NORTH CAROLINA

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

MICHAEL F. EASLEY
GOVERNOR

ROBERT L. POWELL
STATE CONTROLLER

Prepared by Statewide Accounting Division
Office of the State Controller

http://www.ncosc.net/

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Special appreciation is given to the chief fiscal officers and the dedicated accounting personnel throughout the State. Their efforts to contribute accurate and timely financial data for their agencies, universities, community colleges, and institutions made this report possible.

MICHAEL F. EASLEY
Governor of North Carolina

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INTRODUCTORY SECTION

State of North Carolina
Office of the State Controller

Michael F. Easley, Governor | Robert L. Powell, State Controller

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Citizens of North Carolina

It is our pleasure to furnish you with the 2004 Comprehensive Annual Financial Report (CAFR) of the State of North Carolina in compliance with G.S. 143B-426.39. This report has been prepared by the Office of the State Controller. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the State government and this office. To the best of our knowledge and belief, this financial report is complete and reliable in all material respects. We believe all disclosures necessary to enable you to gain an understanding of the State's financial activities have been included.

Although the State budgets and manages its financial affairs on the cash basis of accounting, G.S. 143-20.1 requires the Office of the State Controller to prepare a comprehensive annual financial report (CAFR) in accordance with generally accepted accounting principles in the United States of America (GAAP). Except for exhibits and notes clearly labeled otherwise, this CAFR has been prepared in accordance with GAAP.

For the convenience of users we have divided this comprehensive annual financial report into three major sections, described as follows:

- The **introductory section** includes this transmittal letter and the State's organization chart, including a listing of principal State officials.
- The **financial section** includes management discussion and analysis, the basic financial statements (government-wide financial statements, fund financial statements, and notes), other required supplementary information, the combining and individual fund financial statements, and schedules.
- The **statistical section** includes selected financial, non-financial and demographic information, much of which is presented on a ten-year basis, as well as required supplementary information.

Management of the government is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, requires that management provide a narrative introduction, overview and analysis to accompany the Basic Financial Statements in the form of management discussion and analysis (MD&A). This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

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Raleigh, NC

Profile of the Government

State Reporting Entity and Its Services

The State of North Carolina entity as reported in the CAFR includes all fund types of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches. In addition, the reporting entity includes legally separate component units for which the State is financially accountable. The component units are discretely presented in the government-wide financial statements. The State's discretely presented major component units are the University of North Carolina System; the State's community colleges; Golden LEAF, North Carolina Housing Finance Agency, and North Carolina State Education Assistance Authority. The criteria for inclusion in the reporting entity and its presentation are defined by the Governmental Accounting Standards Board (GASB) in its GASB Codification Section 2100. These criteria are described in Note 1 of the accompanying financial statements.

The State and its component units provide a broad range of services to its citizens, including public education; higher education; health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; transportation; agriculture; and general government services. The costs of these services are reflected in detail and in summary in this report.

Budgetary Control

In addition to internal controls discussed previously, the State maintains budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the General Assembly. Activities of the General Fund and most departmental special revenue funds are included in the annual appropriated budget. The State Highway Fund and the Highway Trust Fund, the State's major special revenue funds, are primarily budgeted on a multi-year basis. Capital projects are funded and planned in accordance with the time it will take to complete the project. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is exercised at both the departmental and university level by way of quarterly allotments, with allotment control exercised by the State Controller, and on the program line-item levels requiring certain approvals by the Director of the Budget. Legislative authorization of departmental expenditures appears in the State Appropriation Bill. This "Certified Budget" is the legal expenditure authority; however, the Office of State Budget and Management (OSBM) may approve executive changes to the legal budget as allowed by law. This results in the "Final Budget" presented in the required supplementary information.

Economic Condition and Outlook

National Economic Outlook

After experiencing robust growth during the first half of the 2004 calendar year, the nation's economy is now working through what is commonly referred to as a "soft patch". This weakness is due to a combination of record energy prices (in actual dollars) and periodic warnings of potential terrorist activity. An additional issue has to do with the fact that the stimulus from three federal tax packages enacted in recent years is starting to run out.

	2001-02 Actual	2002-03 Actual	2003-04 Actual	2004-05 Projected
U.S. INDICATORS				
Real Economic Growth*	0.8%	2.3%	4.4%	3.5%
Nonfarm Employment	-1.0%	-0.6%	0.2%	1.7%
Personal Income	2.0%	2.1%	4.7%	4.9%
Industrial Production	-3.5%	0.5%	2.4%	4.4%
Corporate Profits (Pre-Tax)	-8.6%	17.3%	15.2%	12.1%
Short-Term Interest Rates (Actual Rate)	2.3%	1.4%	1.0%	2.0%
Mortgage Rates (Actual Rate)	6.9%	6.0%	5.7%	6.1%
Inflation (CPI)	1.8%	2.2%	2.2%	2.5%

*Adjusted for inflation.

It will be interesting to see how the current weakness affects the speed with which the Federal Reserve ratchets up interest rates. As recently as last winter many observers felt that the tenuous nature of the recovery would eliminate any rate hikes during 2004. Fed officials even confirmed this operating strategy in unusually candid public remarks.

However, strong growth during the first few months of the year led to a re-examination of the position last spring. After raising the benchmark federal funds rate from .75% to 1% on June 30 and to 1.25% in August, the Federal Reserve is now signaling additional rate hikes will take place at a "measured" pace. The message to be gleaned from the Fed's language is that future actions will depend on how the economic data falls out. The recent weakness may cause monetary officials to hold off on the anticipated September increase, especially in light of their pronouncements about the impact of high energy prices.

In any case, the die has been cast and rates will rise over the next couple of years. During the 1994 tightening, short term borrowing rates rose from 3% to 6% in a 13-month period. Economy.com, the forecasting firm used by Fiscal Research, expects the rates to rise to 2.0% by the first quarter of 2005 and to top out at 5.0% during the first quarter of 2007. The forecasting firm used by the Office of State Budget and Management, Global Insight Inc., is also expecting a 2.0% rate by the end of this year, rising to 3.5% by 2006.

A continuing problem for the economy is the subpar recovery in jobs. This is due to a combination of the movement of jobs overseas and the reticence of employers to ramp up staffing levels in an atmosphere of uncertainty. North Carolina is on the front line of this shift, due in part to NAFTA. This impact had begun well before the 2001 recession, as shown by the job growth data below:

N.C. Employment Growth
In Selected Major Sectors

Year	Manufacturing	Finance	Services
1994	0.5%	1.2%	7.6%
1995	0.5%	1.9%	4.5%
1996	-1.7%	8.2%	4.5%
1997	-1.0%	7.4%	5.7%
1998	-0.5%	5.3%	6.0%
1999	-2.5%	-0.4%	6.0%
2000	-2.4%	0.7%	3.3%
2001	-7.1%	4.6%	1.4%
2002	-8.6%	.7%	1.1%
2003	-6.1%	1.5%	.7%

A second issue has to do with the impact of higher energy prices on consumer spending. From late winter 1999 to early summer 1999, gas prices in North Carolina rose from around 80 cents per gallon to $1.00, and to $1.25 by early 2000. Once motorists realized that the increase might be more than a temporary spike, they cut back on purchases of other items (except for vehicles).

One way to measure this impact is to look at gross state and local sales tax collections. After rising 8.6% for the second quarter of 1999, the rate of increase fell to 6.3% for the third quarter, 5.4% for the fourth quarter, and to 4.5% by the first quarter of 2000. This problem was compounded by the fact that heavy promotional activity by auto dealers propped up car sales. The net result of these factors meant that the additional dollars going to vehicle purchases and energy costs "crowded out" spending on other items.

So far the impact of higher energy prices in 2004 on the overall economy and retail sales has been muted. For one thing, the recovery in equity prices has enhanced the "paper wealth" of many investors. In addition, the substitution of natural gas and other energy sources for fuel oil has minimized the impact of higher fuel prices on manufacturing production costs and family budgets. A third factor is the cash received by homeowners who have refinanced their mortgages.

A concern is that financing for retail activity may be coming from additional credit card usage and such levels cannot be sustained indefinitely. A measure of this issue is the fact that unlike the 1992-94 recovery, sales tax collections are growing much faster than withholding tax receipts.

Due to this concern and the phase out of the impact of the 2001-03 federal tax cuts, the underlying national economic assumptions used in the budget reflect the expectation that growth will slow during the 2004-05 fiscal years.

State Prospects

One of the primary characteristics of the 2001 recession was the impact on the manufacturing sector. This is important to North Carolina because 15% of our nonagricultural employment is in manufacturing versus 11% for the U.S. A more important measure is the share of Gross State Product represented by manufacturing: 21% in North Carolina versus 16% for the nation.

The loss of manufacturing jobs did not begin with the 2001 recession. Data compiled by the Employment Security Commission indicate that manufacturing experienced a fairly rapid recovery from the 1990-91 recession, with employment growth of 2.6% in 1993. In fact, the "boom and bust" nature of manufacturing is one reason why the state's economy grew 33% faster than the national experience following the 1981-82 recession and 45% quicker following the Gulf War downturn. Expressed another way, North Carolina was the fifth fastest growing state during the 1992-93 period in terms of personal income, due in part to the recovery in manufacturing.

After a leveling off period, manufacturing employment began a steady decline in mid-1995 due to the mild national economic slowdown and the kicking in of NAFTA. The rate of decline began to accelerate in February 2001 and peaked at an 8.6% rate in 2002. Particularly hard hit were the textile and apparel sectors, with North Carolina jobs in these sectors dropping over 15% on a year-over-year basis by the spring of 2001. While the rate of decline has slowed due to the start of the economic recovery, the erosion continues. The only saving grace is that the loss of traditional jobs has been so great that these sectors exert a much smaller impact on the overall economy than in the past.

For the 2004-05 fiscal year, we are budgeting on the basis of a continued subpar economic recovery in North Carolina, both in terms of the absolute level and the normal growth premium relative to the U.S. This experience would be very different from the explosive growth in the state's economy during the last two recoveries.

NORTH CAROLINA INDICATORS	2001-02 Actual	2002-03 Actual	2003-04 Actual	2004-05 Projected
Personal Income	2.2%	2.3%	5.2%	5.5%
Nonfarm Employment	-2.1%	-1.1%	0.1%	2.1%
Unemployment Rate (Actual Rate)	6.5%	6.5%	6.0%	5.4%
Average Hourly Earnings (Manufacturing)	2.6%	2.6%	4.4%	3.2%
Retail Sales	2.5%	1.1%	6.7%	3.9%
Housing Activity	7.3%	6.1%	17.0%	-14.3%
Auto Sales	-5.5%	-1.4%	8.5%	-10.9%

— Economic analysis prepared by David Crotts
Fiscal Research Division
North Carolina General Assembly
October 29, 2004

Issues and Observations

During fiscal year 2004, the Governor, the General Assembly, and the departments and agencies of State government worked to address key issues facing State government and the citizens of North Carolina. More discussion of the financial issues of North Carolina can be found in the Management's Discussion and Analysis (MD&A) section of this document.

Other Post-Employment Benefits

Rising healthcare costs continue to be a concern throughout the State and the nation. Healthcare costs impact State budget programs through increasing expenses not only in Medicaid, but also in other State and federal healthcare programs. In recent years, adjustments have been made to deductibles, co-payments, and benefits coverage under the State Health Plan in an attempt to slow the growth of State budget healthcare costs.

In light of the current and future concerns related to rising healthcare costs, the Governmental Accounting Standards Board (GASB) has been working on the issuance of accounting and reporting standards for other post-employment benefits since the mid-90's. In April 2004, GASB issued **Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*** (effective for fiscal year 2006-07), and in June 2004, GASB issued **Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*** (effective for fiscal year 2007-08).

These new standards will require governmental employers to start accounting for the cost of certain post employment benefits while employees are still working. Public sector employers already accrue the cost of pensions as employees are working. These new standards will have a significant impact for most state and local governments. In addition to pensions, many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. The cost of these future benefits is a part of the cost of providing public services *today*. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits, such as life insurance and disability. Currently, the State and most other governmental employers finance OPEB plans on a pay-as-you-go basis. The financial statements generally do not report financial effects of OPEB until the promised benefits are paid, often many years after the related employee services are received.

These new GASB standards will improve the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service, and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. In addition, the proposed accounting change would provide information useful in assessing potential demands on the employer's future cash flows.

In preparation for the implementation of these new standards, the General Assembly through the 2004 Appropriations Act established the Retiree Health Benefit Trust Fund to hold accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and their applicable beneficiaries. Employer contributions to the Fund are irrevocable. The assets of the Fund are dedicated to providing health benefits to retired and disabled employees and their applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions.

Three actuarial studies related to retiree healthcare have been completed as the State has worked to get its hands around the issue and how to deal with it. Each of the three studies, beginning in 1996, have reflected a substantial liability related to the State's commitment to provide healthcare to teacher and state employee retirees. The unfunded actuarial liability has grown based on two formal studies from $5.4 billion in 1996, to $8.1 billion in 1999. More recently, based on an informal estimate, the unfunded accrued liability may be in excess of $10 billion in 2004. This informal study does not reflect any changes that may arise in 2006 due to the "Medicare Prescription Drug, Improvements, and Modernization Act of 2003".

Beginning in fiscal year 2006-07, the actuarial data will be disclosed in the notes to the State CAFR and will also be presented as Required Supplementary Information (RSI). The unfunded actuarial liability will not be recorded as an accounting liability but will be disclosed in the notes to the financial statements, and as required supplementary information.

Beginning with the 2008 CAFR, the difference between the State's contractual requirement and the amount the State contributes or pays for retiree medical benefits will be recorded as an accounting liability on the State's government-wide financial statements.

The State's largest OPEB plan, the Retiree Health Care Plan, is currently being funded on a pay-as-you-go basis, resulting in a significant unfunded actuarial liability. The principal results of the Plan's most recent actuarial valuation are as follows:

Because the GASB's proposed guidance on OPEB will significantly impact the State's CAFR, we have the following recommendations:

- ***The State needs to obtain an actuarial valuation for the retiree health plan at least biennially***. Annual valuations would be preferable for a state of our size, due to the potential impact on teachers and state employees.
- On a prospective basis, the State should consider the long-term impact of the current benefits structure as well as potential changes to that structure**.**

Information Technology

The 2004 General Assembly dedicated considerable time and effort into the evaluation of current information technology management, organization, and operations at the statewide and agency levels for North Carolina State government. The result of that evaluation was legislation enacted in Senate Bill 991 that overhauled information technology authority by transferring it from a central management committee to the Chief Information Officer for the State.

Senate Bill 991 provides for the abolishment of the Information Resources Management Committee, the heretofore approval and oversight group for IT projects, and consolidated all functions under the Chief Information Officer. These functions include:

- **Responsibility for the review, approval and management of all IT projects above an established threshold;**
- **The authority to proceed with an enterprise approach for procurement of IT products and services and the authority to implement such solutions;**
- **The responsibility for review and approval of all agency IT plans and the development of a biennial State Information Technology Plan for submission to the General Assembly;**
- **An assessment of the IT inventory throughout State government and an assessment of the IT deficiencies along with a five year plan for unmet needs;**
- **The creation of an Information Technology Fund that may be used to meet statewide enterprise needs as approved by the General Assembly; and**
- **The authority to establish IT standards statewide.**

In short, the General Assembly adopted the proposal of the Governor to bring the management, oversight and operations of information technology under the direct control of the Governor.

Included in Senate Bill 991 is the continuation of the State Business Infrastructure Program (SBIP) that has been in progress since 2002. This project was authorized by the 2002 General Assembly to evaluate the State's core business functions and report back to the General Assembly with an assessment and plan to address deficiencies. This activity occurred in two phases that included an inventory and assessment, followed by a blueprint for addressing priority deficiencies. The final report was presented to the 2004 General Assembly and funding was authorized under Senate Bill 991 to proceed with the development of business requirements for the most "at risk" component of the study, Human Resources and Payroll (HR/Payroll).

Under the guidance of the Office of the State Controller, and in collaboration with the State Personnel Officer, Chief Information Officer, and Deputy State Budget Officer, the business development phase for HR/Payroll is currently underway. This process is scheduled to be completed by late Spring, at which time an RFP will be developed and the General Assembly will be asked to consider funding for the implementation phase of this component of the SBIP.

If funding is approved, the HR/Payroll implementation will begin by late 2005 with an expected implementation period of between 18 to 24 months.

Concurrent with this is the next phase of the SBIP, the development of a statewide data warehouse for consolidation of information for use by state managers. The SBIP Program Steering Committee will be considering a plan for moving forward with this component of the SBIP within the next thirty to sixty days. Depending on the development plan, the data warehouse project is expected to begin in early 2005.

Financial Information

The MD&A provides an overview of the State's financial activities addressing both governmental and business-type activities reported in the government-wide financial statements. In addition, MD&A focuses on the State's major funds: the General Fund, the Highway Fund and the Highway Trust Fund.

Pension Benefits

The State contributes to the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Legislative Retirement System, the Firemen's and Rescue Squad Workers' Pension Fund, the Supplemental Retirement Income Plan of North Carolina, and the North Carolina National Guard Pension Fund. The Local Governmental Employees' Retirement System is administered by the State but the State is not a participant.

The retirement systems experienced a total return from investments of 12.01% for the one-year period, a return of 4.85% for the three-year period and a return of 4.18% for the five-year period, ended June 30, 2004. These returns represent strong investment results, and reflect the conservative asset allocation and attention to investment quality that have guided the plan's investment policy. The combined North Carolina Retirement Systems lead the nation in fiscal health because of wise management, consistent state contributions and a conservative investment strategy.

The Teachers' and State Employees' Retirement System (TSERS), the largest of the pension trust funds, continued to be fully funded, based on the December 31, 2003 actuarial valuation. Specifically, the TSERS was funded at 108.1%, with the actuarial value of assets of $45.118 billion exceeding the actuarial accrued liability of $41.734 billion by $3.384 billion at December 31, 2003. Employer contributions to the TSERS increased by $55.8 million above the prior fiscal year. Investment balances increased by $3.546 billion, or 8.21% above the prior fiscal year, with a net investment income of $5.132 billion. The TSERS experienced a $149.3 million increase in benefit payments to retirees, an increase of 7.4% from fiscal year 2003.

Debt Administration

The State's general obligation bonds are rated Aa1 by Moody's, AAA by Standard & Poors, and AAA by Fitch. These favorable ratings have enabled the State to sell its bonds at interest rates considerably below the Bond Buyer's Index, thereby providing substantial savings to North Carolina taxpayers.

Cash Management

It is the policy of the State that all agencies, institutions, departments, bureaus, boards, commissions and officers of the State shall devise techniques and procedures for the receipt, deposit and disbursement of monies coming into their control and custody which are designed to maximize interest-bearing investment of cash, and to minimize idle and nonproductive cash balances. The State Controller, with the advice and assistance of the State Treasurer, the State Budget Officer, and the State Auditor, develops, implements, and amends the *Statewide Cash Management Policy*. All cash deposited with the State Treasurer by State entities is managed in pooled investment accounts to maximize interest earnings. During fiscal year 2004, uncommitted State funds were invested in short-term and medium-term U.S. Government notes and bonds, as well as other deposits, which had a composite average yield of 3.22%.

Risk Management

The State maintains self-insurance programs for employee health; general liability; medical malpractice; workers' compensation; and automobile, fire and other property losses. The State limits its risk for general liability; medical malpractice; and automobile fire and other property losses by purchasing private insurance for losses in excess of deductibles. See Note 14 of the Notes to the Financial Statements for a full description of the State's risk management program.

Other Information

Independent Audit

In compliance with State statute, an annual financial audit of the State reporting entity is completed each year by the North Carolina Office of the State Auditor. The Auditor's examination was conducted 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, and his opinion has been included in this report. In addition, the State coordinates the *Single Audit* effort of all federal funds through the State Auditor.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of North Carolina for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2003. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

Acknowledgments

In conclusion, we believe this report provides useful data to all parties using it in evaluating the financial activity of the State of North Carolina. We in the Office of the State Controller express our appreciation to the financial officers throughout State government and to the Office of the State Auditor for their dedicated efforts in assisting us in the preparation of this report. Any questions concerning the information contained in this Comprehensive Annual Financial Report should be directed to the Office of the State Controller at (919) 981-5454.

Respectfully submitted,

Robert L. Powell
State Controller

December 8, 2004

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Certificate of Achievement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

President

Executive Director

ORGANIZATION OF NORTH CAROLINA STATE GOVERNMENT INCLUDING PRINCIPAL STATE OFFICIALS

EXECUTIVE BRANCH

Council of State

- Governor — **Michael F. Easley**
- Lieutenant Governor — **Beverly E. Perdue**
- Secretary of State — **Elaine F. Marshall**
- State Auditor — **Ralph Campbell, Jr.**
- State Treasurer — **Richard H. Moore**
- Superintendent of Public Instruction — **Dr. Michael E. Ward**
- Attorney General — **Roy A. Cooper, III**
- Commissioner of Agriculture — **Britt Cobb, Jr.**
- Commissioner of Labor — **Cherie K. Berry**
- Commissioner of Insurance — **James E. Long**

Cabinet Secretaries — Appointed by the Governor

- Administration — **Gywnn T. Swinson**
- Correction — **Theodis Beck**
- Crime Control and Public Safety — **Bryan E. Beatty**
- Cultural Resources — **Lisbeth C. Evans**
- Commerce — **James T. Fain**
- Environment & Natural Resources — **William G. Ross, Jr.**
- Health and Human Services — **Carmen Hooker Odom**
- Juvenile Justice and Delinquency Prevention — **George L. Sweat**
- Revenue — **E. Norris Tolson**
- Transportation — **W. Lyndo Tippett**

Appointed by Governor, confirmed by Legislature

- Office of the State Controller — **Robert L. Powell**, ***State Controller***
- State Board of Education — **Howard N. Lee**, ***Chairman***

Appointed by State Board of Community Colleges

- **H. Martin Lancaster**, ***President***

Appointed by University Board of Governors

- **Molly C. Broad**, ***President***

LEGISLATIVE BRANCH

General Assembly

Senate

President
Lieutenant Governor

President Pro Tempore
Marc Basnight

Deputy Pres. Pro Tempore
Charlie Smith Dannelly

Majority Leader
Tony Rand

Minority Leader
James Forrester

House of Representatives

Co-Speakers
James B. Black
Richard T. Morgan

Democratic Leader
Joe Hackney

Republican Leader
Joe Kiser

JUDICIAL BRANCH

North Carolina Supreme Court

Chief Justice
I. Beverly Lake, Jr.

Associate Justices
Edward Thomas Brady
Robert H. Edmunds, Jr.
Paul Newby
Mark D. Martin
Sarah Parker
George L. Wainwright, Jr.

Administrative
Office of the Courts
Judge Ralph A. Walker
Director

Component Units

- *University of North Carolina System*
- *The Golden LEAF, Inc.*
- *NC Housing Finance Agency*
- *Community Colleges*
- *State Education Assistance Authority*
- *Other Component Units*

State of North Carolina Web Page
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INDEPENDENT AUDITOR'S REPORT

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of North Carolina, as of and for the year ended June 30, 2004, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of North Carolina'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 North Carolina Housing Finance Agency, which represent 9 percent, 3 percent and 3 percent, respectively, of the assets, net assets and revenues of the aggregate discretely presented component units; the financial statements of the State Education Assistance Authority, which represent 14 percent, 5 percent and 2 percent, respectively, of the assets, net assets and revenues of the aggregate discretely presented component units; the financial statements of the University of North Carolina System – University of North Carolina Health Care System – Rex Healthcare, which represent 2 percent, 2 percent and 4 percent, respectively, of the assets, net assets and revenues of the aggregate discretely presented component units; nor the financial statements of the 401(K) Supplemental Retirement Income Plan, which represent 3 percent, 4 percent and 5 percent, respectively, of the assets, net assets and revenues of the aggregate remaining fund information. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports 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. The financial statements of the University of North Carolina System – University of North Carolina Health Care System – Rex Healthcare and the financial statements of the 401(K) Supplemental Retirement Income Plan were not audited in accordance with *Governmental Audit Standards*. 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 and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of North Carolina, as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 20 to the financial statements, the State of North Carolina implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units* and Governmental Accounting Standards Board Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues,* during the year ended June 30, 2004.

In accordance with *Government Auditing Standards*, we will also issue our report dated December 8, 2004 on our consideration of the State of North Carolina'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 report on internal control and on compliance and other matters will be published at a later date in the State of North Carolina's *Single Audit Report.*

The Management's Discussion and Analysis on pages 28 through 48, the schedules of funding and contributions for all defined benefit pension trust funds on pages 150 and 151 and the Budgetary Comparison Schedule and Notes – General Fund on pages 152 through 155 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries 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 State of North Carolina's basic financial statements. The introductory section, the combining fund financial statements and schedules, and the statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

December 8, 2004

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MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The following is a discussion and analysis of the State of North Carolina's (the State's) financial performance, providing an overview of the activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section.

Financial Highlights

Government-wide Financial Statements:

- The State's total net assets increased slightly as a result of this year's operations. While net assets of governmental activities increased by $613.2 million, or nearly 2.7 percent, net assets of business-type activities decreased by $204.5 million, or about 21.3 percent (decline related to the Unemployment Compensation Fund). At year-end, net assets of governmental activities and business-type activities totaled $22.98 billion and $754.1 million, respectively.
- Component units reported net assets of $10.66 billion, an increase of $1.08 billion or 11.3 percent from the previous year. The majority of the increase ($762 million) is due to the net increase in capital assets for the University of North Carolina System and community colleges (component units). The capital asset additions were financed in part by State debt proceeds.
- GASB Statement No. 39 became effective during the fiscal year (see Notes 20 and 21 to the financial statements). The beginning net assets of the University of North Carolina System and community colleges were increased by $713 million to include nongovernmental component unit foundations.

Fund Financial Statements:

- As of the close of the fiscal year, the General Fund reported a total fund balance of negative $196.3 million, with reserves of $197.4 million, and an unreserved fund balance of negative $393.7 million. The total fund balance of the General Fund decreased from the prior year balance of negative $167.1 million.
- The Highway Fund and the Highway Trust Fund reported total fund balances of $227.8 million and $266.1 million, respectively.
- The State's two major enterprise funds, the Unemployment Compensation Fund and the EPA Revolving Loan Fund, reported net assets of $20.1 million and $640.5 million, respectively. The net assets of the Unemployment Compensation Fund decreased by 93 percent from the prior fiscal year-end.

Capital Assets:

- The State's investment in capital assets (net of accumulated depreciation) was $25.61 billion, which represents an increase of 7.7 percent from the previous fiscal year.
- The largest component of capital assets, the State highway system, includes roadway surfaces, bridges, signage, railings, markings, traffic signals, and other structures related to the State's motor vehicle transportation system. The system includes 78,615 miles of roadway, constituting the second largest highway system in the nation. The system also includes 17,250 bridges spanning 380 miles. At year-end, the State reflected $13.28 billion (net of accumulated depreciation) of highway system infrastructure.
- Major capital asset activity included additions to the State highway system ($1.2 billion), right-of-way acquisitions ($510 million) and the acquisition/construction of correctional facilities ($239 million).

Long-term Debt:

- The State had long-term debt outstanding of $5.54 billion, an increase of 34.9 percent from the previous fiscal year-end. The long-term debt balance includes $519.6 million of special obligation (non-voted) debt issued for governmental activities.
- The State maintained its AAA bond rating with Standard and Poor's and Fitch. In August 2002, Moody's downgraded the State's credit rating for general obligation debt from "AAA" to "Aa1", representing the first time since 1960 that North Carolina had less than a "AAA" rating. In September 2004, Moody's revised the State's outlook to positive from stable.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the State's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information (General Fund budgetary schedule, pension funding progress and contributions) and other supplementary information (combining financial statements) in addition to the basic financial statements. These components are described below.

Government-wide Financial Statements

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better off or worse off as a result of this year's activities? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Net Assets (page 52) presents all of the State's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating.

The Statement of Activities (pages 54 and 55) presents information showing how the State's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

Both statements report three activities:
Governmental Activities – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services.

Business-type Activities – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund and the EPA Revolving Loan Fund are the predominant business-type activities.

Discretely Presented Component Units – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. A description of the component units and an address for obtaining their separately issued financial statements can be found beginning on page 70. All component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State. In addition, financial statements for major component units are presented in the notes to the financial statements (pages 137 and 138).

Fund Financial Statements

The fund financial statements begin on page 58 and provide detailed information about the major individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for a particular purpose. In addition to the major funds, page 160 begins the individual fund data for the non-major funds. The State's funds are divided into three categories, governmental, proprietary, and fiduciary, and they use different accounting approaches.

> ***Governmental funds*** -- Most of the State's basic services are reported in the governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future spending. The governmental fund financial statements provide a detailed short-term view of the State's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. These funds are reported using *modified accrual* accounting, which measures cash and all other financial assets that

can readily be converted to cash. Governmental funds include the general, special revenue, capital project, and permanent funds. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Proprietary funds -- When the State charges customers for the services it provides, whether to outside customers or to other agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting; the same method used by private sector businesses. Enterprise funds are used to report activities for which fees are charged to external users for goods and services. The Unemployment Compensation Fund and the EPA Revolving Loan Fund are our most significant enterprise funds. Internal service funds are used to report activities that provide goods and services to the State's other programs and activities on a cost-reimbursement basis. - such as the State's State Property Fire Insurance Fund, the Motor Fleet Management Fund, Computing Services Fund, and Telecommunications Services Fund. Internal service funds are reported as governmental activities on the government-wide statements.

Fiduciary funds -- The State acts as a trustee or fiduciary, for its employee pension plans. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The State's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets. These funds, which include pension and other employee benefits, private-purpose, investment trust, and agency funds, are reported using accrual accounting. The government-wide financial statements exclude fiduciary fund activities and balances because these assets are restricted in purpose and cannot be used to support the State's own programs.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found beginning on page 68 of this report.

