involved in unresolved legal actions concerning the procurement of construction contracts. The Department believes its positions are meritorious and it is vigorously defending its position. In the event of an unfavorable outcome, the Department's liability could be $3.7 million and that amount is recorded as a liability in the financial statements.

Through June 30, 2007, the State's Joint Bond Review Committee approved the issuance by the Department not to exceed $926 million in General Obligation State Highway Bonds for projects. As of June 30, 2007, $889 million 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 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 30th 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 30th. Currently the Association and Trustee are working under the extended Tolling Agreement as neither party has given notice of its expiration. In compliance with the provisions of the Continuing Disclosure Agreement with the Trustee, the association filed Event Notice No 2007-1 announcing that the Trustee withdraw funds from the Senior Bonds Debt Service Reserve Account in order to pay a portion of the interest payment due on January 2, 2007.

South Carolina Department of Transportation
Budgetary Comparison Schedule (Non-GAAP Budgetary Basis)
Governmental Fund
For the Fiscal Year Ended June 30, 2007
(In Thousands)

	Budgeted Amounts		Actual Amounts (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues				
Earmarked	$ 233	$ 80,681	$ 80,475	$ (206)
General fund	1,101	9,781	1,139	(8,642)
Restricted	1,285,306	1,285,306	1,004,012	(281,294)
Total Revenues	**1,286,640**	**1,375,768**	**1,085,626**	**(290,142)**
Expenditures				
General Administration				
Personal services	14,071	14,322	13,196	1,126
Other operating	19,920	29,810	27,029	2,782
Debt services	-	110	110	-
Land & Buildings				
Other operating	1,450	2,400	2,282	118
Permanent improvement	7,100	6,150	1,540	4,610
Engineering - Adm. Proj. Mgmt.				
Personal services	71,129	71,129	68,298	2,831
Other operating	13,829	13,779	8,850	4,929
Permanent improvements	-	50	5	45
Engineering - Construction				
Other operating	100,000	110,750	102,873	7,877
Permanent improvements	633,963	700,650	425,980	274,670
Allocations	13,000	13,750	9,659	4,091
Highway Maintenance				
Personal services	92,158	92,158	90,116	2,042
Other operating	229,052	229,062	184,572	44,490
Permanent improvements	750	750	1	749
Mass Transit				
Personal services	800	800	478	322
Other operating	750	750	457	293
Allocations	20,872	21,552	16,862	4,690
Toll Operations				
Personal services	234	234	154	80
Other operating	3,479	3,479	3,355	124
Employer Contributions	64,083	64,083	60,120	3,963
Total Expenditures	**1,286,639**	**1,375,768**	**1,015,937**	**359,832**
Net increase (decrease) in fund balance- budgetary basis	-	-	69,689	69,690
Fund balance beginning of year-budgetary basis	83,182	83,182	83,182	-
Fund balance end of year - budgetary basis	$ 83,182	$ 83,182	$ 152,871	$ 69,690

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2007

NOTE 1. BUDGETARY FUNDS

South Carolina's Annual Appropriation Act, the State's legally adopted budget, does not present budgets by GAAP fund. Instead, it presents program-level budgets for the following two funds:

General Funds. These funds are general operating funds. The resources in the funds are primarily taxes. The State expends General Funds to provide traditional State government services.

Total Funds. The Total Funds column in the Appropriations Act includes all budgeted resources. Amounts in this column include General Funds as well as most, but not all, federal and department-generated resources. Total funds include portions of certain proprietary and capital project fund activities as well as most special revenue activities but exclude the pension trust funds and some other fiduciary fund activities.

The Department's legally adopted budget is part of the Total Funds budget for the State. It is presented for the State Highway Fund at the program level including the restricted, earmarked, and general funds appropriated to the Department.

NOTE 2. ORIGINAL AND FINAL BUDGETED AMOUNTS; BASIS OF PRESENTATION

The original appropriations presented in the accompanying schedule for the State Highway Fund include amounts in the Appropriations Act as well as any appropriation reductions specifically authorized by law to prevent duplicate appropriations. The terminology, classification, and format of the appropriations section of the accompanying schedule for department's governmental fund is substantively the same as for the legally enacted budget.