Additional Required Supplementary Information

Following the basic financial statements and note disclosures is additional Required Supplementary Information that further explains and supports the information in the financial statements. The Required Supplementary Information includes General Fund budgetary comparison schedules reconciling the statutory and generally accepted accounting principles (GAAP) fund balances at fiscal year-end, and pension plan trend information related to funding progress and contributions.

Supplementary Information

Supplementary information includes the introductory section, and the combining financial statements for non-major governmental, proprietary, and fiduciary funds and for non-major discretely presented component units. These funds are added together, by fund type, and presented in single columns in the basic financial statements, but are not reported individually, as with major funds, on the governmental fund financial statements.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

The State's combined net assets increased $408.7 million or 1.8 percent over the course of this fiscal year's operations. The net assets of the governmental activities increased $613.2 million or 2.7 percent and business-type activities had a decrease of $204.5 million or 21.3 percent. The following table was derived from the government-wide Statement of Net Assets:

Net Assets
June 30, 2004 and 2003
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2004	2003	2004	2003	2004	2003
Current and other non-current assets	$ 10,668,632	$ 9,882,858	$ 1,217,551	$ 1,161,973	$ 11,886,183	$ 11,044,831
Capital assets, net	25,556,896	23,719,972	49,507	46,272	25,606,403	23,766,244
Total assets	36,225,528	33,602,830	1,267,058	1,208,245	37,492,586	34,811,075
Long-term liabilities	5,970,092	4,376,222	10,242	10,270	5,980,334	4,386,492
Other liabilities	7,274,030	6,858,429	502,697	239,375	7,776,727	7,097,804
Total liabilities	13,244,122	11,234,651	512,939	249,645	13,757,061	11,484,296
Net assets:						
Invested in capital assets, net of related debt	24,706,355	23,449,373	40,277	38,450	24,746,632	23,487,823
Restricted	1,454,729	1,068,233	665,547	863,426	2,120,276	1,931,659
Unrestricted	(3,179,678)	(2,149,427)	48,295	56,724	(3,131,383)	(2,092,703)
Total net assets	$ 22,981,406	$ 22,368,179	$ 754,119	$ 958,600	$ 23,735,525	$ 23,326,779

The largest component of the State's net assets ($24.75 billion) reflects its investment in capital assets (land, buildings, machinery and equipment, State highway system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. Restricted net assets are the next largest component ($2.12 billion). Net assets are restricted when constraints placed on their use are either externally imposed or are imposed by law through constitutional provisions or enabling legislation. The remaining portion, unrestricted net assets, consists of net assets that do not meet the definition of "restricted "or "invested in capital assets, net of related debt."

The government-wide statement of net assets for governmental activities reflects a negative $3.18 billion unrestricted net asset balance. The State of North Carolina, like many other state and local governments, issues general obligation debt and distributes the proceeds to local governments and component units. The proceeds are used to construct new buildings and renovate and modernize existing buildings on the State's community college and university campuses, assist county governments in meeting their public school building capital needs, and to provide grants and loans to local governments for clean water and natural gas projects. Of the $5.54 billion of total long-term debt outstanding at June 30, 2004, $4.57 billion is attributable to debt issued as State aid to component units (universities and community colleges) and local governments. The balance sheets of component unit and local government recipients reflect ownership of the related constructed capital assets without the burden of recording the debt obligation. The policy of selling general obligation bonds and funneling the cash proceeds to non-primary government (non-State) entities has been in place for decades. However, by issuing such debt, the State is left to reflect significant liabilities on its statement of net assets (reflected in the unrestricted net asset component) without the benefit of recording the capital assets constructed or acquired with the proceeds from the debt issuances. Additionally, as of June 30, 2004, the State's governmental activities have significant unfunded liabilities for compensated absences in the amount of $327 million and a $7.5 million cost settlement payable to the federal government (see Note 7 to the financial statements). These unfunded liabilities also contribute to the negative unrestricted net asset balance for governmental activities.

The following financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year:

Changes in Net Assets
For the Fiscal Years Ended June 30, 2004 and 2003
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2004	2003	2004	2003	2004	2003
Revenues:						
Program revenues:						
Charges for services	$ 1,505,090	$ 1,339,016	$ 926,891	$ 688,786	$ 2,431,981	$ 2,027,802
Operating grants and contributions	10,108,124	9,042,843	305,053	504,550	10,413,177	9,547,393
Capital grants and contributions	884,345	527,498	892	1,241	885,237	528,739
General revenues:						
Taxes						
Individual income tax	7,407,455	7,122,099	—	—	7,407,455	7,122,099
Corporate income tax	760,180	921,611	—	—	760,180	921,611
Sales and use tax	4,293,040	4,029,403	—	—	4,293,040	4,029,403
Gasoline tax	1,276,627	1,154,986	—	—	1,276,627	1,154,986
Franchise tax	560,708	584,584	—	—	560,708	584,584
Highway use tax	578,346	552,759	—	—	578,346	552,759
Insurance tax	432,975	417,126	—	—	432,975	417,126
Beverage tax	213,271	198,848	—	—	213,271	198,848
Inheritance tax	128,352	112,150	—	—	128,352	112,150
Other taxes	313,985	289,261	—	—	313,985	289,261
Tobacco settlement	147,224	173,256	—	—	147,224	173,256
Federal grants not restricted to specific programs	136,859	136,859	—	—	136,859	136,859
Unrestricted investment earnings	77,225	103,987	—	—	77,225	103,987
Miscellaneous	62,601	41,137	3	—	62,604	41,137
Total revenues	28,886,407	26,747,423	1,232,839	1,194,577	30,119,246	27,942,000
Expenses:						
General government	807,248	773,807	—	—	807,248	773,807
Primary and secondary education	7,223,766	6,865,921	—	—	7,223,766	6,865,921
Higher education	3,140,794	2,814,375			3,140,794	2,814,375
Health and human services	11,729,904	10,611,537	—	—	11,729,904	10,611,537
Economic development	536,055	489,111	—	—	536,055	489,111
Environment and natural resources	599,575	538,032	—	—	599,575	538,032
Public safety, corrections and regulation	2,093,404	2,029,233	—	—	2,093,404	2,029,233
Transportation	1,870,578	1,640,007	—	—	1,870,578	1,640,007
Agriculture	82,394	73,974	—	—	82,394	73,974
Interest on long-term debt	191,228	151,258	—	—	191,228	151,258
Unemployment compensation	—	—	1,389,266	1,603,796	1,389,266	1,603,796
EPA Revolving Loan	—	—	5,342	4,266	5,342	4,266
Other business-type activities	—	—	43,014	30,750	43,014	30,750
Total expenses	28,274,946	25,987,255	1,437,622	1,638,812	29,712,568	27,626,067
Increase (decrease) in net assets before contributions and transfers	611,461	760,168	(204,783)	(444,235)	406,678	315,933
Contributions to permanent funds	2,068	1,806	—	—	2,068	1,806
Transfers	(302)	4,918	302	(4,918)	—	—
Increase (decrease) in net assets	613,227	766,892	(204,481)	(449,153)	408,746	317,739
Net assets - beginning - restated	22,368,179	21,601,287	958,600	1,407,753	23,326,779	23,009,040
Net assets - ending	$ 22,981,406	$ 22,368,179	$ 754,119	$ 958,600	$ 23,735,525	$ 23,326,779

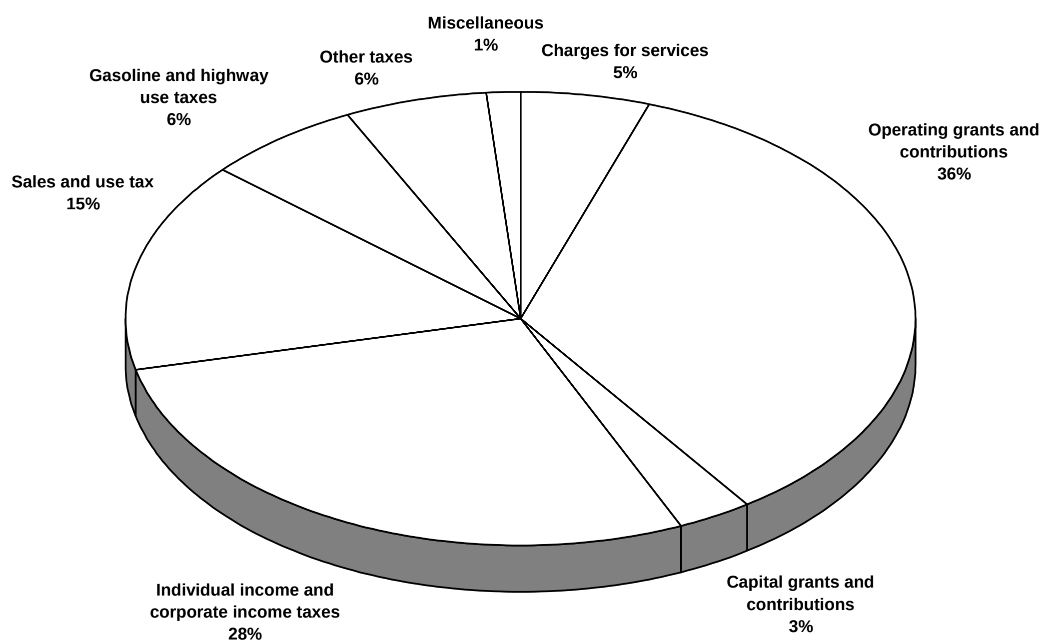
Governmental Activities

As a result of this year's operations, the net assets of governmental activities increased by $613.2 million or 2.7 percent. The net asset increase is primarily related to the overall growth in tax revenues (e.g., individual income, sales and use, and gasoline taxes) and spending reversions realized during the current fiscal year. The major exception to the growth in taxes was corporate taxes, which declined 17.5 percent from the previous fiscal year-end. Key factors in the decline in corporate taxes were reduced collections, an overall increase in the estimated refund rate, and the legislative suspension in the prior year of required distributions to special revenue funds. Although corporate profits were up, corporate tax collections were down because of tax code changes that allowed businesses to write-off expenses more quickly and the utilization of tax breaks and other incentives designed to attract new jobs to the State. Also, in the prior year, a portion of corporate income taxes, required to be distributed to special revenue funds, were retained by the General Fund to manage a budget shortfall.

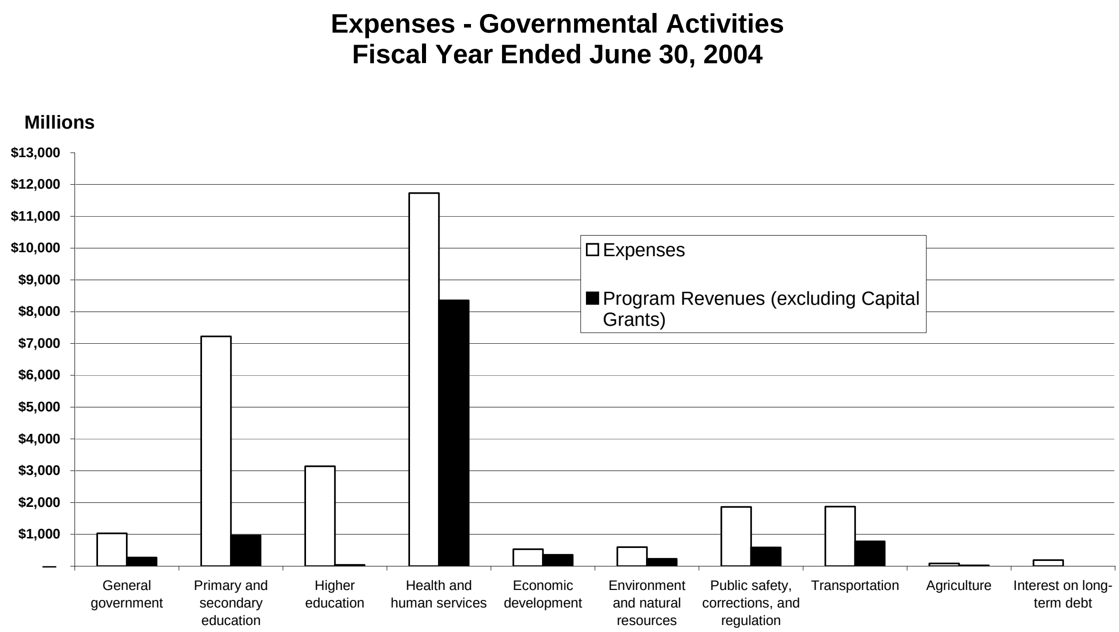
Total expenses of governmental activities grew by 8.8 percent during the current period (compared to total revenues growth of 8.0 percent). The majority of the spending growth was the result of funding increases in the State's two largest functional areas, education and health and human services. The increase in education spending is related to enrollment increases at the State's universities and community colleges and funding increases for the State's public schools. The growth in health and human services is the result of increased spending for Medicaid, which is the State's largest public assistance program. The growth in Medicaid is explained by an increase in individuals eligible for Medicaid services, a large increase in payments for dental services due to a lawsuit settlement that raised dental rates, and a significant increase in prescription drug payments and Disproportionate Share Hospital payments. There were also significant increases in the Electronic Benefits program due to higher client participation as a result of the recent economic downturn.

The following chart depicts revenue sources of governmental activities as percentages of total revenues for the fiscal year:

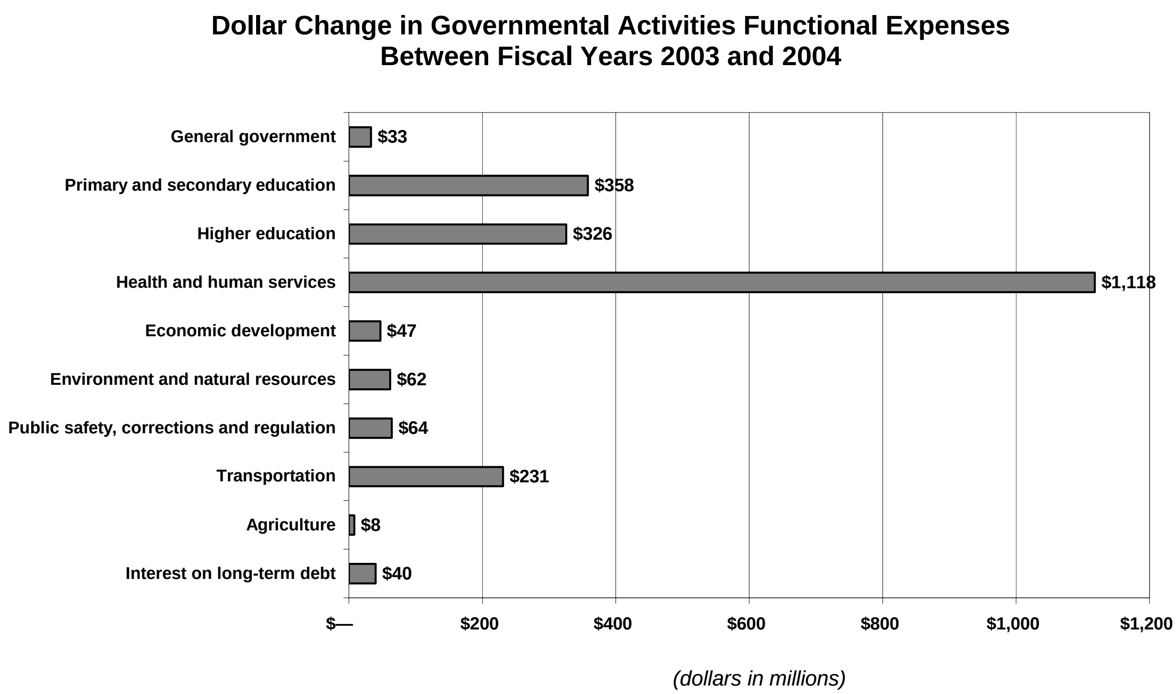
Revenues - Governmental Activities
Fiscal Year Ended June 30, 2004



The following chart depicts the total expenses and total program revenues of the State's governmental functions. This format identifies the extent to which each governmental function is self-financing through fees and intergovernmental aid or draws from the general revenues of the State.



The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2003 and 2004:



Business-type Activities

Business-type activities reflect a decrease in net assets of $204.5 million or 21.3 percent. The key reason for the decline was the Unemployment Compensation Fund’s significant operating loss, which was financed by the proceeds of short-debt. At year-end, the net assets of the Unemployment Compensation Fund were $20.1 million, a decrease of $257.4 million or 92.7 percent from the prior fiscal year-end. The Unemployment Compensation Fund and the EPA Revolving Loan Fund are the predominant activities, comprising 87.6 percent of the total net assets of business-type activities. A more detailed discussion of the State’s enterprise funds is provided in the following section.

FINANCIAL ANALYSIS OF THE STATE'S FUNDS

The State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements

Governmental Funds

The focus of the State's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. As of the end of the fiscal year, the State's governmental funds reported combined ending fund balances of $3.0 billion, a 14.7 percent increase from the prior fiscal year-end (as restated). The majority of the increase was related to debt proceeds recognized in other governmental funds for the N.C. Infrastructure Finance Corporation (Corporation), a blended component unit of the State. The Corporation issued debt for the repair and renovation of State facilities and for the acquisition and construction of correctional facilities. The major governmental funds are discussed individually below.

General Fund

The General Fund is the chief operating fund of the State. The fund balance of the General Fund decreased from a negative $167.139 million at June 30, 2003 (as restated) to a negative $196.287 million at June 30, 2004. A key factor in the decline was the Department of Revenue's revision of the refund rate for corporate taxes, which resulted in a $45.8 million reduction in corporate tax revenues for the 2004 fiscal year (Note: GAAP requires tax revenues to be reported net of estimated refunds). In addition, the total fund deficit continues to be influenced by the excess of accrued expenditures over accrued revenues for the State's Medicaid program. A more detailed analysis of the General Fund is provided in the budgetary highlights section (see next section).

<u>*2003-2004 General Fund Budgetary Highlights*</u>

The General Fund budget for fiscal year 2003-04 was signed into law on June 30, 2003. The enacted budget was founded upon an overall nominal (real growth plus inflation) economic growth rate of 3.5 percent for 2003-04. The appropriated budget included provisions that were designed to increase General Fund revenues. The most significant revenue adjustment was the continuation of two temporary tax increases that were scheduled to expire in 2003. In 2001, the General Assembly temporarily raised the State sales tax rate by a half-cent to 4.5 percent and the highest individual income tax rate from 7.75 percent to 8.25 percent. The budget continues the State sales tax rate at 4.5 percent and the 8.25 percent income tax bracket. In addition, several streamlining and conformity provisions, as well as departmental fees, were authorized that increase General Fund availability. Finally the Department of Revenue was given broader authority and resources to collect unpaid tax liabilities. The following table summarizes the 2004 revenue enhancements (amounts expressed in millions).

Revenue Enhancements – 2004 Fiscal Year

Maintain State sales tax at 4.5%	$ 341.8
Maintain top income tax bracket	37.5
Streamline tax revisions	78.5
Department of Revenue - Project Tax Collect	90.2
Tobacco settlement funds	66.8
Fee increases and trust fund transfers	87.0
Tax reductions for federal conformity	(70.0)
Federal fiscal relief	136.9
Federal disaster relief funds	108.8
Total 2004 enhancements	$ 877.5

The majority of funding increases for 2004 were in the education and human service areas. The budget provided full funding for enrollment increases in the University of North Carolina System ($46.6 million), the community college system ($32 million), and private colleges and universities ($2.8

million). In addition, the budget includes funds to hire additional public school teachers to reduce class size in the second grade ($25.3 million) and to expand the Governor's More-at-Four Program ($8.4 million), which helps prepare at risk four-year-old children for success in school. It also provides funds for the annual step increase for public school teachers ($48.1 million) and for ABC bonuses earned in the 2002-03 school year ($96 million).

The budget provides additional funding for the Health Insurance Program for Children ($12.2 million), which allows all eligible children to receive health care insurance (see Note 14C to the financial statements). In addition, expansion funds are provided for the Mental Health Trust Fund ($12.5 million) to facilitate the progress toward mental health reform.

The budget provided over $200 million in 2003-04 to support employee benefit programs. Specifically, it authorized a $550 one-time compensation bonus for State employees not included on the teacher salary schedule. In addition, the State Health Plan received sufficient funds to cover increased employee-related health care costs without reduction in benefits. The budget also began repayment of the funds withheld from the Retirement System in 2000-01 due to the budget shortfall (Note: the total obligation to the Retirement System was $129.9 million plus accrued interest). Legislation was enacted in 2001 to formalize the General Assembly's intent to repay the debt, subject to the availability of funds, over a five-year period beginning July 1, 2003. The budget authorized the payment of $10 million to partially repay the debt to the Retirement System. At year-end, the General Assembly authorized an additional payment of $20 million to the Retirement System.

General Fund Budget Variances

The original General Fund budget, including State appropriations and appropriations supported by departmental receipts, serves as a starting point or plan for the Governor to execute the General Fund budget pursuant to the powers granted by the Executive Budget Act. At the state level in North Carolina, it is not unusual for the budget to change during the fiscal year in relation to budget adjustments made to accommodate departmental receipts. The General Fund budget supported by State appropriation, is a subset of the General Fund financial schedule presented in the CAFR as required supplementary information. The current CAFR schedule reflects all spending required to support the State's General Fund activities and the funding to support those activities, including State tax and non-tax revenues, federal revenues, student tuition, and other fees, licenses, and fines.

Under current State budget management practice, particularly related to departmental federal receipts, primary emphasis is placed on comparisons of the final authorized budget and actual spending.

At the State level, budgetary cuts related to State appropriations are implemented by decreasing allowable actual expenditures, as opposed to decreasing the State appropriation through a formal legislative process. The Governor and State agencies maintain legal authority to spend the dollars originally appropriated to them, however, in recent years the actual spending has been limited by the collection of tax and nontax revenue. In extremely rare cases, the General Assembly has held special sessions to formally amend the State appropriation budget.

The portion of the original budget comprising departmental receipts is not intended to be the sole controlling point to manage the State's General Fund budget. The final budget includes amendments for departmental receipts collected during the fiscal year as allowed by law. General Fund departmental receipts are typically authorized for expenditure within the activity that generated the receipt. Historically, final estimated receipts have varied significantly from the original estimate at the beginning of the fiscal year. State agencies by law must spend departmental receipts prior to spending tax and nontax supported appropriations. If departmental receipts are higher than expected, appropriated dollars may go unspent and be re-appropriated in a subsequent fiscal year.

Variances – Original and Final Budget

The budget variance between original and final budget for f*ederal funds* revenue is attributable to the awarding of new federal funds during the fiscal year and funds being drawn down to reimburse unanticipated expenditures.

The budget variance for *intra-governmental transactions* revenue is attributable primarily to the following: $81.5 million of statewide encumbrance carry forward amounts from fiscal year 2002-2003, $126.4 million of Medicaid Disproportionate Share, $8.3 million of Department of Health and Human Services (DHHS)-cost report settlement, $272.9 million of DHHS-intra-governmental transfers within a DHHS general fund budget code, $351.2 million of DHHS funds transferred from various budget codes within DHHS, and $14.8 million of Mental Health Trust Fund intra-governmental transfers.

The budget variance for *contributions, gifts and grants* revenue is attributable primarily to the decision by the Division of Medical Assistance to change an accounting process to go on cost allocation, leading to the unexpected budgeting of $129.1 million for the State match.

For expenditures, the variances between the original budget and final budget are related to the corresponding revenue budget variances. As revenue budget accounts are increased, a corresponding increase occurs in the expenditure budget accounts. In addition to those increases, agency expenditure budgets were also increased by the allocation of statewide reserves such as the legislative salary increase, health insurance, and retirement reserves. There was also an additional appropriation of $88.1 million authorized for fiscal year 2003-2004 as a result of special sessions of the General Assembly.

Variances - Final Budget and Actual Results

The budget variance between final budget and actual revenues for *corporate income taxes* occurred because the growth in corporate profits exceeded the forecast. *Investment Income* was below the final budget because market interest rates were below the forecast.

Departmental *federal funds* actually received by agencies were $741.9 million less than the final budget. Of this variance, $357.2 million was attributable to the Department of Public Instruction. Actual federal draw downs are reflective of the actual expenditures of these federal funds. In addition, $190.8 million of the *Federal funds* variance is attributable to the Department of Health and Human Services not incurring qualifying costs as budgeted.

For expenditures, the variances between final budget and actual expenditures for *primary and secondary education* and *public safety, corrections, and regulation* occurred because actual revenues were less than the budgeted revenues; therefore, expenditures that depended on the receipt of these funds could not be made.

The State ended fiscal year 2003-04 with an over-collection of tax revenues of $242.4 million. The major tax categories that exceeded the budgeted forecast were *individual income* (1.1%), *corporate income* (9.2%), and *sales and use* (4.1%). In addition, unexpended appropriations or reversions of $159 million were realized. The State fiscal year 2003-04 closed out with a $289.4 million unreserved fund balance after transferring $116.7 million to the Rainy Day Fund and $76.8 million to the Repair and Renovation Reserve.

Highway Fund

The Highway Fund dates back to 1921, which is when the N.C. General Assembly first imposed the gasoline tax. It accounts for most of the activities of the North Carolina Department of Transportation, including the maintenance and construction of the State's primary, secondary, and urban road systems, the State Highway Patrol, the Division of Motor Vehicles, and transit and rail. The primary revenue sources of the Highway Fund are federal funds, three-fourths of gasoline taxes, vehicle registration fees, and driver's license fees.

The fund balance of the State Highway Fund decreased from $299.9 million at June 30, 2003 to $227.8 million at June 30, 2004, a decrease of 24 percent. The decline was the result of total expenditures exceeding total revenues for the current period. Over the past three years, the North Carolina Department of Transportation has used excess cash to advance construction projects and to accelerate contract resurfacing. Unbudgeted emergency relief expenditures for Hurricane Isabel and several ice storms also impacted cash flow. However, the excess of expenditures over revenues of $185.3 million in 2004 was smaller than the previous fiscal year because total revenues grew at a faster rate than total expenditures. Total revenues increased by $252.2 million or 11.7 percent primarily because of increases in gasoline taxes and federal funds. A 4 percent increase in taxable gallons sold combined with a 3 percent boost in the average fuel tax per gallon raised fuel tax revenues by $89.2 million. Federal billings rose $180.7 million due to increased Federal Highway Administration construction. Total expenditures increased by $207.7 million or 8.7 percent due to increased maintenance and construction expenditures. In addition, operating transfers to other funds increased by $24.4 million. During the fiscal year, the Highway Fund also received an advance of $15.4 million from a municipality for roadway and pedestrian improvements.

In September 2004, the State Board of Transportation approved a new long-range plan that prioritizes transportation investment for the next 25 years. The Statewide Transportation Plan provides a blueprint for greater investment in maintenance, preservation, and modernization of the State's existing highway system as well as other transportation options such as rail and public transportation. The share of transportation dollars spent on new highway projects will drop from 45 percent to 26 percent. The highway needs of the State's growing population will be accommodated in part by maintaining and upgrading existing roads and by increasing anti-congestion measures such as synchronized traffic signals.

The centerpiece of the plan is the Recommended Investment Scenario, which outlines priorities from the estimated $55 billion, in today's dollars, expected to be available over the next 25 years for transportation investment. Based on this scenario, the Department of Transportation (NCDOT) will be able to meet an additional 10 percent of its maintenance and preservation needs and nearly 25 percent more modernization infrastructure needs. Additionally, the scenario proposes increasing NCDOT's investment in other transportation modes. The plan also identifies $84 billion in total transportation needs and states that NCDOT will only be able to meet two-thirds of the State's 25-year transportation needs at its current funding levels, regardless of how NCDOT's resources are allocated. Full implementation of the Recommended Investment Scenario will be gradual.

Highway Trust Fund

Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet highway construction needs in North Carolina. The Highway Trust Fund also provides extra money for the State's municipalities to adequately maintain their streets and pays the debt service on the State's general obligation bonds issued for highway purposes. The principal revenue sources of the Highway Trust Fund are highway use taxes, one-fourth of gasoline taxes, and various title and registration fees. From the proceeds of the highway use tax, $252.4 million was transferred to the general fund for the 2003-04 fiscal year and thereafter, the transfer amount is scheduled to be $240 million per year subject to adjustment for inflation. The General Fund intends to repay by June 30, 2009 the $125 million (plus interest) advanced from the Highway Trust Fund during the 2002-03 fiscal year (see Note 9 to the financial statements).

The fund balance of the Highway Trust Fund increased from $208.2 million at June 30, 2003 to $266.1 million at June 30, 2004, an increase of 27.8 percent. The increase was attributable, in part, to $400 million of highway bonds issued on November 2003. The proceeds of these bonds were used to reimburse highway expenditures of prior years. These bonds constitute a portion of the $950 million highway bond authorization approved by the voters in November 1996 (Note: $250 million of such bonds were issued in 1997). At year-end, the remaining highway bond authorization was $300 million. Total revenues increased by $54.0 million or 5.7 percent, primarily because of increases in the gasoline tax and the highway use tax. Gasoline taxes rose $29.5 million due primarily to a 4 percent increase in taxable gallons sold combined with a 3 percent rise in the average fuel tax per gallon. Highway use taxes on vehicle registrations grew $25.6 million or 4.6 percent. Total expenditures increased by $220.9 million or 36.3%. The increase is due to a significant rise in contract lettings for the Transportation Improvement Program and N.C. Moving Ahead projects to address transportation infrastructure needs.

The 2003 General Assembly passed the Governor's "Moving Ahead" transportation initiative to allow, over two years, the use of $630 million of Highway Trust Fund cash balances for highway preservation, modernization, and maintenance. Additionally, it allows $70 million for public transit, rail, ferry, bicycle, and pedestrian projects.

Enterprise Funds

The State's enterprise funds or business-type activities provide the same type of information found in the government-wide financial statements, but in more detail. The major enterprise funds are discussed individually below.