The State's General Assembly does not approve estimated revenue or fund balance amounts for Other Budgeted Funds which include the State Highway Fund. However, Section 70 (*Recapitulations)* of the Appropriation Act includes net *source of funds* amounts (i.e. estimated cash brought forward from the previous fiscal year plus estimated revenue for the current fiscal year minus estimated cash to be carried forward to the following fiscal year) for three categories of Other Budgeted Funds: Federal, Earmarked, and Restricted. A budget versus actual comparison for the State Highway Fund is presented as required supplementary information.

As operating conditions change, the Department may move appropriations between programs and classifications within programs. However limits are place on increasing/decreasing authorizations for personal services without Budget and Control Board approval. Also, a revision of budgeted amounts over and above the total revenues appropriated requires approval of the Budget and Control Board.

NOTE 3: LEGAL LEVEL OF BUDGETARY CONTROL

The Department maintains budgetary control at the level of summary objective category of expenditure within each program of each department or agency which is the level of detail presented in the accompanying schedule.

NOTE 4: BASIS OF BUDGETING

Current legislation states that the General Assembly intends to appropriate all monies to operate State government for the current fiscal year. Unexpended appropriations lapse on July 31 unless the department or agency is given specific authorization to carry them forward to the next fiscal year. Cash-basis accounting for payroll expenditures is used.

State law does not precisely define the State's basis of budgeting. In practice, however, it is the cash basis with the following exceptions:

- Departments and agencies shall charge certain vendor and interfund payments against the preceding fiscal year's appropriations through July 17.
- The gasoline and motor fuel taxes are recorded on the modified accrual basis in accordance with State law.
- All other revenues are recorded only when the State receives the related cash.

NOTE 5: RECONCILIATION OF BUDGET TO GAAP REPORTING DIFFERENCES

The accompanying budgetary comparison schedule compares the Department's legally adopted budget with actual information in accordance with the legal basis of budgeting. Budgetary accounting principles however differ significantly from GAAP accounting principles. Basis differences arise because the basis of budgeting differs from the GAAP basis used to prepare the statement of revenues, expenditures, and changes in fund balance.

(In Thousands)

	State Highway Fund
Net increase in fund balance - budgetary basis	$ 69,689
Basis of accounting differences:	
Debt service principal and interest payments are a cash appropriation transfer for budget purposes but shown as an expenditure on the govermental fund statements	(95,866)
Proceeds from intergovernmental payable are shown as revenue on governmental fund statement but are not budgeted	19,305
Change in federal revenue accrual between 2006 and 2007	9,379
Other basis differences	3,663
Net increase in fund balance - GAAP basis	$ 6,170

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION
COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 2007
(In Thousands)

	---Assets---			
	Cash and Cash Equivalents	Accrued Current Receivable	Due from State Highway Fund	Total Assets
RIGHT OF WAYS FUND				
Balance at June 30, 2006	$ 335	$ -	$ -	$ 335
Additions	1	-	-	1
Deductions	(4)	-	-	(4)
Balance at June 30, 2007	332	-	-	332
ADVANCE RIGHT OF WAY FUND				
Balance at June 30, 2006	5,387	-	-	5,387
Additions	3,647	-	-	3,647
Deductions	(1,824)	-	-	(1,824)
Balance at June 30, 2007	7,210	-	-	7,210
SPECIAL DEPOSITS				
Balance at June 30, 2006	3,097	-	-	3,097
Additions	2,076	-	-	2,076
Deductions	(2,490)	-	-	(2,490)
Balance at June 30, 2007	2,683	-	-	2,683
COUNTY TRANSPORTATION FUND				
Balance at June 30, 2006	88,006	736	11,950	100,692
Additions	100,919	1,397	67,050	169,366
Deductions	(91,118)	(736)	(73,144)	(164,998)
Balance at June 30, 2007	97,807	1,397	5,856	105,060
TOTALS - ALL AGENCY FUNDS				
Balance at June 30, 2006	96,825	736	11,950	109,511
Additions	106,643	1,397	67,050	175,090
Deletions	(95,436)	(736)	(73,144)	(169,316)
Balance at June 30, 2007	$ 108,032	$ 1,397	$ 5,856	$ 115,285

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, 2007
(In Thousands)

	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, 2006	$ -	$ 335	$ -	$ -	$ 335
Additions	-	1	-	-	1
Deductions	-	(4)	-	-	(4)
Balance at June 30, 2007	-	332	-	-	332
ADVANCE RIGHT OF WAY FUND					
Balance at June 30, 2006	5,387	-	-	-	5,387
Additions	1,824	-	-	-	1,824
Deductions	-	-	-	-	-
Balance at June 30, 2007	7,211	-	-	-	7,211
SPECIAL DEPOSITS					
Balance at June 30, 2006	161	-	2,936	-	3,097
Additions	34	-	2,057	-	2,091
Deductions	(18)	-	(2,487)	-	(2,505)
Balance at June 30, 2007	177	-	2,506	-	2,683
COUNTY TRANSPORTATION FUND					
Balance at June 30, 2006	8,261	-	-	92,431	100,692
Additions	4,175	-	-	97,648	101,823
Deductions	(8,232)	-	-	(89,224)	(97,456)
Balance at June 30, 2007	4,204	-	-	100,855	105,059
TOTALS - ALL AGENCY FUNDS					
Balance at June 30, 2006	13,809	335	2,936	92,431	109,511
Additions	6,033	1	2,057	97,648	105,739
Deletions	(8,250)	(4)	(2,487)	(89,224)	(99,965)
Balance at June 30, 2007	$ 11,592	$ 332	$ 2,506	$ 100,855	$ 115,285

See accompanying independent auditors' report.

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2007

Federal Grantor / Program Title	Federal CFDA Number	Total Federal Expenditures	Expenditures To Subreceipients
Direct Programs:			
U.S. Department of Transportation			
Highway Planning and Construction	20.205*	$ 542,384,188	$ -
Federal Transit - Capital Investment Grants	20.500	2,927,880	2,927,880
Federal Transit - Metropolitan Planning Grants	20.505	490,783	452,340
Fomula Grants for Other Than Urbanized Areas	20.509*	9,172,920	8,557,260
Capital Assistance Program for Elderly Persons and Persons with Disabilities	20.513	1,944,489	1,720,284
State Planning and Research	20.515	78,750	78,750
Total Direct Programs		556,999,010	13,736,514
Indirect Programs:			
Federal Emergency Management Agency			
Passed Through SC Emergency Preparedness Public Assistance Grants	83.544	489,724	-
Totals		$ 557,488,734	$ 13,736,514

* Indicates major program

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2007

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, 2006 through June 30, 2007. This information is presented on the accrual basis of accounting.

Report 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. Richard H. Gilbert, Jr., CPA,
Deputy 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, 2007, which collectively comprise the Department's basic financial statements and have issued our report thereon dated October 1, 2007. Our report was modified to include a reference to other auditors. We conducted our audits 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. Other auditors audited the financial statements of the Connector 2000 Association, Inc., as described in our report on the Department's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies or material weaknesses. However, as discussed below, we identified certain a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider deficiency 2007-1 described in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is a material weakness.

Compliance and Other Matters

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 or other matters that are required to be reported under *Government Auditing Standards.*

We noted a certain matter 2007-2 that is described in the accompanying schedule of findings and responses.

The Department's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Department's response and, accordingly, we express no opinion on it.

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, 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 1, 2007

SCOTT + MCELVEEN LLP

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

Mr. Richard H. Gilbert, Jr., CPA,
Deputy 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, 2007. 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, 2007.

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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 purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

A control deficiency in the Department's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program is more than inconsequential will not be prevented or detected by the Department's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Department's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses as defined above.

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, 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 1, 2007

SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2007

Section I—Summary of Auditors' Results

Financial Statements

1.	Type of auditor's report issued:	Unqualified Opinion	
2.	Internal control over financial reporting:		
	Material weakness identified:	x yes	___ no
	Significant deficiency identified not considered to be material weaknesses?	___ yes	x no
3.	Noncompliance material to the Financial Statements noted?	___ yes	x no

Federal Awards

4.	Internal control over major programs:		
	Material weaknesses identified:	___ yes	x no
	Significant deficiency identified not considered to be a material weakness?	___ yes	x 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)?	___ yes	x 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

Significant Deficiency Considered to be a Material Weakness and/or Violation of State Laws, Rules, or Regulations

2007-1 Recording of Participation Receivables and Revenue

Condition:

The Department provided us with an internally prepared participation agreement schedule. This schedule is used to record the receivables, revenue, and deferred revenue related to participation by various third-parties in the payment of infrastructure and maintenance projects. Key elements in the calculations are the participant's agreed-upon allotment, total project allotment, cash received, the third-party participation percentage, and the cumulative expenditures for the project. Errors were found in the schedule for the documented participant's allotment, total project allotment, cash received, third-party participation percentage, and project expenditures. Also, there was a project on the schedule that should not have been included because it was a State Transportation Infrastructure Bank project rather than a Department project. Further, when the revenue and deferred revenue were recorded, the prior year revenue recognized was not taken into an account.