Unemployment Compensation Fund

The net assets of the Unemployment Compensation Fund decreased by $257.4 million during the current fiscal year, which is a 92.7 percent decrease from the prior fiscal year-end. The decrease is explained primarily by the fund's significant operating loss (excess of operating expenses over operating income), which was financed by the proceeds of short-term debt. The operating loss was $509.6 million this year versus $956.1 million in 2003. At June 30, 2004, the short-term debt balance was $251.8 million compared to zero for the previous year-end. To ensure timely payment of unemployment benefits, the State received repayable advances from its Federal Unemployment Account and issued tax anticipation notes (see Note 6 to the financial statements). The State estimated that it will save millions of dollars in interest payments by selling tax anticipation notes instead of borrowing exclusively from the federal government. Unemployment benefit expenses decreased 13.4 percent in fiscal year 2004 to $1.39 billion. These expenses were lower because the State's unemployment rate fell during the second half of the fiscal year. North Carolina's seasonally adjusted unemployment rate was 5.5 percent in June 2004, making four consecutive months that the rate was below the national average. While manufacturing jobs declined since January 2004, all other sectors of the economy gained jobs during the second half of the fiscal year. Job gains were especially large in professional and business services and in educational and health services.

In fiscal years 2003 and 2002, the State also received funding for extended unemployment benefits. In March 2002, the U.S. Congress signed into law the Temporary Extended Unemployment Compensation Act of 2002. This program, which is financed entirely by federal funds, provided extended benefits to claimants who had exhausted their regular State unemployment benefits. This program ended during the 2004 fiscal year because of the decrease in the State's average unemployment rate.

The 2003 Session of the General Assembly enacted legislation to help preserve the integrity of the unemployment insurance tax system. Session Law 2003-67 (Senate Bill 326) clarifies that an employer cannot avoid an undesirable unemployment insurance rate by shifting employees to a newly created company with a more desirable tax rate. This practice is known as State unemployment tax avoidance or "SUTA dumping" (i.e., since the bulk of the old company's employees are moved to a new company and the higher tax rate of the older company is "dumped").

Starting January 1, 2005, a 20 percent surcharge will be in effect for unemployment insurance contributions, as required by State statute. The surcharge will be in effect because of the fund's low reserves. The proceeds of the surcharge will be credited to the Employment Security Commission Reserve Fund and will improve the solvency of the Unemployment Compensation Fund.

EPA Revolving Loan Fund

The net assets of the EPA Revolving Loan Fund increased by $58.9 million during the current fiscal year, which was a 10.1 percent increase from the prior fiscal year-end. Operating income was $9.99 million (excess of operating revenues over operating expenses). Net nonoperating revenues were $42.9 million, consisting primarily of federal capitalization grants and investment earnings. In addition, $7.4 million of clean water bond proceeds were transferred in from special revenue funds.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2004, the State's investment in capital assets was $25.61 billion, which represents an increase of 7.7 percent from the previous fiscal year-end (see table below).

Capital Assets as of June 30

(net of depreciation, dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
Land	$ 8,300,655	$ 7,713,505	$ 2,563	$ 2,563	$ 8,303,218	$ 7,716,068
Buildings	1,578,963	1,369,455	13,231	13,975	1,592,194	1,383,430
Machinery and equipment	562,864	551,155	1,314	1,047	564,178	552,202
Infrastructure:						
State highway system	13,284,267	12,444,212	—	—	13,284,267	12,444,212
Other infrastructure	76,859	80,489	7,866	8,669	84,725	89,158
Intangible assets	106,506	108,927	—	—	106,506	108,927
Art, literature, and other artifacts	1,126	7	—	—	1,126	7
Construction in progress	1,645,656	1,452,222	24,533	20,018	1,670,189	1,472,240
Total	$ 25,556,896	$ 23,719,972	$ 49,507	$ 46,272	$ 25,606,403	$ 23,766,244
Total percent change between fiscal years 2003 and 2004	**7.7 %**		**7.0 %**		**7.7 %**	

Major capital asset activity includes additions to the State highway system ($1.2 billion), right-of-way acquisitions ($510 million), and the acquisition/construction of correctional facilities ($239 million).

The largest component of capital assets is the State highway system and related right-of-ways. The State has approximately a 78,615-mile highway system, making it the second largest State-maintained highway system in the nation. The system continues to increase as roads are widened and new roads and bridges are constructed.

The 2002-2003 Session of the General Assembly authorized the issuance of up to $300 million of special indebtedness to finance the repair and renovation of State facilities and related infrastructure that are supported by the State's General Fund. Of the $300 million, approximately $157 million will be allocated to the University of North Carolina System (component unit). Each of the sixteen constituent institutions of the UNC System will receive a portion of the proceeds for repairs and renovations. The remaining $143 million of the proceeds will be used to make repairs and renovations to various State facilities located throughout North Carolina. The State issued $125 million in certificates of participation during the 2004 fiscal year to finance repair and renovation projects. At year-end, the remaining authorization was $175 million. In addition, the most recent session of the General Assembly (2003-2004) directed the transfer on June 30, 2004, of $76.8 million from the unrestricted credit balance of the General Fund in fiscal year 2004 to the Repairs and Renovations Reserve Account, to be applied to the repair and renovation of State and university facilities.

In July 2003, the N.C Infrastructure Finance Corporation (Corporation), a blended component unit of the State, acquired three close security correctional facilities by issuing $218.4 million in lease-purchase revenue bonds. Also, during the fiscal year, the Corporation issued $158.96 million in certificates of participation to construct and equip two close security correctional facilities and to begin designing a third facility. The Department of Correction is undertaking construction initiatives to address a cell shortfall and to allow for the implementation of sentencing reform. The State's correctional facility population has more than doubled since 1980. The rapid growth in inmates is attributable to increases in the State's population, increases in length of stay in correctional facilities, and changes in criminal laws.

As further detailed in Note 19(F) to the financial statements, the State has commitments of $1.9 billion for the construction of highway infrastructure, which are expected to be financed by gasoline tax collections and federal funds. Other commitments for the construction and improvement of State government facilities totaled $522.9 million, which are expected to be financed primarily by debt proceeds (certificates of participation), State appropriations, and federal funds.

More detailed information about the State's capital assets is presented in Note 5 to the financial statements.

Long-term Debt

At year-end, the State had total long-term debt outstanding of $5.54 billion, an increase of 34.9 percent from the previous fiscal year-end (see table below).

Outstanding Debt as of June 30
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
General obligation bonds	$ 4,982,860	$ 4,066,990	$ —	$ —	$ 4,982,860	$ 4,066,990
Revenue bonds	218,405	—	9,325	9,570	227,730	9,570
Certificates of participation	301,165	17,500	—	—	301,165	17,500
Notes payable	25,008	9,629	—	—	25,008	9,629
Total	$ 5,527,438	$ 4,094,119	$ 9,325	$ 9,570	$ 5,536,763	$ 4,103,689
Total percent change between fiscal years 2003 and 2004	**35.0 %**		**(2.6)%**		**34.9 %**	

The State's general obligation bonds are secured by a pledge of the faith, credit, and taxing power of the State. The revenue bonds issued by the State are secured solely by specified revenue sources. The certificates of participation (COPs) and lease-purchase revenue bonds issued by the N.C. Infrastructure Finance Corporation, a blended component unit of the State, are secured by lease and installment payments made by the State, and in the event of default, by a security interest in the leased facilities pursuant to a leasehold deed of trust (as applicable). The COPs issued for repair and renovation projects (see below) are not secured by a lien upon or security interest in the projects or any other property of the State. All payments of the State for the COPs and the lease-purchase revenue bonds are subject to appropriation by the General Assembly.

During the 2004 fiscal year, the State issued $1.159 billion in general obligations bonds (excluding refunding issues), $218.41 million in lease-purchase revenue bonds, and $283.96 million in certificates of participation (COPs). The new general obligation debt consisted of $708 million in public improvement bonds (consolidation of clean water bonds and higher education bonds), $400 million in highway bonds, $36 million in natural gas bonds, and $15 million in clean water bonds. The proceeds of the lease-purchase revenue bonds were used to acquire three close security correctional facilities in Alexander, Anson, and Scotland counties. The proceeds of the COPs will be used to construct and equip two close security correctional facilities in Greene and Bertie counties and to finance the cost of design and certain additional costs of a third close security correctional facility in Columbus County. The State also issued COPs for the repair and renovation of State facilities and related infrastructure that are supported by the General Fund.

The State refinanced $336.9 million of its existing debt in 2004 to improve cash flow and to take advantage of lower interest rates. By refinancing the debt, the State will reduce its future debt service payments by approximately $13.5 million over the next ten years.

Higher Education Authorization

The 1999-2000 Session of the General Assembly authorized the issuance of up to $3.1 billion of higher education improvement bonds, which were subsequently approved by the voters of the State. The $3.1 billion bond authorization represents the largest debt authorization in the State's history. The proceeds of these general obligation bonds will be used solely to construct new buildings and to renovate and modernize existing buildings on the State's 58 community college and 16 University of North Carolina campuses. These improvements are needed to meet enrollment demand and to ensure that the State's college and university buildings meet modern code requirements and are equipped to prepare graduates for twenty-first century jobs. The bond legislation passed by the General Assembly specifies the amount of bond funding that will flow to each community college and university campus. At year-end, the authorized but unissued higher education bonds were $1.37 billion.

Recent Legislation and Studies

The most recent session of the General Assembly (2003-04 Session) authorized the issuance of up to $468 million of special indebtedness to finance vital State facilities for health care and biotechnology. No more than $310 million of the special indebtedness may be issued during the 2004-05 fiscal year. The State is authorized to use special indebtedness to provide:

- $338 million for constructing five new projects in the University of North Carolina (UNC) System. These projects consist of a cancer center at UNC-Chapel Hill ($180 million), a cardiovascular institute at East Carolina University ($60 million), a bioinformatics Center at UNC-Charlotte ($35 million), a pharmacy program facility at Elizabeth City State University ($28 million), and a health center at UNC-Asheville ($35 million).
- $50 million for land acquisition and planning for five other projects in the UNC System;
- $35 million for constructing up to five youth development centers;
- $45 million for capital projects within the State Parks System, including repairs and renovations of park facilities and land acquisition. High priority uses of the debt proceeds include acquiring land near military bases to prevent encroachment.

The fiscal impact of the $468 million of special indebtedness on the General Fund is expected to be zero because of the annual transfer of revenue from other sources to the General Fund in an amount to cover the estimated debt service. The debt service for the UNC System facilities and the youth development centers will be reimbursed from the Health and Wellness Trust Fund and the Tobacco Trust Fund (special revenue funds). The debt service for the parks projects is fully funded by the streams of revenue available to the Parks and Recreation Trust Fund, the Natural Heritage Trust Fund, and the Clean Water Management Trust Fund (special revenue funds). The maximum annual debt service is estimated to be $47.4 million in fiscal year 2010-11. The total interest on the $468 million of debt is estimated to be $310 million.

Special indebtedness is non-voted debt that is generally secured only by an interest in State property being acquired or improved (e.g., certificates of participation and lease-purchase revenue bonds). With this type of debt, there is no pledge of the State's faith, credit or taxing power to secure the debt, which is why voter approval is not required. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the State property that serves as security could be disposed of to generate funds to satisfy the debt. Failure to repay the debt would have negative consequences for the State's credit rating. Article 9 of Chapter 142 of the General Statutes prohibits the issuance of special indebtedness except for projects specifically authorized by the General Assembly. The use of alternative financing methods provides financing flexibility to the State and permits the State to take advantage of changing financial and economic environments.

During the 2003-04 Session, the General Assembly created a Debt Affordability Advisory Committee (Committee) to annually advise the Governor and the General Assembly on the estimated debt capacity of the State for the upcoming ten fiscal years. The Committee is responsible for preparing an annual debt affordability study and establishing guidelines for evaluating the State's debt burden. The Committee is required to report its findings and recommendations to the Governor, the General Assembly, and the Fiscal Research Division of the General Assembly by February 1 of each year.

In April 2004, the State Treasurer presented to the House and Senate Finance Committees of the General Assembly, the second Debt Affordability Study for North Carolina. It provides a methodology for measuring, monitoring, and managing the State's debt capacity. The study evaluated the State's current and projected debt burden using indicators such as tax-supported debt to personal income, debt per capita, debt service to tax revenue, and rapidity of principal repayment ratios. In addition, the report includes several recommendations based on the results of the study. According to the report, all of the State's debt ratios are below median levels for all fifty states, as compiled by Moody's Investors Service, and for a peer group of seven states rated triple AAA by all three credit rating agencies. Thus, the study concludes that the State's debt is considered low and is manageable at the current level. However, due to the projected issuance of $2.2 billion of tax-supported debt over the next three years

(62 percent for higher education purposes), all of the State's debt ratios are expected to increase over this period. The State Treasurer noted in the report that credit rating agencies consider a debt affordability study as a positive factor when evaluating issuers and assigning credit ratings.

Credit Ratings

Credit ratings are the rating agencies' assessment of a governmental entity's ability and willingness to repay debt on a timely basis. Credit ratings are an important factor in the public credit markets and can influence interest rates a borrower must pay.

The State's general obligation bonds are rated "AAA" by Fitch Ratings, "Aa1" with a positive outlook by Moody's Investors Service (Moody's) and "AAA" with a stable outlook by Standard & Poor's Ratings Services. All three agencies base their prime ratings on the State's strong, diverse economic base, its sound financial management, and low debt levels. In September 2004, Moody's revised the State's outlook to positive from stable and noted the following:

> "*This rating reflects the State's slowly stabilizing economy, its improving tax revenues, its conservative debt policy, and its effective financial management. While general fund balances remain negative, flexible cash reserves outside the general fund are ample, and pension funding is exceptionally strong. Moody's expects that the state will continue to take actions to restore structural balance and rebuild reserves*."

In August 2002, Moody's downgraded the State's credit rating for general obligation debt from "AAA" to "Aa1", representing the first time since 1960 that North Carolina had less than a "AAA" rating. While Moody's praised the strength of executive powers available to insure a balanced budget, it advised that the primary reasons for the downgrade were the State's continued budget pressure, reliance on non-recurring revenues, and weakened balance sheet. Also, Moody's commented that the task of restoring structural budget balance and rebuilding reserves faces political and economic obstacles.

The certificates of participation and lease-purchase revenue bonds issued by the North Carolina Infrastructure Finance Corporation are rated "AA+" by Standard & Poor's, "AA" by Fitch, and "Aa2" by Moody's.

Limitations on Debt

The Constitution of North Carolina (Article 5, Section 3) imposes limitations upon the increase of certain State debt. It restricts the General Assembly from contracting debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State, except for the following purposes:

1. To fund or refund a valid existing debt;
2. To supply an unforeseen deficiency in the revenue;
3. To borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 percent of such taxes;
4. To suppress riots or insurrections; or to repel invasions;
5. To meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor; and
6. For any other lawful purpose, to the extent of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the next preceding biennium.

More detailed information about the State's long-term liabilities is presented in Note 7 to the financial statements.

Budget and Economic Update

The General Fund budget for 2004-05 was signed into law on July 20, 2004. The enacted budget was founded upon an overall nominal (real growth plus inflation) economic growth rate of 5.5 percent for 2004-05. The budget continues the State sales and use tax rate at 4.5 percent and the 8.25 percent income tax bracket for fiscal year 2004-05 (Note: the half-cent sales tax increase and the high income tax bracket are scheduled to sunset at the end of the year), diverts a portion of the national tobacco settlement payments ($60 million), and uses monies left over at the end of the 2003-04 fiscal year ($289.4 million). It also earmarked an additional $116.7 million for the Rainy Day Fund and $76.8 million for the Repair and Renovation Reserve, indicating the State's intention to continue to replenish its reserves.

The 2004 hurricane season produced six tropical systems that directly impacted North Carolina. Federal, State, and local emergency management officials estimate that these storms caused over $200 million in damages that are eligible for governmental assistance. Assistance is for a variety of services including emergency protective measures, repair and replacement of homes, debris removal, stream clearance, and bridge repair and replacement. In order to match federal funds available to North Carolina for federal disaster recovery services, the Governor ordered State agencies to revert 0.75 percent of their 2004-05 budgets to provide an estimated $120 million for storm relief. Special exemptions are allowed for constitutionally mandated programs as well as emergency situations related to law enforcement, health care, and public safety.

North Carolina's seasonally adjusted unemployment rate as of September 2004 was 4.8 percent, more than a half a percentage point lower than the national unemployment rate of 5.4 percent. September was the seventh consecutive month that the State's unemployment rate was below the national average. For comparison, the State and national unemployment rates as of September 2003 were 6.4 percent and 6.1 percent, respectively.

2004-05 Revenue Update (Cash Basis)

For the first three months of the 2004-05 fiscal year, General Fund revenues, (tax and non-tax revenues) came in $74.3 million higher than the $3.5 billion forecast for the period. A continuation of the current trend would lead to revenue growth of 7.6 percent for the full year versus the 5.5 percent economic growth rate built into the budget. However, an analysis of the collection detail reveals that the improvement is not broad-based. Of the extra collections, $65.1 million came from one source, corporate income taxes. While other taxes are also increasing, the net surplus from other revenues is only $8.8 million. Additionally, $30 million of the extra corporate collections is the result of a one-time settlement in August 2004 of a long-standing corporate tax dispute not directly related to the economy. Also, $31.8 million of the corporate surplus came from a 33 percent rise in September 2004 payments. This rise is in contrast to the 10.2 percent decline in June and the 2.7 percent drop in April (April, June, and September are major corporate collection months). Because of the volatility of the corporate income tax, it will be difficult for the State to maintain this growth as higher interest rates and increased energy costs impact the economy

Other taxes are increasing but at different rates. The withholding of individual income tax receipts are $18.2 million behind schedule for the first quarter (4.6 percent growth versus budgeted rate of 5.7 percent). The primary factor is sluggish job growth. State and local sales tax collections rose by 8.2 percent for the July to September 2004 quarter versus the 6.1 percent projection for the period. However, the rate of growth slowed to 6.7 percent for September from almost 10 percent in August.

The impact of recent hurricanes has taken a severe toll on certain areas of the State. The effect on State and local revenues is hard to measure. In a typical disaster event, the front-end loss in withholding and sales tax revenue is eventually offset by gains during the recovery period due to reconstruction efforts and the makeup of lost production.

The improving revenue picture, though not as broad-based or as strong during prior recoveries, is dampened by the State's $1.1 billion structural budget gap for the 2005-06 fiscal year. The gap is due to a combination of tax increases that will expire ($525 million), one-time transfers used to balance the 2003-04 and the 2004-05 budgets, and one-time budget cuts. The budget gap numbers for North Carolina are typical of other states following the severe 2001-03 recession.

Conditions Expected to Impact Future Operations

The North Carolina Retirement System has identified major issues that will have a significant impact on the State's fiscal condition.

Demographic Factors: The Baby Boomers

The process of retirement for the demographic cohort known as the "Baby Boomers" will have tremendous economic, social, and political impact in North Carolina.

Two critical areas in which the "Boomer" retirement will be significantly consequential are: A) public sector workforce, and B) the cost to the State of providing retirement benefits.

Workforce Impact:

- The Baby Boomers are an eighteen-year cohort, currently between forty (40) and fifty-eight (58) years of age.
- In North Carolina this cohort constitutes approximately 59 percent of the State's public workforce. **Impact: the State's public sector workforce will have to be replenished as this cohort moves into retirement.**
- Further, replacement personnel will be drawn from a shrinking pool of workers made up of considerably smaller generations than the boomer predecessors. **Impact: the State will be faced with an increasingly competitive labor market**.
- **Implications: North Carolina will have to address these impacts by one or more of the following: expand its efforts to retain aging boomers in the public sector and thus slow the rate of retirement, or become more competitive in the labor market in order to recruit workers to State employment or reduce the number of public sector positions.**

Providing Retirement Benefits:

- The first year of the eighteen (18) year boomer cohort has just reached the average age of retirement in the State system for 2003, which is aged 58 ½. **Impact: the first of the Boomer cohort is on the cusp of retirement, marking the beginning of boomer retirement from the North Carolina public sector.**
- The total number of retirees in the North Carolina Teachers' and State Employees' Retirement System will increase 135% through 2022 (the total increase for both the State and the Local government systems is 141%). **Impact: the cost to the State of providing retirement benefits will increase**. (Note: Increasing costs are not driven by the cost of providing an actual pension as employees and employers fund the pension over the employee's service career. The increase in cost will come from administrative expenses and the cost of providing Cost of Living Adjustments (COLAs) for a significantly larger retiree pool.)
- While a set rate for Cost of Living Adjustments (COLA) is not specified in statute, the State has historically provided retirees with an annual COLA that matches the Consumer Price Index (CPI). **Impact: if the State continues to provide a COLA to retirees, expenditures from the General Fund will have to increase to cover the cost of providing such COLAs for an increasing pool of retirees.**
- **Implications: to be competitive in tomorrow's labor market, North Carolina will have to continue to provide attractive benefits such as the State's retirement plan; this will occur during a time when system administration and COLAs costs will increase significantly as the number of retirees exponentially expands.**

Retiree Health Care

The Governmental Accounting Standards Board (GASB) reporting guidelines that will require disclosure of the State's liabilities for retiree health care costs (i.e., GASB Statements No. 43 and 45) is one of the State's largest looming fiscal items. The Retirement System facilitates the benefit by making the deduction for the State Health Plan from retirees' pension checks. The Retirement System is also the front line organization for retirees who want to voice their concerns about changes, or potential changes, to benefits. Ultimately, the provision of health care for the State's public sector retirees is the responsibility of the State Health Plan. The unfunded actuarial liability for retiree health care is substantial because of the State's policy of funding these benefits on a pay-as-you-go basis.

In preparation for the new GASB standards on other postemployment benfits, the North Carolina General Assembly enacted legislation in 2004 establishing a Retiree Health Benefit Fund. The State's contributions to this fund are irrevocable, and the assets of the fund are not subject to the claims of the State's creditors. More detailed information about the State's obligations for Retiree Health Care is presented in the Letter of Transmittal.

In addition, the announcement of a new computer manufacturing facility by Dell, Inc. is expected to impact future operations.

Dell Manufacturing Facility

In November 2004, Governor Michael F. Easley announced that Dell, Inc. (Dell) will build a computer manufacturing facility in North Carolina. Dell, a leading manufacturer and distributor of computers and related products, plans to build and equip a state-of-the-art, 400,000-square-foot manufacturing and distribution facility in the Piedmont Triad region. Dell currently has two U.S. factories in Nashville, Tennessee and Austin, Texas. The North Carolina General Assembly convened a one-day special session on November 4, 2004 an approved an economic incentive for computer manufacturing companies that in the case of Dell, will provide up to $225 million in tax credits over the next fifteen years. For each year in which Dell meets the required performance targets, the State will provide a grant equal to 75 percent of the State personal income withholding taxes derived from the creation of new jobs.

Requests for Information

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the North Carolina Office of the State Controller, Accounting and Financial Reporting Section, 1410 Mail Service Center, Raleigh, N.C. 27699-1410. In addition, this financial report is available on the Office of the State Controller's Internet home page at http://www.ncosc.net/financial/financial.html.

Basic Financial Statements

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Government-Wide Financial Statements

STATEMENT OF NET ASSETS

June 30, 2004 *Exhibit A-1*

(Dollars in Thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Cash and cash equivalents (Note 3)	$ 4,105,858	$ 249,802	$ 4,355,660	$ 2,700,361
Investments (Note 3)	499,164	38,409	537,573	2,050,256
Securities lending collateral (Note 3)	3,426,369	193,909	3,620,278	—
Receivables, net (Note 4)	2,051,983	297,705	2,349,688	735,038
Due from component units (Note 17)	18,202	—	18,202	55,833
Due from primary government (Note 17)	—	—	—	276,402
Internal balances	(58)	58	—	—
Inventories	150,730	485	151,215	69,786
Prepaid items	12,337	1,845	14,182	13,854
Advances to component units (Note 17)	24,242	—	24,242	—
Notes receivable, net (Note 4)	282,678	435,220	717,898	2,890,667
Endowment investments (Note 3)	55,211	—	55,211	1,715,044
Investment in joint venture	—	—	—	8,319
Deferred charges	—	118	118	20,661
Securities held in trust	41,638	—	41,638	—
Pension assets (Note 11)	278	—	278	—
Capital assets-nondepreciable (Note 5)	9,947,437	27,096	9,974,533	1,608,640
Capital assets-depreciable, net (Note 5)	15,609,459	22,411	15,631,870	5,068,825
Total Assets	36,225,528	1,267,058	37,492,586	17,213,686
LIABILITIES				
Accounts payable and accrued liabilities	1,239,924	24,067	1,263,991	549,345
Medical claims payable	762,427	—	762,427	7,308
Unemployment benefits payable	—	20,048	20,048	—
Tax refunds payable	1,056,880	—	1,056,880	—
Obligations under securities lending	3,426,369	193,909	3,620,278	—
Interest payable	57,931	35	57,966	24,201
Short-term debt (Note 6)	—	251,759	251,759	23,841
Due to component units (Note 17)	276,402	—	276,402	55,833
Due to primary government (Note 17)	—	—	—	18,202
Unearned revenue	369,869	12,804	382,673	119,089
Advance from primary government (Note 17)	—	—	—	24,242
Obligations under reverse repurchase agreements	—	—	—	127,859
Deposits payable	918	75	993	13,220
Funds held for others	83,310	—	83,310	479,392
Long-term liabilities (Note 7):				
Due within one year	337,134	349	337,483	237,427
Due in more than one year	5,632,958	9,893	5,642,851	4,869,656
Total Liabilities	13,244,122	512,939	13,757,061	6,549,615
NET ASSETS				
Invested in capital assets, net of related debt	24,706,355	40,277	24,746,632	5,101,688
Restricted for:				
Nonexpendable:				
Environment and natural resources	52,520	—	52,520	—
Higher education	553	—	553	1,024,984
Health and human services	200	—	200	—
Expendable:				
Primary and secondary education	79,083	—	79,083	—
Higher education	368,809	—	368,809	2,180,721
Health and human services	132,078	—	132,078	2,176
Economic development	33,567	—	33,567	278,197
Environment and natural resources	13,772	—	13,772	—
Public safety, corrections, and regulation	199,185	—	199,185	—
Transportation	476,931	—	476,931	—
Unemployment compensation	—	20,125	20,125	—
EPA revolving loan	—	640,374	640,374	—
Other purposes	117,707	5,048	122,755	1,529
Unrestricted	(3,199,354)	48,295	(3,151,059)	2,074,776
Total Net Assets	$ 22,981,406	$ 754,119	$ 23,735,525	$ 10,664,071

The accompanying Notes to the Financial Statements are an integral part of this statement.