Cause:

The primary cause for the inaccuracies in the schedule is that the accounting department is not provided the agreements with third party participants. The agreements contain the provisions of the participation. Normally, the project engineers negotiate and maintain copies of these agreements.

The matter of not taking into account prior year revenue when recording current year amounts was an oversight by the accounting department.

Effect:

Often, the accounting department is not aware of the existence of a participation agreement until the participant sends a payment. When the payment is receipted, the accounting department is not aware of the total amount of participation expected from the participant, and thus, does not have adequate information to determine how much of the receipt is revenue or deferred revenue. It also does not have the information to determine if additional receipts are expected and if a receivable should be recorded during the period for future participation. Further, the budget staff does not have adequate documentation to determine how much to allot to the project for the participant and in some cases does not have adequate information to properly allot the entire project. Finally, when participation amounts are amended, accounting and budget staff do not receive the documentation required to amend the participation schedule and budget allotments.

An audit difference of $1,800,000 was noted to adjust the participation revenue and deferred revenue. An audit difference related to this matter was also noted during last year's audit. In addition, as a result of the accounting department not accounting for the prior year revenue recognized, an adjustment of $14,683,000 was required.

Criteria:

Good accounting practices dictate that all schedules and amounts recorded in the financial statements be adequately supported by corroborating evidence.

Recommendation:

We recommend that:

- The Department implement policies and procedures whereby the accounting division is provided with documentation of all key elements of the participation process.
- The Department not record any revenue or receivables for amounts not adequately supported with corroborating evidence.
- The accounting department match all participation projects included in schedule to the supporting contracts, participant's current allotments and change history, project allotment and change history, and to a statement of cumulative project expenditures. A file containing the above documentation should be maintained for each project for as long as the project remains on the schedule.
- The schedule include total amount of revenue recognized in prior years, current year project expenditures, and the percent of completion for the project. This will add needed clarity to the schedule and prevent financial statement misstatements.
- Create 3 subsections to participation schedule
    - Section A will include all projects where expenditures in excess of original allotment are covered by third party participant
    - Section B will include all projects where expenditures in excess of original allotment are covered by the Department
    - Section C will include all projects where expenditures in excess of original allotment are shared by third party participant and the Department
- In some cases, the third-party participant has paid cash in excess of the original allotment recorded on the schedule. Due to this scenario, we recommend that the participation percentage be recorded based on the greater of the participant allotment or total cash received divided by total allotment.
- Recognize revenue on percentage of completion basis as function of current year project expenditures to:
    - Greater of total expenditures or allotment for Section A participants.
    - Total allotment for Section B participants.
    - Amount determined for Section C participants.

We acknowledge the complexity of the accounting for participation agreements. We commend the accounting department's efforts to improve this area each year. With improved communication and cooperation from other departments within the Department involved in the process, additional improvements can be made.

Other Comment not considered to be a Significant Deficiency and/or a Violation of State Laws, Rules, or Regulations

2007-2 Develop a Fraud Risk Management Program

Condition:

In light of the spate of notorious frauds involving large companies in the last few years, such as Enron, WorldCom, and HealthSouth, there may be a misperception that fraud affects only large publicly owned companies. However, fraud occurs in entities of all sizes, and almost any employee may be capable of perpetrating a fraudulent act given the right set of circumstances. In order to address the risk of fraud, many organizations have developed a Fraud Risk Management Program. The Department does not have such a program.

Cause:

The Department has not allocated the appropriate resources to develop a Fraud Risk Management Program.

Effect:

The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and inadequate controls to prevent or detect fraud. The absence of a Fraud Risk Management Program for the Department increases its exposure to fraud.

Criteria:

Risk assessment, including fraud risk assessment, is one element of internal control. Thus, the Department's internal control structure should include performance of this assessment.

Recommendation:

We recommend that the Department perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation through the development of a Fraud Risk Management Program. Performance of these measures will help to mitigate the Department's exposure to fraud and misappropriation.

Section III—Federal Award Findings and Questioned Costs

Major Programs:

There were no federal award findings or questioned costs for the year ended June 30, 2007.