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STATEMENT OF ACTIVITIES

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

		Program Revenues			
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Net (Expense) Revenue**
Primary Government:					
Governmental Activities:					
General government	$ 807,248	$ 211,648	$ 57,995	$ 780	$ (536,825)
Primary and secondary education	7,223,766	15,181	950,113	—	(6,258,472)
Higher education	3,140,794	263	38,681	—	(3,101,850)
Health and human services	11,729,904	155,971	8,196,547	312	(3,377,074)
Economic development	536,055	34,986	323,456	—	(177,613)
Environment and natural resources	599,575	147,427	82,837	78,502	(290,809)
Public safety, corrections, and regulation	2,093,404	371,625	216,560	9,216	(1,496,003)
Transportation	1,870,578	553,229	229,039	795,103	(293,207)
Agriculture	82,394	14,760	12,896	432	(54,306)
Interest on long-term debt	191,228	—	—	—	(191,228)
Total Governmental Activities	28,274,946	1,505,090	10,108,124	884,345	(15,777,387)
Business-type Activities:					
Unemployment Compensation	1,389,266	878,722	259,513	—	(251,031)
EPA Revolving Loan	5,342	13,876	44,310	—	52,844
Other business-type activities	43,014	34,293	1,230	892	(6,599)
Total Business-type Activities	1,437,622	926,891	305,053	892	(204,786)
Total Primary Government	$ 29,712,568	$ 2,431,981	$ 10,413,177	$ 885,237	$ (15,982,173)
Component Units:					
The Golden LEAF, Inc.	$ 75,445	$ 6	$ 27,683	$ —	$ (47,756)
University of North Carolina System	5,745,387	3,403,410	819,133	49,169	(1,473,675)
Community Colleges	1,322,475	237,722	420,874	124,617	(539,262)
N.C. Housing Finance Agency	202,441	218,945	—	—	16,504
State Education Assistance Authority	137,165	59,414	36,479	—	(41,272)
Other component units	180,710	43,634	9,900	77	(127,099)
Total Component Units	$ 7,663,623	$ 3,963,131	$ 1,314,069	$ 173,863	$ (2,212,560)

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF ACTIVITIES (continued)

For the Fiscal Year Ended June 30, 2004 — *Exhibit A-2*

(Dollars in Thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
Changes in Net Assets:				
Net (expense) revenue	$ (15,777,387)	$ (204,786)	$ (15,982,173)	$ (2,212,560)
General Revenues:				
Taxes				
Individual income tax	7,407,455	—	7,407,455	—
Corporate income tax	760,180	—	760,180	—
Sales and use tax	4,293,040	—	4,293,040	—
Gasoline tax	1,276,627	—	1,276,627	—
Franchise tax	560,708	—	560,708	—
Highway use tax	578,346	—	578,346	—
Insurance tax	432,975	—	432,975	—
Beverage tax	213,271	—	213,271	—
Inheritance tax	128,352	—	128,352	—
Other taxes	313,985	—	313,985	—
Tobacco settlement	147,224	—	147,224	—
Federal grants not restricted to specific programs	136,859	—	136,859	—
Unrestricted investment earnings	77,225	—	77,225	—
State operating aid	—	—	—	2,605,834
State capital aid	—	—	—	627,660
Miscellaneous	62,601	3	62,604	77
Contributions to permanent funds	2,068	—	2,068	—
Contributions to endowments	—	—	—	63,903
Transfers	(302)	302	—	—
Total general revenues, contributions and transfers	16,390,614	305	16,390,919	3,297,474
Change in net assets	613,227	(204,481)	408,746	1,084,914
Net assets — July 1, as restated (Note 21)	22,368,179	958,600	23,326,779	9,579,157
Net assets — June 30	$ 22,981,406	$ 754,119	$ 23,735,525	$ 10,664,071

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FUND FINANCIAL STATEMENTS

BALANCE SHEET
GOVERNMENTAL FUNDS

June 30, 2004 *Exhibit B-1*

(Dollars in Thousands)

	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash and cash equivalents (Note 3)	$ 1,204,341	$ 307,635	$ 320,674	$ 2,222,224	$ 4,054,874
Investments (Note 3)	1,918	—	—	477,761	479,679
Securities lending collateral (Note 3)	2,084,291	295,069	201,363	823,856	3,404,579
Receivables, net: (Note 4)					
Taxes receivable	759,276	85,791	29,888	4,646	879,601
Accounts receivable	333,791	5	658	24,099	358,553
Intergovernmental receivable	714,716	24,928	505	8,347	748,496
Interest receivable	5,505	845	1,103	5,158	12,611
Contributions receivable	28,139	—	—	—	28,139
Other receivables	—	10,417	—	—	10,417
Due from fiduciary funds (Note 4)	2	—	—	1	3
Due from other funds (Note 9)	109	106,635	9,434	149,251	265,429
Due from component units (Note 17)	11,074	—	—	6,082	17,156
Inventories	54,689	66,903	—	28,874	150,466
Prepaid items	—	—	—	132	132
Advances to other funds (Note 9)	—	—	124,006	—	124,006
Advances to component units (Note 17)	—	—	—	24,242	24,242
Notes receivable, net (Note 4)	1,240	137	—	281,301	282,678
Securities held in trust	603	3,820	—	37,215	41,638
Endowment investments (Note 3)	—	—	—	55,211	55,211
Total Assets	$ 5,199,694	$ 902,185	$ 687,631	$ 4,148,400	$ 10,937,910
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable and accrued liabilities:					
Accounts payable	$ 85,011	$ 182,527	$ 74,909	$ 97,852	$ 440,299
Accrued payroll	5,927	34,727	—	871	41,525
Intergovernmental payable	570,944	96,718	43,483	5,838	716,983
Claims payable	—	—	—	27,590	27,590
Medical claims payable	762,427	—	—	—	762,427
Tax refunds payable	1,056,880	—	—	—	1,056,880
Obligations under securities lending	2,084,291	295,069	201,363	823,856	3,404,579
Interest payable	1,558	—	—	—	1,558
Due to fiduciary funds (Note 9)	7,043	—	—	47	7,090
Due to other funds (Note 9)	36,862	7,257	94,543	144,827	283,489
Due to component units (Note 17)	7,644	—	—	268,758	276,402
Deferred revenue	654,271	11,146	7,248	14,153	686,818
Advance from other funds (Note 9)	122,350	1,656	—	—	124,006
Deposits payable	51	—	—	867	918
Funds held for others	722	45,268	—	37,320	83,310
Total Liabilities	5,395,981	674,368	421,546	1,421,979	7,913,874
Fund Balances:					
Reserved (Note 10)	197,448	49,139	124,006	674,029	1,044,622
Unreserved, reported in:					
General Fund (Note 10)	(393,735)	—	—	—	(393,735)
Special Revenue Funds	—	178,678	142,079	1,939,617	2,260,374
Capital Projects Funds	—	—	—	110,395	110,395
Permanent Funds	—	—	—	2,380	2,380
Total Fund Balance	(196,287)	227,817	266,085	2,726,421	3,024,036
Total Liabilities and Fund Balances	$ 5,199,694	$ 902,185	$ 687,631	$ 4,148,400	$ 10,937,910

The accompanying Notes to the Financial Statements are an integral part of this statement.

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS

June 30, 2004 *Exhibit B-1a*

(Dollars in Thousands)

Total fund balances - governmental funds (see Exhibit B-1)		$ 3,024,036
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
- **Capital assets** used in governmental activities are not financial resources and, therefore, are not reported in the funds (see Note 5). These consist of:		
Cost of capital assets (excluding internal service funds)	$ 31,871,385	
Less: Accumulated depreciation (excluding internal service funds)	(6,406,086)	
Net capital assets		25,465,299
- **Some assets**, such as receivables, are not available soon enough to pay for current-period expenditures and thus, are offset by deferred revenue in the governmental funds.		319,205
- **Pension assets**, resulting from contributions in excess of the annual required contribution are not financial resources and, therefore, are not reported in the funds (see Note 11).		278
- **Long-term debt instruments**, such as bonds and notes payable, are not due and payable in the current period and, therefore, the outstanding balances are not reported in the funds (see Note 7). Also, unamortized debt premiums, discounts, and losses on refundings are reported in the Statement of Net Assets but are not reported in the funds. These balances consist of:		
General obligation bonds payable	(4,982,860)	
Lease-purchase revenue bonds payable	(218,405)	
Certificates of participation payable	(301,165)	
Unamortized debt premiums (to be amortized as interest expense)	(158,773)	
Less: Unamortized debt discounts (to be amortized as interest expense)	1,724	
Less: Unamortized loss on refunding (to be amortized as interest expense)	57,940	
Notes payable	(25,008)	
Capital leases payable	(304)	
Net long-term debt		(5,626,851)
- **Other liabilities** not due and payable in the current period and, therefore, not reported in the funds (see Note 7 as applicable) consist of:		
Accrued interest payable	(56,373)	
Compensated absences (excluding internal service funds)	(323,734)	
Obligations for workers compensation	(6,195)	
Arbitrage rebate payable	(43)	
Deferred death benefit payable	(270)	
Cost settlement payable	(7,500)	
Net pension obligation	(2,186)	
Total other liabilities		(396,301)
- **Internal service funds** are used by management to charge the costs of certain activities to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets (see Exhibit B-3).		195,740
Total net assets - governmental activities (see Exhibit A-1)		$ 22,981,406

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES GOVERNMENTAL FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit B-2*

(Dollars in Thousands)

	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Total Governmental Funds
Revenues:					
Taxes:					
Individual income tax	$ 7,404,956	$ —	$ —	$ 493	$ 7,405,449
Corporate income tax	699,441	—	—	60,120	759,561
Sales and use tax	4,268,292	—	—	23,366	4,291,658
Gasoline tax	—	935,381	310,768	30,324	1,276,473
Franchise tax	560,502	—	—	—	560,502
Highway use tax	—	—	578,346	—	578,346
Insurance tax	423,405	—	—	9,570	432,975
Beverage tax	213,271	—	—	—	213,271
Inheritance tax	129,579	—	—	—	129,579
Other taxes	181,057	—	—	132,758	313,815
Federal funds	8,769,925	983,106	—	336,044	10,089,075
Local funds	636,900	4,203	330	16,521	657,954
Investment earnings	100,336	14,354	11,315	34,841	160,846
Interest earnings on loans	—	—	—	5,801	5,801
Sales and services	76,192	1,296	—	132,673	210,161
Rental and lease of property	6,722	16,854	1,115	3,157	27,848
Fees, licenses, and fines	315,621	437,351	94,079	188,252	1,035,303
Tobacco settlement	146,452	—	—	—	146,452
Contributions, gifts, and grants	50,374	741	—	99,616	150,731
Funds escheated	—	—	—	55,330	55,330
Federal funds for fiscal relief	136,859	—	—	—	136,859
Miscellaneous	154,380	12,484	320	29,753	196,937
Total revenues	24,274,264	2,405,770	996,273	1,158,619	28,834,926
Expenditures:					
Current:					
General government	664,607	—	—	46,720	711,327
Primary and secondary education	7,048,359	—	—	174,784	7,223,143
Higher education	2,484,004	—	—	656,694	3,140,698
Health and human services	11,648,072	—	—	74,649	11,722,721
Economic development	182,785	—	—	349,889	532,674
Environment and natural resources	229,286	—	—	352,440	581,726
Public safety, corrections, and regulation	1,728,183	—	—	345,155	2,073,338
Transportation	—	2,590,809	798,233	—	3,389,042
Agriculture	73,413	—	—	8,075	81,488
Capital outlay	—	—	—	385,506	385,506
Debt service:					
Principal retirement	218,749	78	16,675	290	235,792
Interest and fees	168,738	217	15,482	913	185,350
Debt issuance costs	1,198	—	—	3,632	4,830
Total expenditures	24,447,394	2,591,104	830,390	2,398,747	30,267,635
Excess revenues over (under) expenditures	(173,130)	(185,334)	165,883	(1,240,128)	(1,432,709)
Other Financing Sources (Uses):					
Bonds issued	—	—	400,000	977,560	1,377,560
Certificates of participation issued	—	—	—	283,955	283,955
Refunding bonds issued	326,710	—	—	—	326,710
Other debt issued	2,243	15,354	—	—	17,597
Premium on debt issued	22,456	—	31,130	83,670	137,256
Payment to refunded bond escrow agent	(346,915)	—	—	—	(346,915)
Sale of capital assets	1,043	5,822	1,023	2,217	10,105
Transfers in (Note 9)	530,773	317,107	—	718,640	1,566,520
Transfers out (Note 9)	(391,621)	(226,644)	(540,123)	(398,820)	(1,557,208)
Total other financing sources (uses)	144,689	111,639	(107,970)	1,667,222	1,815,580
Net change in fund balances	(28,441)	(73,695)	57,913	427,094	382,871
Fund balances — July 1, as restated (Note 21)	(167,139)	299,920	208,172	2,294,651	2,635,604
Increase (decrease) in reserve for related assets	(707)	1,592	—	4,676	5,561
Fund balances — June 30	$ (196,287)	$ 227,817	$ 266,085	$ 2,726,421	$ 3,024,036

The accompanying Notes to the Financial Statements are an integral part of this statement.

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

June 30, 2004 *Exhibit B-2a*

(Dollars in Thousands)

Net change in fund balances - total governmental funds (see Exhibit B-2)		$ 382,871
Amounts reported for governmental activities in the Statement of Activities are different because:		
- **Capital outlays** are reported as expenditures in governmental funds. However, in the Statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:		
Capital outlays (including construction-in-progress)	$ 2,364,444	
Less: Depreciation expense (excluding internal service funds)	(502,535)	
Net capital outlay adjustment		1,861,909
- **Proceeds from the sale of capital assets** increase financial resources in the funds, whereas in the Statement of Activities only the gain or loss on the sale is reported. This adjustment reduces the proceeds by the book value of the capital assets sold.		(27,844)
- **Donations of capital assets** do not appear in the governmental funds because they are not financial resources, but increase net assets in the statement of activities.		770
- **Long-term debt** proceeds provide current financial resources to governmental funds, while the repayment of the related debt principal consumes those financial resources. These transactions, however, have no effect on net assets. Also, governmental funds report the effect of premiums and similar items when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. In the current period, these amounts consist of:		
Debt issued or incurred:		
Bonds and similar debt issued	(1,679,112)	
Refunding bonds issued	(326,710)	
Premiums on debt issued	(136,960)	
Principal repayments:		
Bonds, notes, and similar debt	235,633	
Capital leases	159	
Payments to escrow agent for refundings	346,915	
Net debt adjustments		(1,560,075)
- **Some revenues** in the Statement of Activities do not provide current financial resources and, therefore, are deferred in the funds. Also, revenues related to prior periods that became available during the current period are reported in the funds but are eliminated in the Statement of Activities. This amount is the net adjustment.		8,515
- **Some expenses** reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not recognized in the funds. Also, some payments related to prior periods are recognized in the funds but are eliminated in the Statement of Activities. In the current period, the net adjustments consist of:		
Accrued interest	(12,593)	
Compensated absences (excluding internal service funds)	(56,169)	
Workers compensation	624	
Arbitrage rebate	1,034	
Deferred death benefit	(165)	
Cost settlement	12,500	
Net pension obligation	2,717	
Amortization of deferred amounts	6,419	
Net expense accruals		(45,633)
- **Inventories** of governmental funds are recorded as expenditures when purchased but in the Statement of Activities are recorded as expenses when consumed.		5,561
- **Internal service funds** are used by management to charge the costs of certain activities to individual funds. The net revenues of internal service funds are included with governmental activities in the Statement of Activities (see Exhibit B-4).		(12,847)
Change in net assets - governmental activities (see Exhibit A-2)		$ 613,227

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS

June 30, 2004 *Exhibit B-3*

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				Governmental Activities —
	Unemployment Compensation Fund	EPA Revolving Loan Fund	Other Enterprise Funds	Total Enterprise Funds	Internal Service Funds
ASSETS					
Current Assets:					
Cash and cash equivalents (Note 3)	$ 15,949	$ 202,890	$ 26,828	$ 245,667	$ 50,984
Investments (Note 3)	—	—	35,022	35,022	19,485
Restricted investments (Note 3)	—	—	2	2	—
Securities lending collateral (Note 3)	7,349	151,980	34,580	193,909	21,790
Receivables: (Note 4					
Accounts receivable, net	23,205	46	407	23,658	13,979
Intergovernmental receivables	—	36	—	36	—
Interest receivable	24	2,565	46	2,635	41
Premiums receivable	—	—	737	737	141
Contributions receivable, net	270,639	—	—	270,639	—
Notes receivable, net (Note 4)	—	27,158	—	27,158	—
Due from fiduciary funds (Note 4)	—	—	—	—	2
Due from other funds (Note 9)	91	—	—	91	19,415
Due from component units (Note 17)	—	—	—	—	1,046
Inventories	—	—	485	485	264
Prepaid items	—	—	1,845	1,845	12,205
Total current assets	317,257	384,675	99,952	801,884	139,352
Noncurrent Assets:					
Restricted/designated cash and cash equivalents (Note 3)	—	—	4,135	4,135	—
Investments (Note 3)	—	—	40	40	—
Restricted investments (Note 3)	—	—	3,345	3,345	—
Notes receivable, net (Note 4)	—	408,062	—	408,062	—
Deferred charges	—	—	118	118	—
Capital assets-nondepreciable (Note 5)	—	—	27,096	27,096	3,298
Capital assets-depreciable, net (Note 5)	—	155	22,256	22,411	88,299
Total noncurrent assets	—	408,217	56,990	465,207	91,597
Total Assets	317,257	792,892	156,942	1,267,091	230,949
LIABILITIES					
Current Liabilities:					
Accounts payable and accrued liabilities					
Accounts payable	6,123	33	482	6,638	4,613
Accrued payroll	—	1	92	93	597
Intergovernmental payable	1,887	—	—	1,887	—
Claims payable	1,716	—	13,733	15,449	1,227
Unemployment benefits payable	20,048	—	—	20,048	—
Obligations under securities lending	7,349	151,980	34,580	193,909	21,790
Interest payable	—	—	35	35	—
Due to other funds (Note 9)	—	8	25	33	1,413
Deferred revenue	8,250	—	4,554	12,804	2,256
Deposits payable	—	—	75	75	—
Short-term debt (Note 6)	251,759	—	—	251,759	—
Bonds payable - current	—	—	255	255	—
Compensated absences - current	—	32	62	94	372
Total current liabilities	297,132	152,054	53,893	503,079	32,268
Noncurrent Liabilities:					
Bonds payable, net	—	—	9,070	9,070	—
Compensated absences	—	309	514	823	2,941
Total noncurrent liabilities	—	309	9,584	9,893	2,941
Total Liabilities	297,132	152,363	63,477	512,972	35,209
NET ASSETS					
Invested in capital assets, net of related debt	—	155	40,122	40,277	91,597
Restricted for:					
Capital outlay	—	—	5,048	5,048	—
Unrestricted	20,125	640,374	48,295	708,794	104,143
Total Net Assets	$ 20,125	$ 640,529	$ 93,465	$ 754,119	$ 195,740

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit B-4*

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				Governmental Activities —
	Unemployment Compensation Fund	EPA Revolving Loan Fund	Other Enterprise Funds	Total Enterprise Funds	Internal Service Funds
Operating Revenues:					
Employer unemployment contributions	$ 840,765	$ —	$ —	$ 840,765	$ —
Federal funds	37,957	—	—	37,957	—
Sales and services	—	1,238	1,086	2,324	211,296
Sales and services used as security for bonds, net	—	—	3,672	3,672	—
Interest earnings on loans	—	12,638	—	12,638	—
Rental and lease earnings	—	—	4,613	4,613	56
Fees, licenses and fines	—	—	11,549	11,549	—
Insurance premiums	—	—	13,259	13,259	16,203
Miscellaneous	—	—	114	114	492
Total operating revenues	878,722	13,876	34,293	926,891	228,047
Operating Expenses:					
Personal services	—	2,897	7,558	10,455	44,455
Supplies and materials	—	10	1,134	1,144	9,409
Services	—	555	6,572	7,127	96,058
Cost of goods sold	—	—	458	458	1,853
Depreciation/amortization	—	18	1,552	1,570	27,772
Claims	—	—	19,647	19,647	1,676
Unemployment benefits	1,388,303	—	—	1,388,303	—
Insurance and bonding	—	—	4,213	4,213	15,101
Other	—	403	1,410	1,813	35,796
Total operating expenses	1,388,303	3,883	42,544	1,434,730	232,120
Operating income (loss)	(509,581)	9,993	(8,251)	(507,839)	(4,073)
Nonoperating Revenues (Expenses):					
Noncapital grants	257,304	37,280	—	294,584	—
Noncapital gifts	—	—	213	213	—
Investment earnings	2,209	7,030	1,005	10,244	779
Interest and fees	(817)	—	(49)	(866)	—
Insurance recoveries	—	—	1	1	145
Gain (loss) on sale of equipment	—	—	3	3	198
Miscellaneous	(146)	(1,459)	(410)	(2,015)	(282)
Total nonoperating revenues (expenses)	258,550	42,851	763	302,164	840
Income (loss) before contributions and transfers	(251,031)	52,844	(7,488)	(205,675)	(3,233)
Capital contributions	—	—	892	892	—
Transfers in (Note 9)	25	7,358	5,814	13,197	136
Transfers out (Note 9)	(6,349)	(1,351)	(5,195)	(12,895)	(9,750)
Change in net assets	(257,355)	58,851	(5,977)	(204,481)	(12,847)
Net assets — July 1, as restated (Note 21)	277,480	581,678	99,442	958,600	208,587
Net assets — June 30	$ 20,125	$ 640,529	$ 93,465	$ 754,119	$ 195,740

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				Governmental Activities —
	Unemployment Compensation Fund	EPA Revolving Loan Fund	Other Enterprise Funds	Total Enterprise Funds	Internal Service Funds
Cash Flows From Operating Activities:					
Receipts from customers	$ 798,508	$ 1,194	$ 33,904	$ 833,606	$ 51,640
Receipts from federal agencies	41,515	—	—	41,515	—
Receipts from other funds	—	—	572	572	178,778
Payments to suppliers	—	(622)	(12,525)	(13,147)	(151,955)
Payments to employees	—	(2,819)	(7,398)	(10,217)	(43,925)
Payments for benefits and claims	(1,386,268)	—	(15,961)	(1,402,229)	(1,038)
Payments to other funds	—	—	(247)	(247)	(7,145)
Loan issuances	—	(53,698)	—	(53,698)	—
Loan repayments — interest	—	12,654	—	12,654	—
Loan repayments — principal	—	28,791	—	28,791	—
Other receipts (payments)	—	(346)	(151)	(497)	(1,617)
Net cash flows provided (used) by operating activities	(546,245)	(14,846)	(1,806)	(562,897)	24,738
Cash Provided From (Used For) Noncapital Financing Activities:					
Grants	257,304	37,283	—	294,587	—
Proceeds from short-term borrowing	748,791	—	—	748,791	—
Principal payments from short-term borrowing	(497,032)	—	—	(497,032)	—
Interest expense and issuance cost	(817)	—	—	(817)	—
Transfers from other funds	25	7,358	4,970	12,353	136
Transfers to other funds	(6,349)	(1,351)	(5,195)	(12,895)	(9,750)
Gifts	—	—	213	213	—
Total cash provided from (used for) noncapital financing activities	501,922	43,290	(12)	545,200	(9,614)
Cash Provided From (Used For) Capital Financing Activities:					
Acquisition and construction of capital assets	—	(45)	(5,286)	(5,331)	(32,159)
Proceeds from the sale of capital assets	—	—	66	66	3,410
Capital contributions	—	—	892	892	—
Principal paid on capital debt	—	—	(245)	(245)	—
Interest paid on capital debt	—	—	(412)	(412)	—
Payment to bond escrow agent	—	—	(43)	(43)	—
Insurance recoveries	—	—	1	1	145
Total cash provided from (used for) capital financing activities	—	(45)	(5,027)	(5,072)	(28,604)
Cash Provided From (Used For) Investment Activities:					
Proceeds from the sale/maturities of non-State Treasurer investments	—	—	12,122	12,122	—
Purchase of non-State Treasurer investments	—	—	(9,356)	(9,356)	—
Purchase into State Treasurer investment pool	—	—	(3,372)	(3,372)	—
Investment earnings	2,090	5,608	712	8,410	654
Total cash provided from (used for) investment activities	2,090	5,608	106	7,804	654
Net increase (decrease) in cash and cash equivalents	(42,233)	34,007	(6,739)	(14,965)	(12,826)
Cash and cash equivalents at July 1	58,182	168,883	37,702	264,767	63,810
Cash and cash equivalents at June 30	$ 15,949	$ 202,890	$ 30,963	$ 249,802	$ 50,984

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit B-5*

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				Governmental Activities —
	Unemployment Compensation Fund	**EPA Revolving Loan Fund**	**Other Enterprise Funds**	**Total Enterprise Funds**	**Internal Service Funds**
Reconciliation of Operating Income to Net Cash Provided From (Used For) Operating Activities:					
Operating income (loss)	$ (509,581)	$ 9,993	$ (8,251)	$ (507,839)	$ (4,073)
Adjustments to reconcile operating income to net cash flows from operating activities:					
Depreciation/amortization	—	18	1,552	1,570	27,772
Mortgage/loan/note principal repayments	—	28,791	—	28,791	—
Mortgages/loans/notes issued	—	(53,698)	—	(53,698)	—
Restatements and adjustments to cash	—	—	275	275	—
Nonoperating miscellaneous income (expense)	—	—	9	9	5
(Increases) decreases in assets:					
Receivables	(40,236)	(29)	1,302	(38,963)	3,945
Due from other funds	(49)	—	—	(49)	(777)
Due from fiduciary funds	—	—	—	—	1
Due from component units	—	—	—	—	(85)
Inventories	—	—	(29)	(29)	(5)
Prepaid items	—	—	698	698	(3,005)
Increases (decreases) in liabilities:					
Accounts payable and accrued liabilities	(796)	(6)	3,876	3,074	1,410
Due to other funds	—	8	19	27	(724)
Unemployment benefits payable	6,644	—	—	6,644	—
Compensated absences	—	77	140	217	507
Deferred revenue	(2,227)	—	(1,354)	(3,581)	(233)
Deposits payable	—	—	(43)	(43)	—
Total cash provided from (used for) operations	$ (546,245)	$ (14,846)	$ (1,806)	$ (562,897)	$ 24,738
Noncash Investing, Capital, and Financing Activities:					
Noncash distributions from the State Treasurer Long-Term Investment Portfolio and/or other agents	$ —	$ —	$ 3,080	3,080	$ 1,601
Transferred assets	—	—	844	844	—
Change in construction in progress as a result of accrual of accounts payable	—	—	(874)	(874)	—
Assets acquired through the assumption of a liability	7,349	151,980	34,580	193,909	21,790
Change in fair value of investments	—	—	(3,014)	(3,014)	(1,749)

STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS

June 30, 2004 *Exhibit B-6*

(Dollars in Thousands)

	Pension and Other Employee Benefit Trust Funds	Investment Trust Fund	Private-Purpose Trust Funds	Agency Funds
ASSETS				
Cash and cash equivalents (Note 3)	$ 320,501	$ 43,160	$ 98,767	$ 2,843,594
Investments (Note 3)				
Annuity contracts	980,480	—	—	—
U.S. Government securities	—	—	2,285	—
State and municipal securities	—	—	1,027	—
Mutual funds	2,131,846	—	—	—
Certificates of deposit	—	—	60,686	462
State Treasurer investment pool	61,185,256	473,303	—	45,191
Securities lending collateral (Note 3)	13,589,908	370,569	552	1,794,869
Receivables				
Taxes receivable	—	—	—	165,100
Accounts receivable	24,267	—	—	849
Intergovernmental receivables	—	—	—	954
Interest receivable	1,338	1,673	2	5,571
Contributions receivable	85,730	—	—	—
Due from other funds (Note 9)	—	—	—	7,090
Notes receivable	128,244	—	—	—
Inventories	—	—	—	301
Sureties	—	—	950,194	50,240
Capital assets-depreciable, net	7	—	—	—
Total Assets	78,447,577	888,705	1,113,513	4,914,221
Liabilities:				
Accounts payable and accrued liabilities				
Accounts payable	16,164	—	—	54
Intergovernmental payables	—	—	—	584,007
Benefits payable	290,252	—	—	—
Distributions payable	—	1,241	—	—
Medical claims payable	166,672	—	—	—
Obligations under securities lending	13,589,908	370,569	552	1,794,869
Due to other funds (Note 9)	5	—	—	—
Deferred revenue	19,284	—	—	—
Deposits payable	—	—	—	1,781
Funds held for others	—	—	—	2,533,510
Compensated absences	54	—	—	—
Total Liabilities	14,082,339	371,810	552	4,914,221
Net Assets:				
Held in trust for:				
Employees' pension and other benefits	64,365,238	—	—	—
Pool participants	—	516,895	—	—
Individuals, organizations and other governments	—	—	1,112,961	—
Total Net Assets	$ 64,365,238	$ 516,895	$ 1,112,961	$ —

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS FIDUCIARY FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit B-7*

(Dollars in Thousands)

	Pension and Other Employee Benefit Trust Funds	Investment Trust Fund	Private-Purpose Trust Funds
Additions:			
Contributions:			
Employer	$ 1,644,814	$ —	$ —
Members	1,468,757	—	—
Trustee deposits	—	—	418,045
Other contributions	18,598	—	—
Total contributions	3,132,169	—	418,045
Investment income			
Investment earnings (loss)	7,331,230	21,170	1,814
Less investment expenses	(242,718)	(4,388)	(6)
Net investment income (loss)	7,088,512	16,782	1,808
Pool share transactions			
Reinvestment of dividends	—	17,176	—
Net share purchases/(redemptions)	—	(30,025)	—
Net pool share transactions	—	(12,849)	—
Other additions:			
Fees, licenses and fines	4,572	—	—
Interest earnings on loans	10,410	—	—
Miscellaneous	2,061	—	—
Total other additions	17,043	—	—
Total additions	10,237,724	3,933	419,853
Deductions:			
Claims and benefits	4,416,835	—	—
Refund of contributions	160,304	—	—
Distributions paid and payable	—	16,782	—
Payments in accordance with trust arrangements	—	—	137,784
Administrative expenses	61,429	—	3
Other deductions	148	—	—
Total deductions	4,638,716	16,782	137,787
Change in net assets	5,599,008	(12,849)	282,066
Net assets — July 1, as restated	58,766,230	529,744	830,895
Net assets — June 30	$ 64,365,238	$ 516,895	$ 1,112,961

The accompanying Notes to the Financial Statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity

The accompanying government-wide financial statements present the State of North Carolina and its component units. The State of North Carolina, as primary government, consists of all organizations that make up its legal entity. All funds, organizations, agencies, boards, commissions, and authorities that are not legally separate are, for financial reporting purposes, part of the primary government. The primary government has a separately elected governing body (the General Assembly) and the primary government must be both legally separate and fiscally independent. Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, to be financially accountable, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific financial benefits to, or impose specific financial burdens on, the State. Financial accountability also exists when an organization is fiscally dependent upon the State. The State's defined benefit pension plans, deferred compensation plans, and other employee benefit plans, being fiduciary in nature, were not evaluated as potential component units but instead are reported as fiduciary funds.

The State's component units are either blended or discretely presented. The blended component unit is so intertwined with the State that it is, in substance, the same as the State and, therefore, is reported as if it was part of the State primary government. The "Component Units" column in the accompanying financial statements include the financial data of the State's discretely presented component units. They are combined and reported in a separate column in the government-wide financial statements to emphasize their legal separateness from the State.

Blended Component Unit

The North Carolina Infrastructure Finance Corporation

The North Carolina Infrastructure Finance Corporation (Corporation) was created by the General Assembly and organized as a separate not-for-profit corporation. It is managed by a three-member board appointed by the State Treasurer. The Corporation is authorized to issue tax-exempt debt to finance the acquisition, construction, repair and renovation of State facilities and related infrastructure. The debt obligations are secured by lease-purchase agreements or installment financing contracts with the State, which constitute the imposition of a financial burden on the State. The substance of the financing agreements is that the assets and debt are those of the State (lessee). The Corporation is reported with the State's governmental funds since it provides services entirely to the State.

Discretely Presented Component Units - Major

The Golden LEAF (Long-term Economic Advancement Foundation), Inc.

The Golden LEAF, Inc. (Foundation) is a legally separate not-for-profit corporation ordered to be created by the Consent Decree and Final Judgment in the State of North Carolina vs. Philip Morris, et al. The Foundation was established to receive and distribute fifty percent of the tobacco settlement funds allocated to North Carolina, such funds to be used to provide economic impact assistance to economically affected or tobacco-dependent regions of North Carolina. The Foundation is governed by a fifteen-member board, all of whom are appointed by either the Governor, President Pro Tempore of the Senate, or the Speaker of the House. The State assigned fifty percent of its share of the settlement to the Foundation, creating a financial benefit/burden relationship.

University of North Carolina System

The Board of Governors of the consolidated University of North Carolina (UNC) System is a legally separate body, composed of thirty-two members elected by the General Assembly. The Board of Governors establishes system-wide administrative policies while budgetary decisions are exercised at the State level. Within the consolidated System are UNC-General Administration, which is the administrative arm of the Board of Governors; the sixteen constituent universities; and the University of North Carolina Health Care System (UNCHCS). Each of the sixteen universities, in turn, is governed by its own separate board of trustees that is responsible for the operations of that campus only. UNCHCS is governed by a separate board of directors. Funding for the UNC System is accomplished by State appropriations, tuition and fees, sales and services, federal grants, state grants, and private donations and grants.

Also included in the System are the financial data of the universities' significant fund-raising foundations (and similarly affiliated organizations). Although the universities do not control the timing or amount of receipts from their foundations, the majority of resources (or income thereon) that the foundations hold and invest are restricted to the activities of the respective universities by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the specific universities, the foundations are considered component units of the universities and are included in the universities' financial statements. The foundations are private not-for-profit organizations that report under Financial Accounting Standards Board pronouncements. As such, certain revenue recognition criteria and presentation features are different from that of the Governmental Accounting Standards Board. The foundations' financial statement formats were modified to make them compatible with the universities' financial statement formats.

NOTES TO THE FINANCIAL STATEMENTS

The following constituent institutions comprise the UNC System for financial reporting purposes:

UNC General Administration
Appalachian State University
East Carolina University
Elizabeth City State University
Fayetteville State University
North Carolina Agricultural and Technical State University
North Carolina Central University
North Carolina School of the Arts
North Carolina State University
University of North Carolina at Asheville
University of North Carolina at Chapel Hill
University of North Carolina at Charlotte
University of North Carolina at Greensboro
University of North Carolina at Pembroke
University of North Carolina at Wilmington
Western Carolina University
Winston-Salem State University
University of North Carolina Health Care System

Community Colleges

There are currently fifty-eight community colleges located throughout the State of North Carolina. Each is a separate component unit of the reporting entity and is legally separate. The State does not appoint a voting majority of each community college board of trustees. However, the State is financially accountable for these institutions because the State Board of Community Colleges (the Board) approves the budgeting of state and federal funds, the associated budget revisions, and the selection of the chief administrative officer of each individual community college. The Board is comprised of state officials or their appointees. Each community college is similar in nature and function to all of the others, and the operations of no community college is considered major in relation to the operations of all community colleges in the system. Therefore, aggregated financial information is presented in this CAFR for all community colleges.

The aggregated financial information for community colleges also includes the financial data of the institutions' significant fund-raising foundations. Although the community colleges do not control the timing or amount of receipts from their foundations, the majority of resources (or income thereon) that the foundations hold and invest are restricted to the activities of the respective community colleges by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the specific community colleges, the foundations are considered component units of the community colleges and are included in the community colleges' financial statements. The foundations are private not-for-profit organizations that report under Financial Accounting Standards Board pronouncements. As such, certain revenue recognition criteria and presentation features are different from that of the Governmental Accounting Standards Board. The foundations' financial statement formats were modified to make them compatible with the community colleges' financial statement formats.

The following are the State's fifty-eight community colleges:

Alamance Comm. College	Asheville-Buncombe Technical Comm. College
Beaufort County Comm. College	Bladen Community College
Blue Ridge Comm. College	Brunswick Comm. College
Caldwell Comm. College and Tech. Institute	Cape Fear Comm. College
Carteret Comm. College	Catawba Valley Comm. College
Central Carolina Comm. College	Central Piedmont Comm. College
Cleveland Comm. College	Coastal Carolina Comm. College
College of The Albemarle	Craven Comm. College
Davidson County Comm. College	Durham Technical Comm. College
Edgecombe Comm. College	Fayetteville Technical Comm. College
Forsyth Technical Comm. College	Gaston College
Guilford Technical Comm. College	Halifax Comm. College
Haywood Comm. College	Isothermal Comm. College
James Sprunt Comm. College	Johnston Comm. College
Lenoir Comm. College	Martin Comm. College
Mayland Comm. College	McDowell Technical Comm. College
Mitchell Comm. College	Montgomery Comm. College
Nash Comm. College	Pamlico Comm. College
Piedmont Comm. College	Pitt Comm. College
Randolph Comm. College	Richmond Comm. College
Roanoke-Chowan Comm. College	Robeson Comm. College
Rockingham Comm. College	Rowan-Cabarrus Comm. College
Sampson Comm. College	Sandhills Comm. College
South Piedmont Comm. College	Southeastern Comm. College
Southwestern Comm. College	Stanly Comm. College
Surry Comm. College	Tri-County Comm. College
Vance-Granville Comm. College	Wake Technical Comm. College
Wayne Comm. College	Western Piedmont Comm. College
Wilkes Comm. College	Wilson Technical Comm. College

North Carolina Housing Finance Agency

The North Carolina Housing Finance Agency is a legally separate organization established to administer programs to finance construction of low and moderate income housing. The Agency has a thirteen-member board of directors, with twelve appointed by either the Governor or the General Assembly. The thirteenth member is elected by the other twelve. The State has the ability to impose its will since it can significantly influence the programs, projects, activities, and level of services of the Agency.

State Education Assistance Authority

The State Education Assistance Authority is a legally separate authority created to provide a system of financial assistance, consisting of grants, loans, work-study or other employment, and other aids, to qualified students to obtain an education beyond the high school level by attending public or private educational institutions. The Authority is governed by a seven-member board of directors, all of whom are appointed by the Governor. The State provides significant operating subsidies to the Authority; therefore, a financial benefit/burden relationship exists between the State and the Authority.

NOTES TO THE FINANCIAL STATEMENTS

Discretely Presented Component Units - Other

North Carolina Phase II Tobacco Certification Entity, Inc.

Phase II is one of the two tobacco settlements negotiated by cigarette-makers and the states. Under this settlement, tobacco companies agreed to create a trust fund for tobacco growers and quota holders in 14 grower states, including North Carolina. The amount allocated for distribution in North Carolina is intended to be paid out in the form of direct payments to qualified growers and quota holders through the year 2010. The money will be distributed in accordance with a plan designed and approved by a certification entity in each State. The certification entity in North Carolina is a nonprofit corporation governed by a fourteen-member board. Three members serve by virtue of their positions as state officials and nine members are appointed by either the Governor, President Pro Tempore of the Senate, or the Speaker of the House. Each year, the board determines the split of the distributable amount between the quota owners and the growers. The State has the ability to impose its will since appointed members may be removed at will.

North Carolina Global TransPark Authority

The North Carolina Global TransPark Authority (formerly North Carolina Air Cargo Airport Authority) is a legally separate authority created to administer the development of the North Carolina Global TransPark. Of the twenty-member governing board, nineteen are voting members. Seven of the voting members are appointed by the Governor and six are appointed by the General Assembly. The State has obligated itself to provide significant funding to the Authority; therefore, a financial benefit/ burden relationship exists between the State and the Authority. Also included in the Authority are the financial data of its blended component unit, the North Carolina Global TransPark Foundation (Foundation). The Authority appoints a majority of the Foundation's governing board and receives financial benefits from the Foundation.

North Carolina State Ports Authority

The North Carolina State Ports Authority is a legally separate authority established to operate the State's port facilities in Wilmington and Morehead City. It is governed by an eleven-member board, all of whom are appointed by either the Governor or the General Assembly. The State has obligated itself to provide significant funding to the Authority; therefore, a financial benefit/burden relationship exists between the State and the Authority.

North Carolina Railroad Company

The North Carolina Railroad Company is a legally separate, for-profit corporation owned by the State for the purpose of promoting trade, industry, and transportation within the State of North Carolina and advancing the economic interests of the State. The Railroad is governed by a fourteen member board, all of whom are elected by shares held by the State. A financial benefit/burden relationship exists between the State and the Railroad. Also, the State is financially accountable since the State's intent in owning the Railroad's stock is to directly enhance its ability to provide governmental services.

North Carolina Agricultural Finance Authority

The North Carolina Agricultural Finance Authority is a legally separate authority created to administer the financing of low-interest loans to farmers. The Authority is governed by a ten-member board, one of whom is a state official and nine of whom are appointed by either the Governor or the General Assembly. A financial benefit/burden relationship exists between the State and the Authority.

North Carolina Partnership for Children, Inc.

The North Carolina Partnership for Children, Inc., is a legally separate organization established to develop a comprehensive long-range strategic plan for early childhood development. A thirty-three-member board governs the Partnership. Certain elected state officials appoint twenty-nine of the members, while four members serve ex officio by virtue of their state positions. The State provides significant operating subsidies to the Partnership creating a benefit/burden relationship.

Regional Economic Development Commissions:

Northeastern North Carolina Regional Economic Development Commission

The Northeastern North Carolina Regional Economic Development Commission is a legally separate organization created to facilitate economic development and tourism in northeastern North Carolina. The Commission consists of seventeen members, including the Secretary of Commerce and the Secretary of the Department of Environment and Natural Resources (or their designees), five members appointed by the Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Southeastern North Carolina Regional Economic Development Commission

The Southeastern North Carolina Regional Economic Development Commission is a legally separate organization created to build economic strength in southeastern North Carolina. The Commission consists of fifteen members, with three appointed by the Governor, two by the Lieutenant Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Western North Carolina Regional Economic Development Commission

The Western North Carolina Regional Economic Development Commission is a legally separate organization created to improve economic opportunity in western North Carolina with sensitivity to the resources of that region. The Commission consists of fifteen members, with five appointed by the N.C. House of Representatives, five by the N.C. Senate, three by the Governor, and two by the Lieutenant Governor. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Availability of Financial Statements

Complete financial statements for the following component units can be obtained from the Office of the State Auditor, 2 South Salisbury Street, 20601 Mail Service Center, Raleigh, N.C. 27699-0601.

Constituent institutions in the UNC System
Community colleges
North Carolina State Ports Authority
North Carolina Partnership for Children, Inc.

Complete financial statements for the following component units can be obtained from the respective administrative offices of those units listed below:

The Golden LEAF, Inc.
800 Tiffany Boulevard, Suite 200
Rocky Mount, NC 27804

N.C. Housing Finance Agency
P.O. Box 28066
Raleigh, N.C. 27611-8066

State Education Assistance Authority
P.O. Box 2688
Chapel Hill, N.C. 27515-2688

North Carolina Railroad Company
2809 Highwoods Boulevard, Suite 100
Raleigh, NC 27604-1000

N.C Phase II Tobacco Certification Entity, Inc.
3000 Highwoods Blvd., Suite 315
Raleigh, N.C. 27604

Northeastern N.C. Regional Economic Development Commission
119 West Water Street
Edenton, N.C. 27932

Southeastern N.C. Regional Economic Development Commission
P.O. Box 2556
Elizabethtown, N.C. 28337

Western N.C. Regional Economic Development Commission
P.O. Box 1258
Arden, N.C. 28704

N.C. Agricultural Finance Authority
c/o N.C. Department of Agriculture And Consumer Services
P.O. Box 27647
Raleigh, NC 27611

N.C. Global TransPark Authority
P.O. Box 1476
Kinston, N.C. 28503-1476

The North Carolina Infrastructure Finance Corporation does not issue separate financial statements.

B. Basis of Presentation

The accompanying financial statements of the State of North Carolina financial reporting entity have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") as applicable to governments. The Governmental Accounting Standards Board (GASB) establishes standards of financial accounting and reporting for state and local governmental entities. In both the government-wide and proprietary fund financial statements, the State also applies Statements and Interpretations of the Financial Accounting Standards Board (FASB) issued on or before November 30, 1989, Accounting Principles Board Opinions, and Accounting Research Bulletins, unless those pronouncements conflict with or contradict GASB pronouncements. The financial statements of the North Carolina Railroad Company (Railroad), a for-profit corporation (discretely presented component unit), have been prepared in accordance with FASB pronouncements.

The financial statements are presented as of and for the fiscal year ended June 30, 2004, except for the USS North Carolina Battleship Commission whose statements are as of and for the fiscal year ended September 30, 2003, and the North Carolina Deferred Compensation Plan, the 401(k) Supplemental Retirement Income Plan, and the North Carolina Railroad Company whose statements are as of and for the fiscal year ended December 31, 2003.

The basic financial statements include both government-wide (based on the State as a whole) and fund financial statements as follows:

Government-wide Financial Statements

The statement of net assets and the statement of activities display information on all the nonfiduciary activities of the primary government (the State) and its component units. Fiduciary activities are excluded from the government-wide statements because they cannot be used to support the State's own programs. As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are interfund services provided and used between functions. Elimination of these charges would misstate both the expenses of the purchasing function and the program revenues of the selling function. These statements distinguish between the governmental and business-type activities of the State. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or identifiable activity are offset by program revenues. Direct expenses are those that are clearly associated with a specific function or identifiable activity. Certain charges to other funds or programs for "centralized" expenses also include an overhead markup that is included in direct expenses. Program revenues include (a) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or identifiable activity (including fees, fines and forfeitures and certain grants and contracts that are essentially contracts for services) and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program or identifiable activity (including restricted investment earnings or losses). Revenues that are not classified as program revenues, including all taxes, are presented as general revenues. Unrestricted resources internally dedicated by the State's governing body (General Assembly) are reported as general revenues rather than as program revenues. The State does not allocate general government (indirect) expenses to other functions.

Fund Financial Statements

The fund financial statements provide information about the State's funds, including its fiduciary funds. Separate statements for each fund category—governmental, proprietary, and fiduciary—are presented. The emphasis of fund financial statements is on major governmental and major enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

The State reports the following major governmental funds:

General Fund
This is the State's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

Highway Fund
This fund accounts for most of the activities of the Department of Transportation, including the construction and maintenance of the State's primary, secondary, and urban road systems. In addition, it supports areas such as the N.C. Ferry System, the Division of Motor Vehicles, public transportation, and railroad operations. The fund provides revenue to other State agencies to support initiatives such as the State Highway Patrol and driver's education. The principal revenues of the Highway Fund are motor fuels taxes, motor vehicle registration fees, driver's license fees, and federal aid. A portion of the motor fuel taxes is distributed to municipalities for local street projects.

Highway Trust Fund
This fund was established by legislation (Chapter 692 of the 1989 Session Laws) to provide a dedicated funding mechanism to meet highway construction needs for North Carolina. Taxes were increased for the specific purpose of improving identified primary transportation corridors within the State and for the completion of urban loops around seven major metropolitan areas. Additionally, this fund provides supplemental allocations for secondary road construction and supplemental assistance to municipalities for local street projects. The fund also makes transfers to the General Fund and the Highway Fund. The principal revenues of the Highway Trust Fund are highway use taxes, motor fuels taxes, and various title and registration fees.

The State reports the following major enterprise funds:

Unemployment Compensation Fund
This fund accounts for the State's unemployment insurance program, which is part of a national system established to provide temporary benefit payments to eligible unemployed workers. The unemployment benefits are financed primarily by State unemployment insurance taxes, distributions of federal unemployment insurance taxes, and federal funding for the unemployment benefits of civilian and military employees and for the extension of unemployment benefits. The unemployment taxes collected from employers are transferred to the United States Treasury and deposited into North Carolina's Unemployment Insurance Trust Fund.

EPA Revolving Loan Fund
This fund accounts for the activities of the State's clean water and drinking water revolving loan programs, which provide low cost loans to units of local government for the construction of wastewater facilities and drinking water infrastructure. These programs are financed primarily by federal capitalization grants from the United States Environmental Protection Agency (EPA), interest earnings on loans, loan repayments, and State funds (i.e., bond proceeds and State appropriations).

Additionally, the State reports the following fund types:

Internal Service Funds
These funds account for workers compensation and state property fire insurance coverages, motor fleet management services, mail services, temporary staffing services, computing and telecommunication services, and surplus property services provided to other departments or agencies of the State and its component units, or to other governments, on a cost-reimbursement basis.

Pension and Other Employee Benefits Trust Funds
These funds account for resources held in trust for the members and beneficiaries of the State's defined benefit pension plans, IRC Section 401(k) plan, IRC Section 457 plan, other defined contribution plans, death benefit plan, disability income plan, and health plan.

Investment Trust Fund
This fund accounts for the external portion of the Investment Pool sponsored by the Department of State Treasurer.

Private-purpose Trust Funds
These funds account for resources held in trust for insurance carriers, designated beneficiaries by the Administrative Office of the Courts, and other departmental trust funds in which the principal and income benefit individuals, private organizations, or other governments.

Agency Funds

These funds account for sales tax collections held on behalf of local governments, resources held by the Administrative Office of the Courts for distribution to designated beneficiaries, the Investment Pool's securities lending assets and liabilities allocated to participating component units, and other resources held by the State in a purely custodial capacity for individuals, private organizations, or other governments.

C. Measurement Focus and Basis of Accounting

Government-wide, Proprietary, and Fiduciary Fund Financial Statements

The government-wide, proprietary, and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, except for agency funds which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

Nonexchange transactions, in which the State receives (or gives) value without directly giving (or receiving) equal value in exchange, include taxes; fines and forfeitures; grants, entitlements, and similar items; and donations. Recognition standards are based on the characteristics and classes of nonexchange transactions. Income taxes, sales taxes, and other similar taxes on earnings or consumption are recognized as revenues, net of estimated refunds and uncollectible amounts, in the accounting period when the underlying exchange transaction has occurred. Franchise taxes, other taxes, and fines and forfeitures are recognized as revenues, net of estimated refunds and uncollectible amounts, in the accounting period when an enforceable legal claim to the assets arises and the use of resources is required or is first permitted. Grants, entitlements, and donations are recognized as revenues, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection. Amounts received before all eligibility requirements have been met are reported as deferred revenues. Grants and similar aid to other organizations are recognized as expenses as soon as recipients have met all eligibility requirements. Amounts paid before all eligibility requirements have been met are reported as prepaid items.

Governmental Fund Financial Statements

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and liabilities are generally included on the balance sheet. The operating statement presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in spendable resources. General capital asset acquisitions are reported as expenditures and proceeds of general long-term debt are reported as other financing sources. Under the modified accrual basis of accounting, revenues are recognized when both measurable and available. Generally, the State considers revenues reported in the governmental funds to be available if they are collectible within thirty-one days after year-end. Exceptions are the federal funds and county funds accrued for the matching share of the medicaid claims payable. Principal revenue sources considered susceptible to accrual include taxes, federal funds, local funds, and investment earnings. Other revenues are considered to be measurable and available only when cash is received by the State. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, compensated absences, obligations for workers' compensation, and arbitrage rebate liabilities, which are recognized as expenditures when payment is due. Pension expenditures are recognized when amounts are contributed to a plan.

D. Cash and Cash Equivalents

This classification includes undeposited receipts; petty cash; deposits held by the State Treasurer in the Short-term Investment portfolio (see Note 3); and demand and time deposits with private financial institutions, excluding certificates of deposit. The Short-term Investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.

E. Investments

This classification includes deposits held by the State Treasurer in certain long-term investment portfolios (see Note 3) as well as investments held separately by the State and its component units. Investments are generally reported at fair value. Additional investment valuation information is provided in Note 3. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

F. Securities Lending

Cash and securities received as collateral on securities lending transactions are reported as assets in the accompanying financial statements. Liabilities resulting from the securities lending transactions are also reported. Certain component units of the State deposit funds with the State Treasurer's Investment Pool, which participates in securities lending activities. The component units' position in the pool and related securities lending assets and liabilities are reported in an agency fund. Additional disclosures about the State Treasurer's securities lending transactions are provided in Note 3.

G. Receivables and Payables

Receivables in all funds represent amounts that have arisen in the ordinary course of business and are shown net of allowances for uncollectible amounts.

NOTES TO THE FINANCIAL STATEMENTS

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either “due to/due from other funds” (i.e., current portion of interfund loans) or “advances to/from other funds” (i.e., the non-current portion of interfund loans). All other outstanding balances between funds related to services provided and used, reimbursements, and transfers are classified as “due to/due from other funds.” Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as “internal balances.”

In the fund financial statements, advances between funds (and to component units) and notes receivable are offset by a reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

H. Inventories and Prepaid Items

The inventories of the State and component units are valued at cost using either the first-in, first-out, last invoice cost, or average cost method. These inventories consist of general supplies and materials. Institutions of the UNC system and community colleges also use these valuations along with the retail inventory method for some bookstore operations. The State Highway Fund (special revenue fund) accounts for its maintenance and construction inventories using the average cost method.

Except for maintenance and construction inventories of the State Highway Fund, inventories in the State's governmental funds are recorded as expenditures when purchased. In the fund financial statements, inventories are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources. All other inventories of the State and its component units are recognized as expenses or expenditures when consumed.

Certain payments to vendors and grantees reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

I. Restricted/Designated Assets

In the enterprise funds, unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations (i.e., are restricted for the acquisition/construction of capital assets). Unrestricted assets that are internally designated for capital purposes are also classified as noncurrent. Certain other assets are classified as restricted because their use is limited by statute.

J. Capital Assets

Capital assets, which include property, plant, equipment; easements; and infrastructure assets (e.g., State highway network, utility systems, and similar items), are reported in the government-wide financial statements and the fund financial statements for proprietary funds. Purchased or constructed capital assets are reported at cost or estimated historical cost. Donated fixed assets are recorded at their estimated fair value at the date of donation. The State highway network constructed prior to July 1, 2001 is recorded at estimated historical cost. Since July 1, 2001 the State highway network is recorded at cost. The initial estimated historical cost of the network is based on construction expenditures reported by the Department of Transportation less amounts estimated for the cost of right-of-ways and land improvements. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend its useful life are not capitalized.

Generally, capital assets are defined by the State and component units as assets with an initial value or cost greater than or equal to $5,000 and an estimated useful life of two or more years. Exceptions are certain component units (The Golden LEAF, Inc., N.C. Housing Finance Agency, N.C. Phase II Tobacco Certification Entity, Inc., N.C. State Ports Authority, N.C. Railroad Company, and N.C. Regional Economic Development Commissions), which maintain minimum thresholds of $1,000 or below.

The value of assets constructed by the State and its component units for their own use includes all material direct and indirect construction costs that are increased as a result of the construction. In proprietary funds and component units, interest costs incurred (if material) are capitalized during the period of construction.

The depreciation methods and estimated useful lives used by the state and component units are as follows:

Asset Class	Method	Estimated Useful Life
Buildings	Straight-line	10-50 years
Machinery and Equipment	Straight-line	2-25 years
	Units of output for motor vehicles	90,000 miles
Intangible assets	Straight-line	2-40 years
Art, literature, and other artifacts	Straight-line	2-25 years
General infrastructure	Straight-line	10-75 years
State highway network	Composite	50 years

For the State highway network, depreciation is based on a weighted average of the estimated useful lives of dissimilar assets in the network (e.g., subsurface foundations, roadway surfaces, bridges, traffic control devices, guardrails, markings, signage, etc.).

K. Tax Refund Liabilities

Tax refund liabilities consist primarily of accrued income and sales and use tax refunds due to taxpayers. During the calendar year, the State collects employee withholdings and taxpayers' payments for income taxes. At June 30, the State estimates the amount it owes taxpayers for income tax overpayments during the preceding six months. Sales and use tax refund liabilities are also estimated at June 30. These liabilities are recorded as "Tax refunds payable".

L. Compensated Absences

Employees of the State and component units are permitted to accumulate earned but unused vacation pay benefits. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. Also, when determining the vacation pay liability due within one year, leave is considered taken on a last in, first out (LIFO) basis. In governmental funds, a liability for these amounts is reported only as payments come due each period upon the occurrence of relevant events such as employee resignations and retirements. The State's policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave.

In addition, to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly effective September 30, 2002 and July 1, 2003. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not part of the 30 day maximum applicable to regular vacation leave and is not subject to conversion to sick leave.

There is no liability for unpaid accumulated sick leave because the State has no obligation to pay sick leave upon employee termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

M. Long-Term Liabilities

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the columns for governmental activities, business-type activities, and component units. These amounts are also reported as liabilities in the fund financial statements for proprietary funds. Debt premiums of the State are deferred and amortized over the life of the debt using the effective interest method, if material. Losses on the State's refundings are deferred and amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter, using the effective interest method. Losses on refundings of the NC Housing Finance Agency are deferred and amortized using the straight-line method. Debt premiums, discounts, and losses on refundings of the University of North Carolina System (component unit) are generally deferred and amortized using the straight-line method, if material. Long-term debt is reported net of the applicable debt premium, discount, and/or deferred loss on refunding. Debt issuance costs of the State's governmental activities and the University of North Carolina System (component unit) are generally expensed. Debt issuance costs of the State's business-type activities and the NC Housing Finance Agency and the NC State Education Assistance Authority (component units) are deferred and amortized over the life of the debt using the straight-line method.

Capital appreciation bonds are those bonds that are issued at stated interest rates (which may be zero) significantly below their effective interest rate, resulting in a substantial discount (deep discount). The implicit interest (i.e., discount) is not paid until the bonds mature. Therefore, the net value of the bonds accrete (i.e., the discount is reduced) over the life of the bonds. This deep-discount debt is reported in the government-wide financial statements at its net or accreted value rather than at face value.

In the fund financial statements, governmental fund types recognize debt premiums, as well as debt issuance costs, during the current period. The face amount of the debt issued and premiums received are reported as other financing sources. Issuance costs, whether or not withheld from the actual proceeds received, are reported as debt service expenditures.

N. Sureties

Sureties include various assets, including securities from insurance companies and bail bondsmen doing business within North Carolina, that have been placed in safekeeping with a financial institution or the State Treasurer, as required by applicable general statutes.

O. Net Assets/Fund Balance

Net assets are reported as restricted when constraints placed on them are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or are imposed by law through constitutional provisions or enabling legislation. Situations where the State's internal governing body (General Assembly) places restrictions on existing resources or earmarks existing revenue sources are considered to be constraints that are internally imposed. Such internally dedicated net assets are presented as unrestricted.

Under some programs, the State has the option of using either restricted or unrestricted resources to make certain payments. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use receipts first (which include restricted and unrestricted resources), then state appropriations as necessary. Receipts are defined as all funds collected by an agency or institution other than State appropriations. The decision to use restricted or unrestricted receipts to fund a payment is transactional-based within the departmental management system in place at the agency or institution. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are (a) externally restricted for a specific use, (b) not available for appropriation or expenditure because the underlying asset is not an available financial resource, or (c) for encumbrances, which represent commitments related to unperformed contracts for services and undelivered goods. Designations of fund balance represent tentative management plans that are subject to change (See Note 10, Fund Balance Reserves and Designations).

P. Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items and capital contributions. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Proprietary fund operating revenues result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as noncapital grants and investment earnings, result from nonexchange transactions or ancillary activities. Capital contributions are reported separately, after nonoperating revenues and expenses.

Q. Food Stamps

In accordance with GASB Statement No. 24, Accounting and Financial Reporting for Certain Grants and Other Financial Assistance, the State recognizes distributions of food stamp benefits as revenue and expenditures in the general fund, whether the benefits are distributed directly or through agents and whether the benefits are in paper or electronic form. Expenditures are recognized when the benefits are distributed to the individual recipients by the State or its agents; revenue is recognized at the same time. Revenue, expenditures, and balances of food stamps are measured based on face value.

NOTE 2: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Fund Balance / Net Assets Deficit

Primary Government

At June 30, 2004, the General Fund has a fund balance deficit of $196.287 million, compared to a deficit balance of $166.955 million the previous year. The slowdown in the economy has lead to a decline in the rate of growth in taxes and an increase in spending for governmental services.

At June 30, 2004, the following special revenue fund reported a fund balance deficit: Leaking Petroleum Underground Storage Tank Cleanup Fund, $14.847 million.

At June 30, 2004, the following pension and other employee benefit trust fund reported a net assets deficit: Disability Income Plan of N.C., $29.860 million.

NOTE 3: DEPOSITS AND INVESTMENTS

A. Deposits and Investments with State Treasurer

Unless specifically exempt, every agency of the State and certain component units are required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Certain local governmental units that are not part of the reporting entity are also allowed to deposit money with the State Treasurer. Expenditures for the primary government and certain component units are made by warrants issued by the agencies and drawn on the State Treasurer. The State Treasurer processes these warrants each day when presented by the Federal Reserve Bank. General Statute 147-69.1 authorizes the State Treasurer to invest all deposits in obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits with specified financial institutions; prime quality commercial paper; specified bills of exchange or time drafts; asset-backed securities; and corporate bonds and notes with specified ratings.

General Statute 147-69.2 authorizes the State Treasurer to invest the deposits of certain special funds, including the pension trust funds, the State Health Plan, the Disability Income Plan of N.C., the Escheats Fund, the Public School Insurance Fund, the State Education Assistance Authority, and trust funds of the University of North Carolina System, in the investments authorized in General Statute 147-69.1; general obligations of other states; general obligations of North Carolina local governments; asset-backed securities bearing specific ratings; and obligations of any company incorporated within or outside the United States bearing specific ratings. The deposits of the pension trust funds may be invested in all of the above plus certain insurance contracts; group trusts; individual, common or collective trusts of banks and trust companies; real estate investment trusts; limited partnership interest in limited liability partnerships or limited liability companies; and certain stocks and mutual funds.

External Investment Pool

To ensure that these and other legal and regulatory limitations are met, all cash deposited with the State Treasurer, except for bond proceeds, is maintained in the Investment Pool. This pool, a governmental external investment pool, consists of the following individual investment portfolios:

Short-term Investment – This portfolio may hold any of the investments authorized by General Statute 147-69.1. The Short-term Investment portfolio is the primary cash management account for the State and is managed in such a manner as to be readily convertible into cash. The primary participants of this portfolio are the General Fund and the Highway Funds. Other participants include the remaining portfolios listed below and various boards, commissions, community colleges, and school administrative units that make voluntary deposits with the State Treasurer.

Long-term Investment – This portfolio may hold the fixed-income investments authorized by General Statutes 147-69.1 and 147-69.2. Since the deposits in this fund are typically not needed for day-to-day operations, the investment vehicles used generally have a longer term and higher return than those held in the Short-term Investment portfolio. The primary participants of the portfolio are the pension trust funds and various special trust funds.

Equity Investment – This portfolio holds an equity-based trust. The State's pension trust funds are the sole participants in the portfolio.

Real Estate Investment – This portfolio holds investments in real estate-based trust funds and group annuity contracts. The State's pension trust funds are the sole participants in the portfolio.