Prior Year Comments:

During the current year audit, we reviewed the status of corrective action taken on the Financial Statement Findings as reported in our prior year's report on internal control and compliance of the Department dated September 29, 2006, resulting from the audit of the financial statements for the year ended June 30, 2006. We found that adequate corrective action was taken for all of the management letter comments, findings and questioned costs except for items 2006-1 and 2006-5, which are repeated above as comments 2007-1 and 2007-2.

SCDOT
South Carolina
Department of Transportation

CORRECTIVE ACTION PLAN

October 12, 2007

Richard H. Gilbert, Jr., CPA
Deputy State Auditor
Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, SC 29201

Dear Mr. Gilbert;

The South Carolina Department of Transportation respectfully submits the following Corrective Action Plan for the year ended June 30, 2007.

The Plan outlines actions, taken, or to be taken, to address:

- "significant deficiencies considered to be material weaknesses and/or violations of state law, rules, and regulations", and
- "control deficiencies not considered to be material weaknesses, significant deficiencies, and/or violations of state laws, rules and regulations",

contained in the audit report prepared by Scott McElveen, LLP dated October 1, 2007. Each audit recommendation is repeated prior to our response and numbered as in the audit report.

Condition Considered to be a Material Weakness and/or Violation of State Law, Rule, or Regulation

2007-1 Recording of Participation Receivables and Revenue

Recommendation:

We recommend that:

- The Department implement policies and procedures whereby the accounting division is provided with documentation of all key elements of the participation process.
- The Department not record any revenue or receivables for amounts not adequately supported with corroborating evidence.
- The accounting department match all participation projects included in schedule to the supporting contracts, participant's current allotments and change history,

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project allotment and change history, and to a statement of cumulative project expenditures. A file containing the above documentation should be maintained for each project for as long as the project remains on the schedule.

- The schedule include total amount of revenue recognized in prior years, current year project expenditures, and the percent of completion for the project. This will add needed clarity to the schedule and prevent financial statement misstatements.
- Create 3 subsections to participation schedule
    - Section A will include all projects where expenditures in excess of original allotment are covered by third party participant
    - Section B will include all projects where expenditures in excess of original allotment are covered by the Department
    - Section C will include all projects where expenditures in excess of original allotment are shared by third party participant and the Department
- In some cases, the third-party participant has paid cash in excess of the original allotment recorded on the schedule. Due to this scenario, we recommend that the participation percentage be recorded based on the greater of the participant allotment or total cash received divided by total allotment.
- Recognize revenue on % of completion basis as function of current year project expenditures to:
    - Greater of total expenditures or allotment for section A participants.
    - Total allotment for section B participants.
    - Amount determined for section C participants.

We acknowledge the complexity of the accounting for participation agreements. We commend the accounting department's efforts to improve this area each year. With improved communication and cooperation from other departments within the Department involved in the process, additional improvements can be made.

Corrective Action

The accounting department has already begun to review the internally prepared schedule for participation agreements, revenue, deferred revenue, and accounts receivable associated with the agreements. The schedule is being modified taking into account the above recommendations and will be reviewed by management quarterly. Also accounting is working with the various engineering areas and the contract services area to review policies as necessary and obtain supporting documentation such as signed agreements, letters, etc. to substantiate the amounts to be recorded and ensure that in the future documentation is provided to accounting as new agreements are made. Meetings are being established with accounting, budget, federal aid, and engineering to review the various agreements and participation match programs. These meetings will begin in late October 2007 and will continue through out the year to ensure all amounts are properly recorded and documented. This finding is repeated from previous audits and every effort is being made to ensure the deficiencies are corrected.

Control Deficiencies not considered to be Material Weaknesses, Significant Deficiencies, and/or Violations of State Laws, Rules, or Regulations

2007-2 Develop a Fraud Risk Management Program

Recommendation:

We recommend that the Department perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation through the development of a Fraud Risk Management Program. Performance of these measures will help to mitigate the Department's exposure to fraud and misappropriation.

Corrective Action

The Department recognizes the importance of developing a comprehensive fraud risk management program as a part of the Department's overall Internal Control Policies, and has the support of top management. Recent discussions have been held with the current staff of Contract Audits, Director of Finance and Administration, and the Secretary of Transportation to focus a group to review and implement where necessary, the development of standard operating procedures, identifying deficiencies in procedures and policies that would allow fraud to occur, and create an awareness of identifying and reporting possible fraud through out the department.

If we can provide any additional information, please do not hesitate to call.

Angela R Feaster, CGFO

Angela R. Feaster, CGFO
Controller

cc.ScottMcElveen