Alternative Investment – This portfolio holds investments in limited partnerships and equities received in the form of distributions from its primary investments. The State's pension trust funds are the sole participants in the portfolio.

All of the above investment portfolios operate like individual investment pools, except that an investment portfolio may hold shares in other investment portfolios at the discretion of the State Treasurer and subject to the legal limitations discussed above. To this extent, the deposits are commingled; and therefore, the State Treasurer considers all investment portfolios to be part of a single pool, the Investment Pool. The Investment Pool contains deposits from funds and component units of the reporting entity (internal portion) as well as deposits from certain legally separate organizations outside the reporting entity (external portion). This pool is not registered with the SEC and is not subject to any formal oversight other than that of the legislative body.

At year-end, the condensed financial statements for the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

Statement of Net Assets
June 30, 2004

Assets:	
Cash and cash equivalents......................	$ 683,111
Other assets..	360,864
Investments...	87,756,385
Total assets...	88,800,360
Liabilities:	
Distributions payable................................	23,119
Obligations under securities lending.........	19,386,506
Total liabilities..	19,409,625
Net Assets:	
Internal:	
Primary government.............................	66,497,884
Component units..................................	2,375,956
External..	516,895
Total net assets.....................................	$ 69,390,735

Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2004

Revenues:	
Investment income..................................	$ 7,164,655
Expenses:	
Securities lending....................................	213,588
Investment management..........................	94,689
Total expenses.......................................	308,277
Net increase in net assets resulting from operations.......................	6,856,378
Distributions to participants:	
Distributions paid and payable.................	(6,856,378)
Share transactions:	
Reinvestment of distributions...................	6,860,099
Net share redemptions............................	(1,565,422)
Total increase in net assets......................	5,294,677
Net assets:	
Beginning of year......................................	64,096,058
End of year..	$ 69,390,735

The external portion of the Investment Pool is presented in the State's financial statements as an investment trust fund. Each fund and component unit's share of the internal equity in the Investment Pool is reported in the State's financial statements as an asset of those funds or component units. Equity in the Short-term Investment portfolio is reported as cash and cash equivalents while equity in the Long-term Investment, Equity Investment, Real Estate Investment, and Alternative Investment portfolios is reported as investments. The internal equity of the pool differs from the amount of assets reported by the funds and component units due to the typical banker/customer outstanding and in-transit items. Additionally, each fund reports its share of the assets and liabilities arising from securities lending transactions. The State reports the assets and liabilities arising from securities lending transactions for component units as part of the State's agency funds, rather than allocate them to the component units.

Investments in nonparticipating contracts, such as nonnegotiable certificates of deposit, are reported at cost. Other investments held in the Short-term Investment portfolio are reported at amortized cost, which approximates fair value. All other investments are reported at fair value. Fair values are determined daily for the Long-term Investment and Equity Investment portfolios and quarterly for the Real Estate Investment and Alternative Investment portfolios. The fair value of fixed income securities is based on future principal and interest payments discounted using current yields for similar instruments. Investments in real estate trusts, limited partnerships, and the equity trust are valued using market prices provided by the third party professionals. Participants' shares sold and redeemed are determined in the same manner as is used to report investments, and the State Treasurer does not provide or obtain legally binding guarantees to support share values.

Net investment income earned by the Investment Pool is generally distributed on a pro rata basis. However, in accordance with legal requirements, the General Fund receives all investment income earned by funds created for purposes of meeting appropriations. For the fiscal year ended June 30, 2004, $28,859,477 of investment income associated with other funds was credited to the General Fund.

Bond Proceeds Investment Accounts

The State Treasurer has established separate investment accounts for each State bond issue to comply with IRS regulations on bond arbitrage. A private investment company under contract with the State Treasurer manages these separate accounts. The investments are valued at amortized cost, which approximates fair value. In the State's financial statements, each fund's equity in these accounts is reported as cash and cash equivalents.

Demand and Time Deposits

Agency deposits to the Investment Pool may be made in any bank, savings and loan association or trust company in the State approved by the State Treasurer. Depositories are required, in accordance with the rules in the North Carolina Administrative Code (Chapter 20 NCAC 7), to collateralize all balances of the State Treasurer which are not insured. Basically, these rules require that the bank maintain, as collateral in an escrow account established by the State Treasurer with a third-party bank, securities of a type enumerated in the rules, in an amount whose market value is not less than the amount of the time deposits and the average balance of demand deposits for the preceding quarter less the allowable deposit insurance on the deposits. Generally, rules require the securities to be governmental in origin (e.g., U.S. Treasury and U.S. agency obligations, or state and local government obligations) or the highest grade commercial paper and bankers' acceptances. Financial institutions generally may elect to collateralize deposits separately (dedicated method) or to include the deposits of North Carolina local government units in the same collateral pool with the State and certain component units (pooling method). Financial institutions report quarterly on bank balances and amounts secured by insurance and amounts protected by securities. The State Treasurer maintains no records of financial institution balances of local governments collateralized in the pool with State Treasurer deposits. Since the amounts of local government deposits in the pooling method banks are not known, the risk of being under-collateralized at any given time is increased. Therefore, the institution's financial condition may cause the State Treasurer to require a particular institution to utilize the dedicated method exclusively for the protection of each public depositor.

At June 30, 2004, the deposits maintained by the State Treasurer consisted of (dollars in thousands):

	Carrying Value	*Bank Balance*
Demand	$ 76,165	$ 83,968
Time	208,946	208,946
Total Deposits	$ 285,111	$ 292,914

At year-end, 94 percent of the balances in financial institutions were deposited under the pooling method. Because the financial institutions complied with the collateralization policies and procedures by utilizing either the dedicated method or the pooling method described above, the State Treasurer considers all of its deposits to be either insured or covered by collateral held by its escrow agent in its name.

Investments

Investments held by the Investment Pool and the bond proceeds investment accounts are categorized into three categories of credit risk to give an indication of the level of credit risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the owner or its agent in the owner's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the financial institution's trust department or agent in the owner's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by a financial institution's trust department or agent, but not in the owner's name.

At year-end, the balances of the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

	Category 1	*Category* 3	*Carrying Amount*
Investments Categorized:			
Corporate bonds and notes:			
Not on loan	$ 6,695,535	$ 7,208,715	$ 13,904,250
On loan for securities collateral	54,482	—	54,482
GNMAs:			
Not on loan	1,855,622	—	1,855,622
On loan for securities collateral	260,851	—	260,851
Asset backed securities	—	8,303,458	8,303,458
U.S. government and agency securities:			
Not on loan	1,586,165	507,502	2,093,667
On loan for securities collateral	1,218,773	—	1,218,773
Repurchase agreements	398,000	3,366,831	3,764,831
Domestic equities	3,042	—	3,042
Total Investments Categorized	$ 12,072,470	$ 19,386,506	31,458,976
Investments Not Categorized:			
Equity-based trust			35,146,959
Alternative investments			703,484
Real estate trust funds			1,687,422
Investments held by broker/dealers under securities loans with cash collateral:			
U.S. government and agency securities			13,614,265
GNMAs			4,143,928
Corporate bonds and notes			1,399,351
Total Investments			$ 88,154,385

During the year other investment types may have been owned by the Investment Pool, but all material investment types and categories are disclosed above.

Equity-based Trust - The State Treasurer has contracted with an external party (Trustee) to create the "Treasurer of the State of North Carolina Equity Investment Fund Pooled Trust" (the Trust). The State's pension trust funds are the only depositors in the Trust. The State Treasurer employs investment managers to manage the assets, primarily in equity and equity-based securities in accordance with the General Statutes and parameters provided by the State Treasurer. The Trustee maintains custody of the underlying securities in the name of the Trust, services the securities, and maintains all related accounting records. The Trustee also acts as a securities lending agent for the Trust, invests residual cash in a cash sweep fund, and may be temporarily employed as an investment manager. The State Treasurer maintains beneficial interest in the Trust and no direct ownership of the securities; consequently, the investment is not presented above in a credit risk category.

At year-end, the major investment classifications of the Investment Pool had the following attributes (dollars in thousands):

Investment Classification	Carrying Amount	Principal Amount	Range of Interest Rates	Range of Maturities
U.S. government and agency securities...............	$ 16,419,203	$ 15,379,178	1.13%-8.88%	15 Days - 29 Years
Corporate bonds and notes..................................	8,149,368	7,687,407	3.50%-9.80%	4 Years - 34 Years
GNMAs..	6,260,401	6,150,980	5.0%-9.0%	13 Years - 30 Years
Repurchase agreements......................................	398,000	398,000	1.20%	1 Day
Securities purchased with cash collateral under securities lending program:				
Asset backed securities...............................	8,303,458	8,303,458	1.17%-1.62%	15 Days - 5 Years
Corporate bonds and notes..........................	7,208,715	7,208,715	1.15%-1.75%	23 Days - 3 Years
U.S. government and agency securities........	507,502	507,502	1.09%-1.27%	47 Days - 1 Year
Repurchase agreements...............................	3,366,831	3,366,831	1.50%-1.65%	1 Day
Equity-based trust..	35,146,959	Not applicable	Not applicable	Not applicable

At year-end, the balances of the bond proceeds investment accounts were as follows (dollars in thousands):

	Category 1	Carrying Amount
Investments Categorized:		
Repurchase agreements...	$ 661,651	$ 661,651
US government and agency securities..............	131,016	131,016
Commercial paper.............	36,220	36,220
Total Investments........	$ 828,887	$ 828,887

Securities Lending

Based on the authority provided in G.S. 147-69.3(e), the State Treasurer lends securities from its Investment Pool to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. During the year the custodian lent U.S. government and agency securities, GNMAs, corporate bonds and notes for collateral. The custodian is permitted to receive cash, U.S. government and agency securities, or irrevocable letters of credit as collateral for the securities lent. The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower. Securities lent at year-end for cash collateral are presented as unclassified in the preceding schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the collateral. The State Treasurer cannot pledge or sell the collateral securities received unless the borrower defaults.

The cash collateral received is invested by the custodian agent and held in a separate account in the name of the State Treasurer. The average maturities of the cash collateral investments are less than the average maturities of the securities lent. While cash can be invested in securities ranging from overnight to five years, the custodian agent is not permitted to make investments where the weighted average maturity of all investments exceeds 30 days. At June 30, 2004, the weighted average maturity of unmatched investments was approximately 26 days.

At year-end, the State Treasurer had no credit risk exposure to borrowers because the amounts the Treasurer owed the borrowers exceeded the amounts the borrowers owed the State. The securities custodian is contractually obligated to indemnify the Treasurer for certain conditions, the two most important are default on the part of the borrowers and failure to maintain the daily mark-to-market on the loans.

B. Deposits Outside the State Treasurer

In addition to the pooled deposits maintained by the State Treasurer, other deposits are maintained outside the State Treasurer by the primary government and certain component units. As a general rule, these deposits are not covered by the

NOTES TO THE FINANCIAL STATEMENTS

rules in Chapter 20 NCAC 7 requiring collateralization of uninsured deposits.

Primary Government

At June 30, 2004, the deposits maintained outside the State Treasurer by the primary government consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Demand	$ 299,850	$ 30,713
Time	299,877	310,668
Total Deposits	$ 599,727	$ 341,381

Of these bank balances, $179.344 million was covered by federal depository insurance, $112.497 million by collateral held by the State's escrow agent in the depositor's name, and $49.540 million was uninsured and uncollateralized.

Component Units

(University of North Carolina System, The Golden LEAF, Inc., State Education Assistance Authority, and North Carolina Housing Finance Agency)

At June 30, 2004, the deposits maintained outside the State Treasurer by the University of North Carolina System consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Demand	$ 37,205	$ 10,047
Time	19,667	21,789
Total Deposits	$ 56,872	$ 31,836

Of these bank balances, $4.256 million was covered by federal depository insurance, $1.930 million by collateral held by the universities' escrow agent in the depositor's name, $44 thousand was covered by collateral held in the pledging bank's trust department in the depositor's name and $25.606 million was uninsured and uncollateralized.

At June 30, 2004, the deposits maintained outside the State Treasurer by the The Golden LEAF, Inc. consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Demand	$ 459	$ 1,129
Time	318	318
Total Deposits	$ 777	$ 1,447

Of these bank balances, $ 600 thousand was covered by federal depository insurance and $847 thousand was uninsured and uncollateralized.

At June 30, 2004, the deposits maintained outside the State Treasurer by the State Education Assistance Authority consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Time	$ 84,115	$ 84,115
Total Deposits	$ 84,115	$ 84,115

The entire balance of $84.115 million was uninsured and uncollateralized.

At June 30, 2004, the deposits maintained outside the State Treasurer by the North Carolina Housing Finance Agency consisted of (dollars in thousands):

	Carrying Value	Bank Balance
Time	$ 3,507	$ 3,507
Total Deposits	$ 3,507	$ 3,507

The entire balance of $3.507 million was covered by collateral held by the escrow agent in the depositor's name.

C. Investments Outside the State Treasurer

Investments in participating investment contracts, external investment pools, open-end mutual funds, debt securities, equity securities, and all investments of the Deferred Compensation Plan are reported at fair value. Investments in certificates of deposit, investment agreements, bank investment contracts, real estate, real estate investment trusts, and limited partnerships are reported at cost. Detailed disclosures about investments held outside the State Treasurer are presented below.

Primary Government

All organizations within the primary government are required to follow certain investment guidelines as outlined by the General Statutes. Of these organizations, the various clerks of superior court, the N.C. Deferred Compensation Plan (457), and the 401(k) Supplemental Retirement Income Plan comprise 99% of the total investments maintained by the primary government at June 30, 2004. The investments by these funds adhere to the following General Statutes guidelines.

General Statute 7A-112(a) authorizes the Clerk of the Superior Court to invest in obligations of or fully guaranteed by the United States; obligations of the State of North Carolina; general obligations of North Carolina local governments; and shares, deposits, savings certificates, and certificates of deposits of specified institutions.

General Statute 143B-426.24(j) allows the Deferred Compensation Plan Board to acquire investment vehicles from any company authorized to conduct such business in this State or may establish, alter, amend and modify, to the extent it deems necessary or desirable, a trust for the purpose of facilitating the administration, investment and maintenance of assets acquired by the investment of deferred funds. All assets of the Plan, including all deferred amounts, property and rights purchased with deferred amounts, and all income attributed thereto shall be held in trust for the exclusive benefit of the Plan participants and their beneficiaries.

NOTES TO THE FINANCIAL STATEMENTS

General Statute 135-90 places no specific investment restrictions on the 401(k) Supplemental Retirement Income Plan. However, in the absence of specific legislation, the form of governance over the investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care.

At year-end the investment balances maintained outside the State Treasurer for the primary government were as follows (dollars in thousands):

	Category 1	Category 2	Category 3	Carrying Amount
Investments Categorized:				
U.S. government securities	$ 2,285	$ 544	$ 1,805	$ 4,634
State and municipal securities	1,028	—	—	1,028
Corporate bonds	—	—	131	131
Corporate common stock	18,637	—	1,254	19,891
Total Investments Categorized	$ 21,950	$ 544	$ 3,190	25,684
Investments Not Categorized:				
Money market funds				2,210
Mutual funds				2,135,230
Annuity contracts				980,479
Total Investments				$ 3,143,603

Component Units

(University of North Carolina System, The Golden LEAF, Inc., State Education Assistance Authority, and North Carolina Housing Finance Agency)

The component units of the State are required to follow certain investment guidelines as outlined by the General Statutes.

The General Statutes place no specific investment restrictions on the University of North Carolina System or The Golden LEAF, Inc. However, in the absence of specific legislation, the form of governance over these investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care. The University of North Carolina at Chapel Hill operates an Investment Fund, which is a governmental external investment pool. The University operates the Investment Fund for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Separate financial statements for the Investment Fund may be obtained from the University.

The State Education Assistance Authority is authorized by the University of North Carolina Board of Governors pursuant to General Statute 116-36.2 to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed in Section A of this note.

General Statute 122A-11 authorizes the North Carolina Housing Finance Agency to invest in shares of or deposits in banks or trust companies outside as well as in this State, provided any such moneys on deposit outside this State are collateralized to the same extent and manner as if deposited in this State; evidences of ownership of, or fractional undivided interests in, future interest and principal payments on direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity of custodian; obligations which are collateralized by mortgage pass-through securities guaranteed by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association; trust certificate or similar instrument evidencing an equity investment in a trust or similar arrangement, which is formed for the purpose of issuing obligations which are collateralized by mortgage pass-through or participation certificates guaranteed by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association; and repurchase agreements.

NOTES TO THE FINANCIAL STATEMENTS

At year-end, investment balances maintained outside the State Treasurer for the University of North Carolina System were as follows (dollars in thousands):

	Category 1	Category 2	Category 3	Carrying Amount
Investments Categorized:				
U.S. government securities	$ 55,404	$ 7,747	$ 119	$ 63,270
Collateralized mortgage obligations	49,950	57	—	50,007
State and municipal securities	3,684	60	—	3,744
Corporate bonds	29,000	4,335	54,798	88,133
Corporate common stock	160,505	27,987	786	189,278
Repurchase agreements	—	—	672	672
International corporate bonds	4,945	—	—	4,945
International equity securities	12,048	1,264	—	13,312
Total Investments Categorized	$ 315,536	$ 41,450	$ 56,375	413,361
Investments Not Categorized:				
Money market funds				153,131
Mutual funds				835,839
Annuity contracts				40
Real estate				42,559
Real estate investment trust				10,829
Limited partnerships				611,208
Investments held by broker-dealers under reverse repurchase agreements:				
U.S. government securities				130,612
Pooled investments				293
Other investments				73,142
Total Investments				$ 2,271,014

At year-end, investment balances maintained outside the State Treasurer for The Golden LEAF, Inc. were as follows (dollars in thousands):

	Category 1	Category 3	Carrying Amount
Investments Categorized:			
U.S. government securities	$ 14,715	$ —	$ 14,715
Corporate bonds	73,401	—	73,401
Corporate common stock	140,712	—	140,712
International stock	—	20,185	20,185
Total Investments Categorized	$ 228,828	$ 20,185	249,013
Investments Not Categorized:			
Money market funds			80,993
Real estate			24,345
Limited partnerships			60,057
Total Investments			$ 414,408

At year-end, investment balances maintained outside the State Treasurer for the State Education Assistance Authority were as follows (dollars in thousands):

	Category 1	Category 3	Carrying Amount
Investments Categorized:			
U.S. government securities	$ 7,048	$ —	$ 7,048
Corporate common stock	—	12,270	12,270
Repurchase agreements	148,588	—	148,588
Total Investments Categorized	$ 155,636	$ 12,270	167,906
Investments Not Categorized:			
Mutual funds			92,532
Annuity contracts			13,301
Total Investments			$ 273,739

NOTES TO THE FINANCIAL STATEMENTS

At year-end, investment balances maintained outside the State Treasurer for the North Carolina Housing Finance Agency were as follows (dollars in thousands):

	Category 1	Carrying Amount
Investments Categorized:		
U.S. government securities......................	$ 67,054	$ 67,054
Repurchase agreements..........................	178,259	178,259
Total Investments............................	$ 245,313	$ 245,313

Limited Partnerships – The limited partnership positions are primarily held by the University of North Carolina at Chapel Hill. The University uses various external money managers to identify specific investment funds and limited partnerships that meet asset allocation and investment management objectives. The University invests in these funds and partnerships to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. These investments generally include equity and bond funds. Certain investment funds expose the University to significant amounts of market risk by trading or holding derivative securities and by leveraging the securities in the fund. The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes.

Reverse Repurchase Agreements - The University of North Carolina at Chapel Hill enters into fixed coupon reverse repurchase agreements, that is, the sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing dealers a margin against a decline in fair value of the securities. If the dealers default on their obligations to resell these securities to the University or provide securities or cash of equal value, the University would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. The credit exposure at year-end was $372,489. At June 30, 2004 reverse repurchase agreements are both fixed term and open (on-demand) agreements. The amount and interest rate of the open agreements may be changed daily and either party may terminate the transaction at any time. The University's practice for investing the proceeds of reverse repurchase agreements is for the term to maturity of the investment to be the same as the term of the reverse repurchase agreement.

NOTE 4: RECEIVABLES

Receivables at year-end are reported net of allowances for doubtful accounts as follows (dollars in thousands):

Governmental Activities:

	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Internal Service Funds[1]	Total
Receivables, gross (excluding notes)	$ 2,133,235	$ 127,659	$ 32,154	$ 42,595	$ 14,163	$ 2,349,806
Allowance for doubtful accounts	(291,806)	(5,673)	—	(344)	—	(297,823)
Receivables, net	$ 1,841,429	$ 121,986	$ 32,154	$ 42,251	$ 14,163	$ 2,051,983
Notes receivable, gross	$ 1,240	$ 137	$ —	$ 327,071	$ —	$ 328,448
Allowance for doubtful accounts	—	—	—	(45,770)	—	(45,770)
Notes receivable, net	$ 1,240	$ 137	$ —	$ 281,301	$ —	$ 282,678

(1) Includes balances due from fiduciary funds.

Within governmental activities, the only significant receivables not expected to be collected within one year are $166.6 million of notes receivable in other governmental funds and $1.2 million of notes receivable in the General Fund.

Business-Type Activities:

	Unemployment Compensation Fund	EPA Revolving Loan Fund	Other Enterprise Funds	Total
Receivables, gross (excluding notes)	$ 329,242	$ 2,647	$ 1,225	$ 333,114
Allowance for doubtful accounts	(35,374)	—	(35)	(35,409)
Receivables, net	$ 293,868	$ 2,647	$ 1,190	$ 297,705
Notes receivable, gross	$ —	$ 435,220	$ —	$ 435,220
Allowance for doubtful accounts	—	—	—	—
Notes receivable, net	$ —	$ 435,220	$ —	$ 435,220

Revenues of other enterprise funds are reported net of uncollectible amounts. Total uncollectible amounts related to revenues of the current period are $29 thousand related to sales and services used as security for bonds.

Within business-type activities, the only significant receivables not expected to be collected within one year are $408.1 million of notes receivable in the EPA Revolving Loan Fund.

NOTE 5: CAPITAL ASSETS

Primary Government. A summary of changes in capital assets for the year ended June 30, 2004 is presented below (dollars in thousands).

Governmental Activities:	Balance July 1, 2003 (as restated)	Additions	Deductions	Balance June 30, 2004
Capital Assets, nondepreciable:				
Land	$ 7,713,505	$ 597,353	$ 10,203	$ 8,300,655
Art, literature, and other artifacts	7	1,119	—	1,126
Construction in progress	1,452,222	1,420,820	1,227,386	1,645,656
Total capital assets-nondepreciable	9,165,734	2,019,292	1,237,589	9,947,437
Capital Assets, depreciable:				
Buildings	1,954,881	255,482	5,026	2,205,337
Machinery and equipment	1,443,831	140,953	73,968	1,510,816
Intangibles	206,902	3,018	6,517	203,403
General infrastructure	168,449	3,249	825	170,873
State highway system	16,932,688	1,202,765	33,433	18,102,020
Total capital assets-depreciable	20,706,751	1,605,467	119,769	22,192,449
Less accumulated depreciation for:				
Buildings	(585,426)	(41,557)	(609)	(626,374)
Machinery and equipment	(892,676)	(115,184)	(59,908)	(947,952)
Intangibles	(97,975)	(5,018)	(6,096)	(96,897)
General infrastructure	(87,960)	(6,507)	(453)	(94,014)
State highway system	(4,488,476)	(362,041)	(32,764)	(4,817,753)
Total accumulated depreciation	(6,152,513)	(530,307)	(99,830)	(6,582,990)
Total capital assets-depreciable, net	14,554,238	1,075,160	19,939	15,609,459
Governmental activities capital assets, net	$ 23,719,972	$ 3,094,452	$ 1,257,528	$ 25,556,896

Notes To The Financial Statements

Business-type Activities:

	Balance July 1, 2003 (as restated)	Additions	Deductions	Balance June 30, 2004
Capital Assets, nondepreciable:				
Land	$ 2,563	$ —	$ —	$ 2,563
Construction in progress	20,018	4,515	—	24,533
Total capital assets-nondepreciable	22,581	4,515	—	27,096
Capital Assets, depreciable:				
Buildings	28,791	—	51	28,740
Machinery and equipment	3,310	355	94	3,571
General infrastructure	21,330	—	—	21,330
Total capital assets-depreciable	53,431	355	145	53,641
Less accumulated depreciation for:				
Buildings	(14,816)	(693)	—	(15,509)
Machinery and equipment	(2,263)	(74)	(80)	(2,257)
General infrastructure	(12,661)	(803)	—	(13,464)
Total accumulated depreciation	(29,740)	(1,570)	(80)	(31,230)
Total capital assets-depreciable, net	23,691	(1,215)	65	22,411
Business-type activities capital assets, net	$ 46,272	$ 3,300	$ 65	$ 49,507

Depreciation expense was charged to functions/programs of the primary government as follows (dollars in thousands):

Governmental activities:	
General government	$ 37,134
Primary and secondary education	1,700
Higher Education	94
Health and human services	13,644
Economic development	1,485
Environment and natural resources	10,945
Public safety, correction, and regulation	42,502
Transportation	419,165
Agriculture	3,638
Total depreciation expense	$ 530,307
Business-type activities:	
Town of Butner Water and Sewer	$ 642
N.C. State Fair	472
USS North Carolina Battleship Commission	95
Agricultural Farmers Market	281
EPA Revolving Loan Fund	18
Other business-type activities	62
Total depreciation expense	$ 1,570

NOTES TO THE FINANCIAL STATEMENTS

Component Units (University of North Carolina System and Community Colleges). Capital asset activity for the University of North Carolina System and Community Colleges for the fiscal year ended June 30, 2004, was as follows (dollars in thousands):

University of North Carolina System:	Balance July 1, 2003 (as restated)	Additions	Deductions	Balance June 30, 2004
Capital Assets, nondepreciable:				
Land	$ 156,790	$ 8,457	$ 784	$ 164,463
Art, literature, and other artifacts	91,858	4,463	33	96,288
Construction in progress	776,747	715,965	521,306	971,406
Total capital assets-nondepreciable	1,025,395	728,885	522,123	1,232,157
Capital Assets, depreciable:				
Buildings	3,874,046	534,247	10,082	4,398,211
Machinery and equipment	1,181,334	103,563	71,223	1,213,674
Intangibles	1,000	—	—	1,000
Art, literature, and other artifacts	1,694	30	—	1,724
General infrastructure	669,087	56,135	183	725,039
Total capital assets-depreciable	5,727,161	693,975	81,488	6,339,648
Less accumulated depreciation for:				
Buildings	(1,356,988)	(114,331)	(3,774)	(1,467,545)
Machinery and equipment	(724,953)	(108,103)	(61,800)	(771,256)
Art, literature, and other artifacts	(508)	(145)	—	(653)
General infrastructure	(221,900)	(23,890)	(153)	(245,637)
Total accumulated depreciation	(2,304,349)	(246,469)	(65,727)	(2,485,091)
Total capital assets-depreciable, net	3,422,812	447,506	15,761	3,854,557
University of North Carolina System capital assets, net	$ 4,448,207	$ 1,176,391	$ 537,884	$ 5,086,714

Capital assets of nongovernmental component units of the University of North Carolina System are excluded from the above amounts. At June 30, 2004, nongovernmental component unit foundations and similarly affiliated organizations of the University of North Carolina System had nondepreciable capital assets of $23.022 million and net depreciable capital assets of $115.918 million.

NOTES TO THE FINANCIAL STATEMENTS

Community Colleges:

	Balance July 1, 2003 (as restated)	Additions	Deductions	Balance June 30, 2004
Capital Assets, nondepreciable:				
Land	$ 85,578	$ 3,468	$ 648	$ 88,398
Art, literature, and other artifacts	348	64	—	412
Construction in progress	97,071	125,017	32,223	189,865
Total capital assets-nondepreciable	182,997	128,549	32,871	278,675
Capital Assets, depreciable:				
Buildings	1,153,807	57,669	6,412	1,205,064
Machinery and equipment	159,784	16,869	5,364	171,289
Art, literature, and other artifacts	129	—	9	120
General infrastructure	53,699	5,412	109	59,002
Total capital assets-depreciable	1,367,419	79,950	11,894	1,435,475
Less accumulated depreciation for:				
Buildings	(361,244)	(30,043)	(783)	(390,504)
Machinery and equipment	(93,874)	(11,565)	(4,037)	(101,402)
Art, literature, and other artifacts	(14)	(2)	(7)	(9)
General infrastructure	(28,083)	(3,396)	(124)	(31,355)
Total accumulated depreciation	(483,215)	(45,006)	(4,951)	(523,270)
Total capital assets-depreciable, net	884,204	34,944	6,943	912,205
Community Colleges capital assets, net	$ 1,067,201	$ 163,493	$ 39,814	$ 1,190,880

Capital assets of nongovernmental component units of community colleges are excluded from the above amounts. At June 30, 2004, nongovernmental component unit foundations and similarly affiliated organizations of community colleges had nondepreciable capital assets of $7.773 million and net depreciable capital assets of $798 thousand.

NOTE 6: SHORT-TERM DEBT

Primary Government

Beginning January 1, 2004, the State received repayable advances from the Federal Unemployment Account (FUA) to finance an operating deficit in the State's unemployment compensation fund. The tax anticipation notes issued for the period September 30 – December 31, 2003 were repaid as employer contributions became available beginning January 1, 2004. Once the tax anticipation notes were repaid in total, the State used the employer contributions to reduce the amount of repayable advances requested. The State took additional advances after June 30 (see Note 22); however, all advances from the FUA were repaid in full by September 30, 2004. Advances taken from January 1 to September 30, which are repaid in full on or before September 30, are considered cash flow advances and do not accrue interest provided that the State does not take additional advances from October 1 through December 31 (of same calendar year). The State does not plan to take additional FUA advances through December 31, 2004.

Short-term debt activity for the fiscal year ended June 30, 2004, was as follows (dollars in thousands):

	Balance July 1, 2003	Draws	Repayments	Balance June 30, 2004
FUA Advance..........................	$ —	$ 556,771	$ 305,012	$ 251,759
Anticipation Notes...................	—	192,019	192,019	—

Component Units

University of North Carolina System

North Carolina State University has available commercial paper program financing for short-term credit up to $60 million to finance capital construction projects. The University's available funds are pledged to the commercial paper program financing with the anticipation of converting to general revenue bond financing in the future. As of June 30, 2004, $15 million in commercial paper was outstanding. Of this amount, $13 million was tax-exempt commercial paper and $2 million was taxable commercial paper.

Commercial paper was issued from the University of North Carolina General Revenue Bonds, Series 2002A, to provide interim financing for the construction of capital projects. Commercial paper was redeemed with proceeds from the University of North Carolina General Revenue Bonds, Series 2003.

In February 2004, Rex Healthcare entered into a revolving line of credit agreement with a financial institution to borrow up to $15 million for working capital needs. The line of credit is unsecured and bears interest at a variable rate that is based on the London Interbank Offered Rate (LIBOR). Interest payments are due monthly through November 5, 2005, when all principal and accrued interest is due. During 2004, Rex drew approximately $6 million on this line of credit. In June 2004, Rex repaid the full outstanding balance.

Short-term debt activity for the University of North Carolina System for the fiscal year ended June 30, 2004, was as follows (dollars in thousands):

	Balance July 1, 2003	Draws	Repayments	Balance June 30, 2004
Revolving Line of Credit..........	$ —	$ 6,000	$ 6,000	$ —
Commercial Paper Program.................................	19,000	40,950	36,109	23,841

NOTE 7: LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities

Primary Government. Long-term liability activity for the year ended June 30, 2004, was as follows (dollars in thousands):

	Balance July 1, 2003 (as restated)	Increases	Decreases	Balance June 30, 2004	Amounts Due Within One Year
Governmental activities:					
Bonds and similar debt payable:					
General obligation bonds	$ 4,066,990	$ 1,485,865	$ 569,995	$ 4,982,860	$ 274,385
Lease-purchase revenue bonds	—	218,405	—	218,405	7,000
Certificates of participation	17,500	283,955	290	301,165	14,380
Less deferred amounts:					
For issuance discounts	(2,362)	—	(638)	(1,724)	—
On refunding	(53,778)	(10,045)	(5,883)	(57,940)	—
Add issuance premium	34,753	136,960	12,940	158,773	—
Total bonds and similar debt payable	4,063,103	2,115,140	576,704	5,601,539	295,765
Notes payable	9,629	17,597	2,218	25,008	2,856
Capital leases payable	463	—	159	304	166
Arbitrage rebate payable	1,077	—	1,034	43	—
Compensated absences	270,370	263,199	206,522	327,047	34,682
Net pension obligation	4,656	13,209	15,679	2,186	—
Workers' compensation	6,819	795	1,419	6,195	1,030
Deferred death benefit payable	105	165	—	270	135
Cost settlement payable	20,000	—	12,500	7,500	2,500
Governmental activity long-term liabilities	$ 4,376,222	$ 2,410,105	$ 816,235	$ 5,970,092	$ 337,134
Business-type activities:					
Bonds payable:					
Revenue bonds	$ 9,570	$ —	$ 245	$ 9,325	$ 255
Total bonds payable	9,570	—	245	9,325	255
Compensated absences	700	782	565	917	94
Business-type activity long-term liabilities	$ 10,270	$ 782	$ 810	$ 10,242	$ 349

For governmental activities, the compensated absences, net pension obligation, workers compensation, and cost settlement liabilities are generally liquidated by the General Fund. Arbitrage rebate payable is generally liquidated by other governmental funds. A portion of compensated absences is also liquidated by the Highway Fund. Internal service funds predominantly serve the governmental funds. Accordingly, long-term liabilities for them are included as part of the above totals for governmental activities. At year-end, $3.313 million of internal service funds compensated absences are included in the above amounts.

Component Units (University of North Carolina System, North Carolina Housing Finance Agency, and the State Education Assistance Authority). Long-term liability activity for the year ended June 30, 2004, was as follows (dollars in thousands):

	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004	Amounts Due Within One Year
University of North Carolina System:					
Bonds payable:					
Revenue bonds	$ 1,525,307	$ 206,715	$ 96,518	$ 1,635,504	$ 158,155
Less deferred amounts:					
For issuance discounts	(60,074)	(369)	(3,939)	(56,504)	—
On refunding	(20,838)	(3,156)	(1,184)	(22,810)	—
Add issuance premium	10,065	5,468	846	14,687	—
Total bonds payable	1,454,460	208,658	92,241	1,570,877	158,155
Notes payable	56,927	—	13,214	43,713	3,640
Capital leases payable	1,943	15,790	997	16,736	2,202
Arbitrage rebate payable	3,309	487	67	3,729	—
Annuity and life income payable	9,401	1,303	1,290	9,414	895
Compensated absences	189,249	193,967	152,747	230,469	17,773
Total long-term liabilities	$ 1,715,289	$ 420,205	$ 260,556	$ 1,874,938	$ 182,665

Long-term liabilities of nongovernmental component units of the University of North Carolina System are excluded from the above amounts. At June 30, 2004, nongovernmental component unit foundations and similarly affiliated organizations of the University of North Carolina System had total long-term liabilities of $206.685 million, of which $13.226 million was due within one year and $193.459 million was due in more than one year.

	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004	Amounts Due Within One Year
North Carolina Housing Finance Agency:					
Bonds payable:					
Revenue bonds	$ 1,305,637	$ 190,360	$ 227,860	$ 1,268,137	$ 27,967
Less deferred amounts:					
For issuance discounts	(18,329)	(2,368)	(888)	(19,809)	—
On refunding	(2,336)	—	(2,168)	(168)	—
Total bonds payable	1,284,972	187,992	224,804	1,248,160	27,967
Arbitrage rebate payable	643	974	528	1,089	498
Compensated absences	373	147	—	520	30
Total long-term liabilities	$ 1,285,988	$ 189,113	$ 225,332	$ 1,249,769	$ 28,495

	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004	Amounts Due Within One Year
State Education Assistance Authority:					
Bonds payable:					
Revenue bonds	$ 1,299,806	$ 470,000	$ 83,838	$ 1,685,968	$ 1,000
Total bonds payable	1,299,806	470,000	83,838	1,685,968	1,000
Arbitrage rebate payable	2,488	306	—	2,794	—
Compensated absences	165	37	7	195	8
Total long-term liabilities	$ 1,302,459	$ 470,343	$ 83,845	$ 1,688,957	$ 1,008

B. Bonds, Certificates of Participation, and Notes Payable

Bonds, certificates of participation, and notes payable at June 30, 2004 were as follows (dollars in thousands):

	Interest Rates	Maturing Through Year	Original Issue Amount	Outstanding Balance
Primary Government:				
Governmental activities:				
General obligation bonds	1.06% - 6.90%*	2028	$ 5,602,819	$ 4,982,860
Lease-purchase revenue bonds	2.00% - 5.25%	2023	218,405	218,405
Certificates of participation	2.00% - 5.25%	2024	301,455	301,165
Notes payable	2.89% - 15.00%	2008	32,720	25,008
Business-type activities:				
Revenue bonds payable	4.21%*	2025	$ 9,905	$ 9,325
Component Units:				
Revenue bonds payable:				
University of North Carolina System	1.00% - 9.05%*	2034	$ 1,829,372	$ 1,635,504
N.C. Housing Finance Agency	1.00% - 8.25%*	2043	2,746,066	1,268,137
State Education Assistance Authority	1.15% - 6.35%*	2033	1,846,250	1,685,968
Notes payable:				
University of North Carolina System	1.77% - 8.13%	2013	$ 53,777	$ 43,713

* For variable rate debt, interest rates in effect at June 30, 2004 are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

The full faith, credit, and taxing power of the State are pledged for the payment of principal and interest on general obligation bonds. The certificates of participation (COPs) and lease-purchase revenue bonds issued by the N.C. Infrastructure Finance Corporation, a blended component unit of the State, are secured by lease and installment payments made by the State and in the event of default, by a security interest in the leased facilities pursuant to a leasehold deed of trust (as applicable). The COPs issued for repair and renovation projects are not secured by a lien upon or security interest in the projects or in any other property of the State. All payments of the State for the COPs and lease-purchase revenue bonds are subject to appropriation by the General Assembly. Other long-term debts of the State and its component units are payable solely from certain resources of the funds to which they relate.

C. Bonds Authorized but Unissued

The amount of authorized but unissued general obligation bonds of the primary government at June 30, 2004, totaled $1.894 billion as follows: higher education $1.368 billion; highway construction $300 million; clean water $210 million; and natural gas $16 million.

The amount of authorized but unissued debt of the primary government subject to annual appropriation requirements at June 30, 2004 totaled $424.1 million as follows: repair and renovation $175 million, hospital $110 million, prisons $132 million, and other projects $7.1 million.

D. Demand Bonds

Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a "put" feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the issuer's remarketing or paying agents.

Component Units

University of North Carolina System

With regards to the following demand bonds, the issuer has not entered into take out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

The University of North Carolina at Chapel Hill - General Revenue, Series 2001B and 2001C

On February 7, 2001 the University issued two series of variable rate demand bonds in the amount of $54,970,000 (2001B) and $54,970,000 (2001C) that each have a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding December 1, 2001. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and Parking System, Series

1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agents, Lehman Brothers, Inc (2001B) and UBS Financial Services, Inc..

The line of credit issued by Toronto-Dominion Bank and Chase Manhattan Bank expired on February 4, 2004, and a new line of credit was issued by JP Morgan Chase Bank on February 4, 2004. Under the new line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal, and, while the bonds are bearing interest at the daily or weekly rate, accrued interest on bonds delivered for purchase.

The University is required to pay a quarterly commitment fee for the line of credit of .13% per annum based on the unused portion of the line of credit commitment. If the University's credit rating for unsecured debt were to drop below Aa3 (or its equivalent) by Moody's Investors Service (Moody's), AA- (or its equivalent) by Standard and Poor's (S&P), or AA- (or its equivalent) by Fitch Ratings (Fitch), the quarterly commitment fee would increase to .18%. If the University's credit rating for unsecured debt were to drop below A3 (or its equivalent) by Moody's, A- (or its equivalent) by S&P, or A- (or its equivalent) by Fitch, the quarterly commitment fee would increase to .28%. Additionally, if the University were to terminate the line of credit prior to February 2, 2005, then the University must pay a termination fee of $50,000 less any unused commitment fees paid to date.

Under the line of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the line of credit. Interest at the rate of Prime plus 1.0% (Prime plus 2.0% after 60 days) is payable quarterly and upon draw repayment. At June 30, 2004, no purchase draws had been made under the line of credit.

The new line of credit agreement expires on February 2, 2005. However, between November 3, 2004, and December 3, 2004, the University may request that the Bank extend the expiration date for another year. The Bank shall respond affirmatively or negatively within 30 days after receipt of such request.

North Carolina Central University – Revenue Bonds Series 2003A

In October of 2003, the North Carolina Capital Facilities Finance Agency issued Student Housing Facilities Revenue Demand Bonds ($21,475,000 Variable Rate Revenue Demand Bonds, Series 2003A) that have a maturity date of October 1, 2034. The issuer, the North Carolina Capital Facilities Finance Agency, loaned the proceeds of the Series 2003 Bonds to the NCCU Real Estate Foundation, Inc. (Foundation). The Foundation used the proceeds to finance the costs of building a student housing facility at North Carolina Central University, to fund a debt service reserve fund for the 2003A Bonds, to pay a portion of the interest on the bonds during construction of the project, and to pay certain costs of issuance of the bonds. The 2003A Bonds are subject to mandatory sinking fund redemption at the principal amount on the interest payment dates or immediately preceding October 1, 2005.

The Student Housing Facilities Revenue Demand Bonds (Series 2003) has an Irrevocable Letter of Credit (LOC) for $21,819,518. The LOC is to secure the payment of the principal and purchase price of interest on the Series 2003 Bonds. The LOC was issued by Wachovia Bank, N.A. and expires on October 15, 2006. The LOC may be extended by request from the Foundation by delivering a notice of extension to the trustee with a new expiration date. At June 30, 2004, the LOC rate for the bonds was 1.40% and the total amount drawn on it was $139,459.

The Foundation paid Wachovia Bank, N.A. a commitment fee $109,098 for the letter of credit on the date the bonds were issued. Additionally, the Foundation paid credit facility fees in the amount of $222,256 during the fiscal year. If the Foundation terminates the letter of credit on or before August 1, 2006, then the Foundation must pay a termination fee of $25,000. The Bonds are not under a take out agreement, however, in the event of termination 100% of the unpaid principle will be due and payable plus any unpaid and accrued interest.

Under the LOC agreement, the proceeds of each drawing under the LOC to pay the portion of the purchase price of series 2003 bonds allocable to principal will constitute a tender advance and must be reimbursed as provided in the agreement. The Foundation is required to repay each tender advance to Wachovia Bank, N.A. plus an interest rate of prime plus 1.0%. The amount of any tender advance made is repaid based on the earliest to occur of the date the credit provider bonds purchased pursuant to such tender advances are remarketed, the close of business on the date that is 180 days after the tender was made and/or the termination date. At June 30, 2004, no tender advances had been made under the letter of credit.

The Student Housing Facilities Revenue Demand Bonds (Series 2003) has remarketing fees. The remarketing fee is an upfront charge to reset the interest rates on a weekly basis. The remarketing agent is Wachovia Bank, N.A. for the Series 2003A Bonds. At June 30, 2004, the remarketing fee rate for the bonds was 0.125%.

With regards to the following demand bonds, the issuer has entered into take-out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

North Carolina State University - Revenue Bonds (Centennial Campus Projects), Series 1999A

On September 22, 1999 the University issued tax-exempt variable rate revenue demand bonds in the amount of $13,500,000 that have a final maturity date of December 15, 2019. The bonds are subject to mandatory sinking fund redemption that began on December 1, 2000. The University's proceeds of this issuance were used to (i) discharge a portion of a loan from Wachovia Bank, N.A. the proceeds from which were used for the construction and equipping of a building known as the Partners II Building located on the Centennial Campus of N.C. State, (ii) paying the cost of relocating utility easements on the Centennial Campus of N.C. State, and (iii) paying the costs incurred in connection with the issuance of the 1999A Bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven (7) days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, Lehman Brothers, Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Wachovia Bank, N.A., a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.20% of the available commitment, payable quarterly in arrears, beginning on October 1, 1999 and on each January 1, April 1, July 1 and October 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2004, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility has been extended and is scheduled to expire on September 15, 2008, unless otherwise extended based on the terms of the agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in twenty (20) quarterly installments, beginning the first business day that is at least 180 days following such expiration date or termination date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of $13,100,000 of demand bonds was “put” and not resold, the University would be required to pay $2,742,020 a year for 5 years under this agreement assuming a 1.75% interest rate.

North Carolina State University - General Revenue Bonds, Series 2003B

On June 20, 2003 the University issued tax-exempt variable rate revenue demand bonds in the amount of $45,660,000 that have a final maturity date of October 1, 2027. The bonds are subject to mandatory sinking fund redemption that begins on October 1, 2004. The University's proceeds of this issuance were used to pay a portion of the costs of certain improvements on the campus of the University, to refund certain debt previously incurred for that purpose, and to pay the costs incurred in connection with the issuance of the 2003B bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven (7) days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, UBS Financial Services Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Bayerische Landesbank, a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.20% of the available commitment, payable quarterly in arrears, beginning on July 1, 2003 and on each October 1, January 1, April 1 and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the Bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2004, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity facility is scheduled to expire on June 19, 2008, unless otherwise extended based on the terms of the agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in twenty (20) quarterly installments, beginning the first business day of January, April, July or October, whichever first occurs on or following the Purchase Date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of $45,660,000 of demand bonds was “put” and not resold, the University would be required to pay $9,557,300 a year for 5 years under this agreement assuming a 1.75% interest rate.

University of North Carolina Hospitals - Revenue Bonds, Series 2001A and Series 2001B

On January 31, 2001, the Hospitals issued two series of tax-exempt variable rate demand bonds in the amount of

$55,000,000/2001A and $55,000,000/2001B that have a final maturity date of February 15, 2031. The bonds are subject to mandatory sinking fund redemption that began on February 15, 2002. A portion of the proceeds was used to reimburse the Hospitals for $75,000,000 spent allowing the UNC Health Care System to acquire controlling interest in Rex Healthcare Inc. The remaining proceeds are to be used for the renovation of space vacated after the opening of the North Carolina Women's Hospital, North Carolina Children's Hospital, and associated support services. While initially bearing interest in a daily mode, the mode on these bonds may change to a weekly rate, a unit pricing rate, a term rate or a fixed rate.

While in daily mode, the bonds are subject to purchase on any business day upon demand by telephonic notice of tender to the remarketing agent on the purchase date and delivery to the bond Tender Agent, Wachovia Bank, N.A. The Hospitals' remarketing agents, Merrill Lynch, Pierce, Fenner & Smith Incorporated (Series 2001A) and Banc of America Securities LLC (Series 2001B) have agreed to exercise their best efforts to remarket bonds for which a notice of purchase has been received. The quarterly remarketing fee is payable in arrears and is equal to 0.08% of the outstanding principal amount of the bonds assigned to each agent.

Under separate Standby Bond Purchase Agreements for the Series 2001A and Series 2001B (Agreements) between the Hospitals and Landesbank Hessen-Thuringen Girozentrale, a Liquidity Facility has been established for the Tender Agent to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. These Agreements require a facility fee equal to .22% of the available commitment, payable quarterly in arrears, beginning on April 2, 2001, and on the first business day of each July, October, January and April thereafter until the expiration date or the termination date of the Agreements.

Under the Agreements, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Formula Rate (Base Rate equal to the higher of the Prime Rate for such day or the sum of .50% plus the Federal Funds Rate) subject to a maximum rate as permitted by law. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is due quarterly (the first business day of January, April, July and October) for each period in which Bank Bonds are outstanding. At June 30, 2004 and 2003, there were no Bank Bonds held by the Liquidity Facility.

Included in the Agreements is a take out provision, in case the remarketing agent is unable to resell any bonds that are "put" within 90 days of the "put" date. In this situation, the Hospitals is required to redeem the Bank Bonds held by the Liquidity Facility. The agreements allow the Hospitals to redeem bank bonds in equal quarterly installments, on the first business day of January, April, July and October. The payments will commence with the first business day of any such month that is at least 90 days following the applicable purchase date of the Bank Bond and end no later than the fifth anniversary of such purchase date. If the take out agreement were to be exercised because the entire outstanding $107,000,000 of demand bonds was "put" and not resold, the Hospitals would be required to pay $23,717,756 a year for five years under the installment loan agreement assuming a 4 percent prime interest rate.

The current expiration date of the Agreements is July 26, 2005. The Hospitals may request additional extensions of up to 364 days. Extensions are at the discretion of Liquidity Provider.

University of North Carolina Hospitals - Revenue Refunding Bonds, Series 2003A and Series 2003B

On February 13, 2003, the Hospitals issued two series of tax-exempt variable rate demand bonds in the amount of $63,770,000/2003A and $34,245,000/2003B that have a final maturity date of February 1, 2029. The bonds are subject to mandatory sinking fund redemption that began on February 1, 2004. The proceeds were used to advance refund $88,325,000 of the Series 1996 Bonds. While initially bearing interest in a weekly mode, the mode on these bonds may change to a daily rate, a unit pricing rate, a term rate or a fixed rate.

While in the weekly mode, the bonds are subject to purchase on demand with seven days' notice to the remarketing agent and delivery to the bond Tender Agent, Wachovia Bank, N.A. The Hospitals' remarketing agents, Banc of America Securities LLC (Series 2003A) and Wachovia Bank, N.A. (Series 2003B) have agreed to exercise their best efforts to remarket bonds for which a notice of purchase has been received. The quarterly remarketing fee is payable in arrears and is equal to 0.08% of the outstanding principal amount of the bonds assigned to the remarketing agent for Series 2003A and is equal to 0.07% of the outstanding principal amount of the bonds assigned to the remarketing agent for Series 2003B.

Under separate Standby Bond Purchase Agreements for the Series 2003A and Series 2003B (Agreements) between the Hospitals and Bank of America, N.A. (Series 2003A) or Wachovia Bank, N.A. (Series 2003B) a Liquidity Facility has been established for the Tender Agent to draw amounts sufficient to pay the purchase price on bonds delivered for purchase when remarketing proceeds or other funds are not available. These Agreements require a facility fee equal to .20% for Series 2003A and .22% for Series 2003B of the available commitment, payable quarterly in advance, beginning on February 13, 2003, and on each February 1, May 1, August 1, and November 1 thereafter until the expiration date or the termination date of the Agreements.

Under the Agreements, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Bank Bond Interest Rate (for Series 2003A, the rate equals the London Interbank Offered Rate (LIBOR) plus 2.50% for the first 90 days and then equals LIBOR plus 4.00%; for

Series 2003B, the rate equals Prime Rate for the first 90 days and then equals Prime plus 1.00%) subject to a maximum rate as permitted by law. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is on the first business day of each month for each period in which Bank Bonds are outstanding. At June 30, 2004, there were no Bank Bonds held by the Liquidity Facility.

Included in the Agreements is a take out provision, in case the remarketing agent is unable to resell any bonds that are "put" within 90 days of the "put" date. In this situation, the Hospitals is required to redeem the Bank Bonds held by the Liquidity Facility. The Series 2003A agreement allows the Hospitals to redeem bank bonds in twelve equal quarterly installments, on the first February 1, May 1, August 1 and November 1 that occurs at least 90 days following the applicable purchase date of the Bank Bond. If the take out agreement were to be exercised because the entire outstanding $63,420,000 of demand bonds was "put" and not resold, the Hospitals would be required to pay $23,029,812 a year for three years under the installment loan agreement assuming a 5.37 percent interest rate (LIBOR plus 4%). The Series 2003B agreement allows the Hospitals to redeem bank bonds in 36 equal monthly installments, on the first business day of each calendar month after the loan date. Payments commence with the first business day of any such month that is at least 120 days following the applicable purchase date of the Bank Bond. If the take out agreement were to be exercised because the entire outstanding $34,060,000 of demand bonds was "put" and not resold, the Hospitals would be required to pay $12,249,708 a year for three years under the installment loan agreement assuming a 5.00 percent interest rate (Prime plus 1%).

The current expiration date of the Series 2003A Agreement is July 1, 2005 and July 31, 2006 for the Series 2003B Agreement. The Hospitals may request additional extensions that are approved at the discretion of the Liquidity Provider.

E. Interest Rate Swaps

<u>Primary Government</u>

Governmental Activities

Objective. As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance in December 2002, the State entered into two interest rate swaps in connection with its $499,870,000 Variable Rate General Obligation Refunding Bonds, Series 2002B-F. The intention of the swap agreements was to effectively change the State’s interest rate on the bonds to a synthetic fixed rate of 3.283% (Swap 1) and 3.089% (Swap 2). For comparison, the State sold fixed rate bonds on the same day as the swap, with the same maturity, at an interest rate of 4.452%.

In June 2003, the State entered into a third swap agreement (Swap 3) to lower its borrowing costs and, due to potential market volatility, reduce its exposure to variable interest rates in connection with $355,000,000 Variable Rate Public Improvement Bonds, Series 2002 D, E, F, and G. Effective July 1, 2003, the intention of this third swap agreement was to effectively change the interest rate on the bonds to a synthetic fixed rate of 1.06% (Swap 3) for a period of two years.

Terms. The bonds and the related swap agreements mature on June 1, 2019 (Swap 1) and June 1, 2017 (Swap 2) and the combined swaps’ notional amount of $499,870,000 matches the $499,870,000 million variable-rate bonds. The swaps were entered into at the same time the bonds were issued (December 2002.). Starting in fiscal year 2012 the combined notional value of the swaps and the combined principal amount of the associated debt decline. Under the swaps the State pays the counterparties a fixed payment of 3.283% (Swap 1) and 3.089% (Swap 2) and receives a variable payment computed at 64 percent of the London Interbank Offered Rate (LIBOR). Conversely, the bonds’ variables-rate coupons are closely associated with the Bond Market Association Municipal Swap Index (BMA).

Swap 3 is effective for a period of two years beginning July 1, 2003 and ending July 1, 2005, with an option for the counterparty to extend the swap at the same rates until July 1, 2006 with a notional amount of $355,000,000 which matches the bonds outstanding. Under Swap 3, the State pays the counterparty a fixed payment 1.06% and receives a variable payment at the BMA.

Fair value. Because interest rates have risen since execution of the swaps, the swaps have positive fair values of $2,923,039 (Swap 1), $3,132,527 (Swap 2), and $2,666,561 (Swap 3) as of June 30, 2004. The swap’s positive fair value may be countered by an increase in total interest payments required under the variable rate bonds, creating a higher synthetic interest rate. Because the coupons on the State’s variable-rate bonds are adjusted every seven days to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from the counterparties representing estimates of the amounts that would be paid for replacement transactions.

Credit risk. The swaps' fair values represented the State's credit risk exposure to the counterparty as of June 30, 2004. The State's maximum possible loss is equivalent to the fair value of the swaps. The counterparty's current ratings for each swap are:

	Moody's Investors Service	Standard & Poor's	Fitch Ratings
Swap 1	Aa1	AA	AA
Swap 2	Aaa	AA+	
Swap 3	Aa1	AA	

To mitigate the potential for credit risk, if the counterparty's credit quality falls to a specified rating, the counterparty will be required to collateralize a portion (up to 100%) of the fair value. For Swap 1, if the counterparty's credit quality falls to A1 (Moody's) or A+ (either S&P or Fitch) and their exposure exceeds $5,000,000, then the swap will be collateralized by the counterparty with cash, U.S. government or agency securities, or other collateral acceptable to the State. For Swap 2, if the credit quality falls to Aa1 (Moody's) or AA+ (S&P) and their exposure exceeds $10,000,000, then the swap will be collateralized by the counterparty with cash, U.S. government or agency securities, or other collateral acceptable to the State. For Swap 3, if either party's rating falls below A3 (Moody's) or A- (S&P), a credit support agreement can be negotiated that will require the levels and types of collateral to be posted. An additional termination event occurs if the counterparty fails to maintain: for Swap 1, at least two ratings of at least Baa1 (Moody's) or BBB+ (S&P and Fitch); for Swap 2, at least one rating of at least Baa3 (Moody's) or BBB- (S&P); for Swap 3, at least an A3 (Moody's) or A- (S&P).

Basis risk and termination risk. Swap 1 and Swap 2 expose the State to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rates of 3.283% and 3.089% and the synthetic rates as of June 30, 2004 of 3.437% (Swap 1) and 3.243% (Swap 2). As of June 30, 2004, the rate on the State's bonds was 1.03%, whereas 64 percent of LIBOR was 0.876%. The swaps may be terminated by the State with 15 days notice and the counterparties can only terminate the swaps if the State's rating falls below Baa1 with Moody's, or BBB+ with either S&P or Fitch for Swap 1, and on Swap 2, below Baa3 with Moody's or BBB- with either S&P or Fitch, or an Event of Default occurs.

Swap 3 exposes the State to basis risk should the actual rate on the State's bonds vary from BMA. As of June 30, 2004, the rate on the State's bonds was 1.03%, whereas the BMA was 1.05%. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 1.06% and the actual synthetic rate of 1.04% as of June 30, 2004. The swap can be terminated by the State with 15 days notice and the counterparty can only terminate the swap if the State's rating falls below A3 (Moody's) or A- (S&P) or an Event of Default occurs.

Market-access risk/Rollover-risk. Swap 1 and Swap 2 are for the term (maturity) of the Bonds and therefore there is no market-access risk or rollover risk. Swap 3 exposes the State to market-access/rollover risk when the swap matures on July 1, 2005, or if extended by the counterparty, on July 1, 2006. When Swap 3 matures, the interest rate on the underlying debt will return to a variable rate.

Business-type Activities

Objective. In order to protect against the potential of rising interest rates, the Town of Butner, State of North Carolina entered into an interest rate swap in connection with its $9,905,000 Butner Water and Sewer System Revenue Bond Series 2001. The intention of the swap agreements was to effectively change the State's interest rate on the bonds to a fixed rate of 4.21% (plus remarketing and liquidity fees and any difference between the variable rate received by the State (65% of LIBOR) and the rate paid by the State on the Variable Rate Bonds).

Terms. The swap agreement was with Bank of America, N.A. based on a notional amount of $9,905,000 to mature on September 1, 2025. The swap's notional amount of $9,905,000 matches the $9,905,000 variable-rate bonds. Under the swap, the State pays a fixed payment of 4.21% to Bank of America, N.A. and receives a variable payment of 65% of the LIBOR (LIBOR was 1.369% at June 30, 2004). On the other hand, the bond's variable-rate coupons (1.08 % at 6/30/2004) are closely associated with the variable BMA, which was 1.05% as of June 30, 2004.

Fair Value. Because interest rates have declined since execution of the swap, the swap has a negative fair value (the State would have to pay the counterparty if the State terminated the swap) of $700,284 (Bank of America, N.A.) as of June 30, 2004. The swap's negative fair value if terminated may be countered by a reduction in total interest payments required under a new swap creating a lower synthetic fixed rate. Because the coupons on the State's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from the counterparty representing mid-market or average estimates/quotes of the amounts that would be paid for replacement transactions (having the effect of preserving the economic benefit to the party).

Credit risk: As of June 30, 2004, the State was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the State would be exposed to credit risk in the amount of the derivative's fair value.

Basis risk and termination risk. The Swap exposes the State to basis risk (including effects of any reduction in marginal tax rates) should the relationship between LIBOR and BMA converge, changing the synthetic rate to the State on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 4.21 % and the actual synthetic rate as of June 30, 2004 of (3.32% + 1.08%) 4.40% reflecting a Bond Rate/LIBOR relationship of 78.90% compared to 65% of LIBOR the State is receiving (as of June 30). The swap may be terminated by either party if the other party fails to perform under the terms of the contract. If the swap is terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the Town would be liable to the counterparty for that amount.

Component Units

University of North Carolina System

University of North Carolina at Chapel Hill

Objective. In order to protect against the risk of interest rate changes, effective October 3, 2000, the University entered into an interest rate swap contract agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) related to $22,000,000 of The University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Bonds, Series 2001B, and the interest swap agreement was amended to reflect the refunding.

Terms, fair value and credit risk. Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the BMA on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. The notional amount of the swap reduces annually; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2004, rates were as follows:

	Terms	Rates
Fixed payment to Lehman	Fixed	5.24
Variable payment from Lehman	BMA	0.98
Net interest rate swap payments		4.26
Variable rate bond coupon payments		1.01
Synthetic interest rate on bonds		5.27

As of June 30, 2004, the swap had a negative fair value of $3,513,801. The fair value was developed by Lehman Brothers. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for LIBOR due on the date of each future net settlement on the swap.

As of June 30, 2004, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than $1,000,000, at that point Lehman would be required to collateralize 103% of their exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A1 by Moody's, A by S&P, and A+ by Fitch.

Basis risk. The University receives the BMA from Lehman Brothers and pays a floating rate to its bondholders set by the remarketing agent. The University incurs basis risk when its bonds begin to trade at a yield above the BMA. Basis risk also exists since swap payments are made quarterly while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a BMA swap to a percentage of LIBOR swap. This would introduce basis risk. If the weekly reset interest rates on the University's bonds are in excess of 65% of LIBOR, the University will experience an increase in debt service above the fixed rate on the swap to the extent that the interest rates on the bonds exceed 65% of LIBOR.

Termination risk. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Lehman Brothers fails to perform under terms of the contract.

North Carolina State University

Objective. In order to protect against the potential of rising interest rates, the University entered into three separate pay-fixed, receive-variable interest rate swaps at a cost anticipated to be less than what the University would have paid to issue fixed-rate debt.

Terms, fair values, and credit risk. The University's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated "bonds payable" category. The terms, fair values, and credit ratings of the outstanding swaps as of June 30, 2004 were as follows (dollars in thousands).

Associated Bond Issue	Notional Amounts	Effective Date	Fixed Rate Paid	Variable Rate Received	Fair Values	Swap Termination Date	Counterparty Credit Rating
Centennial Campus 1999A	$9,000	10/1/1999	4.574%	67% of LIBOR	$(851)	12/01/2019	A1 / A+ / A+
General Revenue 2003B	24,655	6/20/2003	3.54%	BMA[1]	1,827	10/01/2027	Aa1 / AA- /AA-
General Revenue 2003B	21,005	6/20/2003	1.19%	BMA	123	7/1/2005[2]	Aa1 / AA- /AA-
Total	$54,660				$1,099		

[1] Variable rate received is the BMA from 6/20/03 to 7/1/06, thereafter, the variable rate received will be 75% of LIBOR
[2] Counterparty has the option to extend the swap to July 1, 2007

Because rates have declined since 1999, the Centennial Campus swap has a negative fair value as of June 30, 2004. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the market values as of June 30, 2004.

As of June 30, 2004, the University was exposed to credit risk in the amount of the positive fair value on the General Revenue 2003B derivatives' fair value. The swap agreements do not contain a requirement for collateral, although the General Revenue 2003B swaps require termination should the University's or the counterparty's credit rating fall below either Baa2 as issued by Moody's or BBB as issued by S&P or Fitch. Also, under the terms of the swap agreements, should one party become insolvent or otherwise default on its obligations, provisions permit the nondefaulting party to accelerate and terminate all outstanding transactions. Of the three agreements entered into by the University, two swaps, approximating 83% of the notional amount of the swaps outstanding, are held with one counterparty. All the counterparties are rated A1or better.

Basis risk. The University is exposed to basis risk on the swaps when the variable payment received is based on an index other than BMA. Should the relationship between LIBOR and BMA move to convergence, the expected cost savings may not be realized. As of June 30, 2004, the BMA rate was 1.05 percent, whereas 67% of LIBOR was .91 percent.

Termination risk. The University or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. If any of the swaps are terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the University would be liable to the counterparty for that amount.

North Carolina Central University

In October of 2003, the North Carolina Capital Facilities Finance Agency issued Student Housing Facilities Revenue Bonds ($21,475,000 Variable Rate Revenue Demand Bonds, Series 2003A) and Taxable Student Housing Facilities Revenue Bonds ($100,000 Variable Rate Revenue Demand Bonds, Series 2003B). The issuer, the North Carolina Capital Facilities Finance Agency, loaned the proceeds of the Series 2003 Bonds to the NCCU Real Estate Foundation, Inc. (Foundation).

Objective. As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance in October 2003, effective March 24, 2004, the Foundation entered into two interest rate swaps with Wachovia Bank, N.A., in connection with its $21,475,000 Variable Rate Revenue Demand Bonds, Series 2003A. The intention of the swap agreements was to effectively change the interest rate on the bonds to a synthetic fixed rate of 3.515% (Swap 1) and 2.71% (Swap 2).

Terms. The bonds and the related swap agreements mature on October 1, 2024 (Swap 1) and April 1, 2009 (Swap 2) and the combined swaps' notional amount of $17,180,000 hedges 80% of the $21,475,000 million variable-rate bonds. Starting in fiscal year 2006, the combined notional value of the swaps and the combined principal amount of the associated debt decline. Under the swaps, the Foundation pays Wachovia Bank, N.A. a fixed rate of 3.515% (Swap 1) and 2.71% (Swap 2) and receives a variable rate at 70% and 100% of LIBOR and BMA, respectively. The bonds' variables-rate coupons are closely associated with the BMA.

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Fair value. Because interest rates have risen since execution of the swaps, the swaps have positive fair values of $213,437 (Swap 1) and $136,521 (Swap 2) as of June 30, 2004. The swap's positive fair value may be countered by an increase in total interest payments required under the variable rate bonds, creating a higher synthetic interest rate. Because the coupons on the Foundation's variable-rate bond are adjusted every seven days to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from Wachovia Bank, N.A. representing estimates of the amounts that would be paid upon terminating the transactions.

Credit risk. As of June 30, 2004, the Foundation was exposed to credit risk because the swaps had a positive fair value. The Foundation is exposed to credit risk in the amount of the derivatives' fair values. Swap 1 and Swap 2's counterparty (Wachovia Bank, N.A.) was rated Aa2 by Moody's, A+ by S&P, and AA- by Fitch.

Basis risk and termination risk. Swap 1 exposes the Foundation to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 3.515% and the actual of 3.647% (Swap 1) at June 30, 2004. As of June 30, 2004, the rate on the Foundation's Bonds was 1.09%, whereas 70 % of LIBOR was 0.958%.

Swap 2 exposes the Foundation to basis risk should the actual rate on the Foundation's Bond vary from the BMA. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 2.71% and the actual of 2.75% (Swap 2) at June 30, 2004. As of June 30, 2004, the rate on the Foundation's bonds was 1.09%, whereas the BMA index was 1.05%.

Market-access risk/Rollover-risk. Swap 1 and Swap 2 expose the Foundation to market-access/rollover risk when the swaps mature on October 1, 2024 and April 1, 2009 respectively. When Swap 1 and Swap 2 mature, the interest rate on the underlying debt will return to a variable rate.

University of North Carolina Hospitals

Objective. In order to protect against the risk of interest rate changes, the Hospitals entered into an interest rate swap contract agreement with Bank of America, N.A. (BOA) on February 13, 2003. The agreement covers the Variable Rate Revenue Refunding Bonds, Series 2003A ($63,770,000) and Series 2003B ($34,245,000). The 2003 series of bonds partially refunded Fixed Rate Revenue Bonds, Series 1996.

Terms, fair values, and credit risk. Under this agreement, BOA pays the Hospitals interest on the notional amount based on 67% of the arithmetic mean of the USD-LIBOR-BBA (with a designated maturity of one month) on a monthly basis. Also on a monthly basis, the Hospitals pays BOA interest at the fixed rate of 3.48%. No cash was paid or received by the Hospitals upon initiation of the agreement. The notional amount of the swap reduces annually; the reductions began in February 2004 and end in February 2029. The swap agreement terminates February 1, 2029. As of June 30, 2004, rates were as follows:

	Terms	2003A Rates	2003B Rates
Fixed payment to BOA	Fixed	3.48	3.48
Variable payment from BOA	LIBOR BBA	0.81	0.81
Net interest rate swap payments		2.67	2.67
Variable rate bond coupon payments		1.08	1.04
Synthetic interest rate on bonds		3.75	3.71

Because rates have started to increase, the swap agreement has a mark-to-market value of $1,393,549 as of June 30, 2004 compared to a negative mark-to-market value of $5,972,285 as of June 30, 2003. BOA develops the mark-to-market value. Their method calculates the present value of the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for LIBOR due on the date of each future net settlement on the swap.

As of June 30, 2004, the Hospitals is exposed to credit risk equal to the value of the swap. BOA is currently rated Aa1 by Moody's, AA- by S&P, and AA- by Fitch. At such time that their ratings fall below A3 for Moody's or below A- for S&P, BOA will be required to collateralize a portion of their exposure (up to 100%).

Basis risk. The Hospitals receives 67% of 1-month LIBOR-BBA Index from BOA and pays a floating rate to its bondholders set by the remarketing agent. The Hospitals incurs basis risk when its bonds trade at a yield above 67% of 1-month LIBOR-BBA Index. If the relationship of the Hospitals' bonds trade to a percentage of LIBOR greater than 67%, the Hospitals will experience an increase in debt service above the fixed rate on the swap.

Termination risk. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Hospitals or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If the swap is terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the Hospitals would be liable to the counterparty for that amount. Termination could result in the Hospitals being required to make an unanticipated termination payment.

North Carolina Housing Finance Agency

Objective. The North Carolina Housing Finance Agency (the Agency) has entered into interest rate swaps in connection with its $80 million variable-rate revenue bonds associated with several series in its Single Family Resolution as a means to lower its borrowing costs when compared against fixed-rate bonds at the time of issuance. The intention of the swaps was to effectively lower the Agency's interest rate on the long term bonds to a fixed rate.

Terms and fair value. The terms and fair value of the outstanding swaps as of June 30, 2004 were as follows (dollars in thousands).

Series	Counterparty	Notional Amount	Date of Swap	Maturity Date of Swap	Fixed Rate	Fair Values
15	UBS AG	$20,000	5/8/2003	7/1/2032	3.510%	$304
16	Bank of America, N.A.	20,000	9/16/2003	7/1/2032	3.810%	(231)
17	Bank of America, N.A.	20,000	12/11/2003	7/1/2033	3.725%	(122)
18	Goldman Sachs Mitsui Marine	20,000	4/20/2004	1/1/2035	3.288%	773
		$80,000				$724

Under all of the swaps, the Agency pays the counterparties a fixed rate and receives a variable payment computed as 63% on the LIBOR, plus 30 basis points. The bonds' variable-rate coupons are based on the variable BMA, which was 1.06% as of June 30, 2004.

In total, the swaps have a positive fair value of $724,696 as of June 30, 2004. Because the aggregate fair value of the swaps is positive, the Agency is exposed to credit risk. Because the coupons on the Agency's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Basis risk and termination risk. The swaps expose the Agency to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. Series 15 swap may be terminated if the counterparty's credit rating falls below A3 as issued by Moody's or A- as issued by Fitch or S&P. For series 16, 17 and 18, collateral thresholds have been established if the counterparty's ratings reach A2 for Moody's or A for S&P. Series 16, 17 and 18 swaps may be terminated if the counterparty's rating falls below Baa as issued by Moody's or BBB as issued by S&P.

F. Debt Service Requirements

The following schedules show the annual debt service requirements to maturity for general obligation bonds, certificates of participation, revenue bonds, and notes payable (dollars in thousands). Debt service requirements are disclosed for the primary government (governmental activities and business-type activities) and component units (University of North Carolina System, North Carolina Housing Finance Agency, and the State Education Assistance Authority).

The schedules also include the net swap payments for debt with interest rate swaps. More detailed information about interest rate swaps is presented in Note 7(E). The debt service requirements of variable rate debt and net swap payments are based on rates as of June 30, 2004 and assume that current interest rates remain the same for their term. As rates vary, variable-rate bond interest payments and net swap payments will vary.

	Governmental Activities						
	General Obligation Bonds			Certificates of Participation		Lease-Purchase Revenue Bonds	
Fiscal Year Ending June 30	Principal	Interest	Interest Rate Swaps, Net	Principal	Interest	Principal	Interest
2005	$ 274,385	$ 203,269	$ 11,545	$ 14,380	$ 13,519	$ 7,000	$ 10,158
2006	281,400	192,076	11,510	14,600	13,045	8,000	9,824
2007	281,170	179,758	11,510	14,615	12,649	8,000	9,446
2008	281,240	167,107	11,510	14,640	12,139	8,000	9,150
2009	280,275	153,833	11,510	14,670	11,564	8,000	8,862
2010-2014	1,406,490	566,814	55,340	73,735	48,490	40,000	38,601
2015-2019	1,404,145	283,792	29,705	74,755	30,735	40,000	28,795
2020-2024	644,855	97,314	—	79,770	11,576	99,405	12,339
2025-2029	128,900	8,366	—	—	—	—	—
Total	$ 4,982,860	$ 1,852,329	$ 142,630	$ 301,165	$ 153,717	$ 218,405	$ 127,175

	Business-type Activities		
	Revenue Bonds		
Fiscal Year Ending June 30	Principal	Interest	Interest Rate Swaps, Net
2005	$ 255	$ 99	$ 286
2006	270	96	278
2007	280	93	269
2008	295	90	260
2009	305	86	250
2010-2014	1,750	377	1,094
2015-2019	2,180	270	784
2020-2024	2,720	137	398
2025-2029	1,270	10	30
Total	$ 9,325	$ 1,258	$ 3,649

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	Revenue Bonds							
	University of North Carolina System			North Carolina Housing Finance Agency			State Education Assistance Authority	
Fiscal Year Ending June 30	Principal	Interest	Interest Rate Swaps, Net	Principal	Interest	Interest Rate Swaps, Net	Principal	Interest
2005	$ 62,017	$ 59,287	$ 4,828	$ 27,967	$ 63,242	$ 1,919	$ 1,000	$ 25,212
2006	65,440	56,723	4,766	30,730	63,507	1,886	1,000	25,157
2007	68,034	53,986	4,720	31,360	61,346	1,845	—	25,157
2008	69,440	51,070	4,678	33,250	59,899	1,805	—	25,157
2009	71,880	48,013	4,587	35,045	58,419	1,765	55,614	25,089
2010-2014	366,079	195,307	21,628	202,760	265,238	8,292	414,454	113,210
2015-2019	358,889	125,877	18,696	227,935	207,212	7,386	423,900	59,718
2020-2024	304,980	66,389	12,845	198,975	156,521	6,202	—	50,009
2025-2029	192,155	22,835	3,701	321,575	88,475	3,938	270,000	46,103
2030-2034	75,170	5,331	—	152,740	17,860	1,011	520,000	21,215
2035-2039	1,420	9	—	3,750	943	32	—	—
2040-2044	—	—	—	2,050	233	—	—	—
Total	$ 1,635,504	$ 684,827	$ 80,449	$ 1,268,137	$ 1,042,895	$ 36,081	$ 1,685,968	$ 416,027

	Notes Payable			
	Governmental Activities		University of North Carolina System	
Fiscal Year Ending June 30	Principal	Interest	Principal	Interest
2005	$ 2,856	$ 357	$ 3,640	$ 998
2006	2,976	237	36,263	390
2007	17,127	2,348	1,039	180
2008	2,049	57	1,039	131
2009	—	—	775	82
2010-2014	—	—	957	61
Total	$ 25,008	$ 2,999	$ 43,713	$ 1,842

G. Bond Defeasances

The State and its component units extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

Primary Government

On August 1, 2003, the State issued $91,000,000 and $235,710,000 in General Obligation Refunding Bonds, Series 2003D and Series 2003E, respectively, with average interest rates of 4.25% and 4.85%, respectively. The current refunding component, Series D, was used to refund $92,370,000 of outstanding Prison and Youth Services Facilities Bonds, Series 1993B and 1993C, with a combined average interest rate of 5.14%. The advance refunding component, Series E, was used to advance refund (defease) $244,500,000 of outstanding Capital Improvement 1994A Bonds, with a combined average interest rate of 4.72%. Net proceeds of $95,646,814 and $254,155,159, Series D and E, respectively, resulted from the bond sales. Of the Series E net proceeds amount, $253,240,735 were used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent and were used to redeem the outstanding Capital Improvement 1994A Bonds on February 1, 2004. The State reduced its debt service requirements by $13,486,582 over the next ten years and obtained an economic gain of $11,504,123.

Component Units

University of North Carolina System

University of North Carolina at Charlotte

On October 29, 2003, the University issued $8,635,000 in Pooled 2003-A General Obligation Bonds with an average interest rate of 4.45%. The refunding component of this bond issue was used to advance refund (defease) $8,650,000 of outstanding Housing and Dining Series M Revenue Bonds, with a combined average interest rate of 5.17%. Net proceeds of $9,171,001 resulted from the bond sale. Of the net proceeds amount, $9,043,985 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by $488,220 over the next 12 years and obtained an economic gain of $482,234. At June 30, 2004, the outstanding balance was $8,650,000 for the defeased Housing and Dining Series M Revenue Bonds.

On October 29, 2003, University issued $8,770,000 in Pooled 2003-A General Obligation Bonds with an average interest rate of 4.16%. The refunding component of this bond issue was used to advance refund (defease) $8,415,000 of outstanding Student Activity Center Revenue Bonds, (which was a portion of the outstanding bonds for this issue), with a combined average interest rate of 5.46%. Net proceeds of $9,439,085 resulted from the bond sale. Of the net proceeds amount, $9,299,017 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by $349,849 over the next 13 years and obtained an economic gain of $216,058. At June 30, 2004, the outstanding balance was $8,415,000 for the defeased Student Activity Center Revenue Bonds.

On March 31, 2004, University issued $4,480,000 in Pooled 2004-A General Revenue Bonds with an average interest rate of 3.74%. The refunding component of this bond issue was used to advance refund (defease) $4,035,000 of outstanding Parking Series 1996 Revenue Bonds, with a combined average interest rate of 5.86%. Net proceeds of $4,562,974 resulted from the bond sale. Of the net proceeds amount, $4,465,236 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by $347,354 over the next 17 years and obtained an economic gain of $306,985. At June 30, 2004, the outstanding balance was $4,035,000 for the defeased Parking Series 1996 Revenue Bonds.

North Carolina Central University

On March 31, 2004, the University issued $8,670,000 in UNC System Pool Revenue Bonds, Series 2004B with an average interest rate of 3.92%. The refunding component of this bond issue was used to advance refund (defease) $7,690,000 of outstanding Housing Revenue Bond, Series 1996, with a combined average interest rate of 5.34%. Net proceeds of $8,768,853 resulted from the bond sale. Of the net proceeds amount, $8,768,853 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by $194,133 over the next 19 years and obtained an economic gain of $280,533. At June 30, 2004, the outstanding balance was $7,690,000 for the defeased Housing Revenue Bonds, Series 1996.

North Carolina Housing Finance Agency

On November 4, 2003, the Agency issued $14,065,000 in 1992 Multifamily tax exempt fixed rate bonds (Series C) with an average interest rate of 3.52% and $23,015,000 in 1992 Multifamily variable taxable bonds (Series D) using a weekly interest rate. These bond proceeds, along with a bond call, were used to optionally refund all of 1992 Multifamily Series B Bonds with a combined average interest rate of 6.51% on November 14, 2003. For Series C, the current refunding was done for the benefit of owners who could restructure under the HUD Section 8 program. The refunding allowed these owners to pay mortgage loan interest of 5.60% rather than the 11.05% that they had been paying previously. It is anticipated that the Series D mortgages will be prepaid in the next two years and these bonds will be fully redeemed. Mortgage loans of $14,068,000 were transferred from Series B to Series C and mortgage loans of $20,654,000 were transferred from Series B to Series D. The Agency reduced its debt service requirements by $8,811,000 over the next 21 years, which resulted in an economic gain of $4,243,000. The variable rate component was calculated at 5.90% which is the ten year average of the twenty year treasury.

Prior Year Defeasances

During prior years, the State and certain component units defeased certain general obligation and other bonds. For those defeasances involving advance refundings, the proceeds and any securities purchased with the proceeds were placed in an irrevocable trust with an escrow agent in an amount sufficient to provide for all future debt service payments on the refunded bonds. Since adequate funds have been placed with a trustee to pay fully the principal and interest on these bonds, the liabilities are not recorded in these financial statements. At June 30, 2004, the outstanding balance of prior year defeased bonds was $459.9 million for the primary government and $129.1 million for the component units.

H. Bond Redemptions

The bond series resolutions for the North Carolina Housing Finance Agency provide for various methods of redemption. Bonds are redeemed at par from prepayments of mortgage loans securing the issues, from unexpended bond proceeds of the issues, or from funds released via the related decreases in the respective debt service reserve requirements. In addition, various bond issues are redeemable at the option of the Agency with premiums ranging up to 2% for up to twelve years after the date of issue.

NOTE 8: LEASE OBLIGATIONS—OPERATING AND CAPITAL

The State and its component units have entered into various operating and capital leases for office space and for office, communications, computer and other equipment. Any operating leases with scheduled rent increases are considered immaterial to the future minimum lease payments and current rental expenditures. Operating lease payments are recorded as expenditures or expenses of the related funds when paid or incurred. For the year ended June 30, 2004, total operating lease expenditures were $66 million for Primary Government, $34.1 million for Universities, and $5.3 million for Community Colleges. Future minimum lease commitments for noncancelable operating leases and capital leases as of June 30, 2004 are (dollars in thousands):

	Operating Leases			**Capital Leases**		
		Component Units			*Component Units*	
Fiscal Year	*Primary Government*	University of North Carolina System	Community Colleges	*Governmental Activities*	University of North Carolina System	Community Colleges
2005	$ 46,822	$ 18,774	$ 4,212	$ 203	$ 2,415	$ 570
2006	37,084	13,584	2,405	91	1,581	490
2007	25,245	10,123	1,489	40	1,351	442
2008	18,285	7,013	918	14	1,249	401
2009	10,051	3,848	368	—	1,164	340
2010 - 2014	18,267	10,118	454	—	3,224	1,162
2015 - 2019	9,832	4,742	—	—	2,108	—
2020 - 2024	9,832	4,722	—	—	1,663	—
2025 - 2029	9,832	4,711	—	—	2,352	—
2030 - 2034	8,082	—	—	—	—	—
2035 - 2039	8,082	—	—	—	—	—
2040 - 2044	8,082	—	—	—	—	—
2045 - 2049	8,082	—	—	—	—	—
2050 - 2054	4,849	—	—	—	—	—
Total Future Minimum Lease Payments.........	$ 222,427	$ 77,635	$ 9,846	348	17,107	3,405
Less: Amounts Representing Interest				44	371	716
Present Value of Future Minimum Lease Payments				$ 304	$ 16,736	$ 2,689

At June 30, 2004, capital assets acquired under capital leases are as follows (dollars in thousands):

	Primary Government	*Component Units*	
	Governmental Activities	University of North Carolina System	Community Colleges
Buildings..	$ —	$ 12,219	$ 1,711
Machinery and Equipment................	637	5,321	1,691
Other..	—	1,043	154
Less: Accumulated Depreciation.....	—	(1,990)	(328)
Total Capital Assets.......................	$ 637	$ 16,593	$ 3,228

NOTE 9: INTERFUND BALANCES AND TRANSFERS

A. Interfund Balances

Due To/From Fiduciary Funds

The General Fund balance of $7.04 million due to fiduciary funds is related to local sales taxes collected in the general fund and due to the agency fund. The other balances due to fiduciary funds are related to balances held on behalf of patients at the State's mental health facilities. The balances due from fiduciary funds are primarily for services provided to pension and other employee benefit trust funds. Amounts payable to or receivable from fiduciary funds are considered interfund balances in the fund financial statements, but are not reported as internal balances in the government-wide statement of net assets.

Due To/From Other Funds

Balances due to/from other funds at June 30, 2004, consisted of the following (dollars in thousands):

	Due From Other Funds						
	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Unemployment Compensation Fund	Internal Service Funds	Total
Due To Other Funds							
General Fund	$ —	$ 9,092	$ 9,209	$ 3,991	$ —	$ 14,570	$ 36,862
Highway Fund	—	—	225	4,817	—	2,215	7,257
Highway Trust Fund	—	94,543	—	—	—	—	94,543
Other Governmental Funds	106	3,000	—	140,439	91	1,191	144,827
EPA Revolving Loan Fund	—	—	—	—	—	8	8
Nonmajor Enterprise Funds	—	—	—	—	—	25	25
Internal Service Funds	3	—	—	4	—	1,406	1,413
Total	$ 109	$ 106,635	$ 9,434	$ 149,251	$ 91	$ 19,415	$ 284,935

These balances resulted primarily from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made. Amounts reported in the funds as interfund receivables and payables were eliminated in the governmental and business-type activities columns of the government-wide statement of net assets, except for the net residual amounts due between governmental and business-type activities, which were presented as internal balances.

Advances To/From Other Funds

The balance of $122.35 million advanced to the General Fund from the Highway Trust Fund was made to meet a constitutional requirement of a balanced budget for the General Fund for the fiscal year ended June 30, 2003. The General Assembly intends to make payments from the General Fund back to the Highway Trust Fund during the fiscal years ending June 30, 2005 through June 30, 2009 including interest at the net rate of return generated by the State Treasurer's Short Term Investment Fund.

The balance of $1.66 million advanced to the Highway Fund from the Highway Trust Fund resulted from a loan made to the Division of Motor Vehicles to provide funds to pay the charges for telecommunications services associated with the emissions inspection and maintenance program that accrued during the 2001 calendar year. This advance will be repaid with interest at a rate equal to the average annual yield that the State Treasurer obtains on investment of funds in the Highway Trust Fund.

B. Interfund Transfers

Transfers in/out of other funds for the fiscal year ended June 30, 2004 consisted of the following (dollars in thousands):

	Transfers Out								
Transfers In	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Unemployment Compensation Fund	EPA Revolving Loan Fund	Other Enterprise Funds	Internal Service Funds	Total
General Fund	$ —	$ 56,942	$ 253,202	$ 219,842	$ 240	$ 190	$ 317	$ 40	$ 530,773
Highway Fund	30,186	—	286,921	—	—	—	—	—	317,107
Other Governmental Funds	356,695	169,702	—	170,385	6,109	1,161	4,878	9,710	718,640
Unemployment Compensation Fund	—	—	—	25	—	—	—	—	25
EPA Revolving Loan Fund	154	—	—	7,204	—	—	—	—	7,358
Other Enterprise Funds	4,500	—	—	1,314	—	—	—	—	5,814
Internal Service Funds	86	—	—	50	—	—	—	—	136
Total	$ 391,621	$ 226,644	$ 540,123	$ 398,820	$ 6,349	$ 1,351	$ 5,195	$ 9,750	$ 1,579,853

Transfers are primarily used to (1) transfer revenues and bond proceeds from the fund required by State statute or budget to collect the revenue to the fund required by State statute or budget to expend them, (2) provide unrestricted revenues collected in the general fund to finance operating and capital programs accounted for in other funds in accordance with budgetary authorizations, and (3) reflect reversions of State funds from other funds to the General Fund in accordance with Office of State Budget and Management requirements.

The Highway Trust Fund was created in 1989 to accumulate certain taxes and fees related to highway and vehicle use. Each year legislation mandates that a portion of these revenues be transferred to the Highway Fund for transportation programs and administration of the Highway Trust Fund. The total transfer for this fiscal year was $286.9 million.

Also when the Highway Trust Fund was created, the revenue from the sales tax on motor vehicles was transferred from the General Fund to the Highway Trust Fund. To offset a portion of this revenue loss in the General Fund, the Highway Trust Fund is required to transfer funds to the General Fund each year. The total transfer for this fiscal year was $252.4 million.

In order to meet the constitutional requirement for a balanced budget for the General Fund, the General Assembly, as part of The Current Operations and Capital Improvements Appropriations Act of 2003, identified resources to meet spending requirements. Among these resources were transfers from various funds to the General Fund including $105.7 million from other governmental funds.

NOTE 10: FUND BALANCE RESERVES AND DESIGNATIONS

Reserved Fund Balance. The State's reserved fund balances represent those portions of the fund balances that are either (a) externally restricted for a specific use, (b) not available for appropriation or expenditure because the underlying asset is not an available financial resource for current appropriation or expenditure, or (c) for encumbrances, which represent commitments related to unperformed contracts for services and undelivered goods. The reserved fund balances at June 30, 2004, are (dollars in thousands):

	Governmental Funds				
	General Fund	*Highway Fund*	*Highway Trust Fund*	*Other Governmental Funds*	*Total Governmental Funds*
Specific encumbrances	$ 31,987	$ 3,342	$ —	$ —	$ 35,329
Inventories	54,689	4,467	—	28,874	88,030
Investments	57	—	—	14	71
Wildlife endowment	—	—	—	52,520	52,520
Notes receivable	1,240	137	—	281,301	282,678
Compensated absences	—	36,844	—	—	36,844
Retirees' health premiums	80,924	—	—	—	80,924
Prepaid items	—	—	—	132	132
Continuing programs	27,720	—	—	—	27,720
Capital projects	—	—	—	171,241	171,241
Loan and grant commitments	—	2,148	—	100,575	102,723
Advance to other funds	—	—	124,006	—	124,006
Other purposes	831	2,201	—	39,372	42,404
Total reserved fund balance	$ 197,448	$ 49,139	$ 124,006	$ 674,029	$ 1,044,622

Unreserved Designated Fund Balance. The State's unreserved fund balance designations in the General Fund represent tentative plans for use in a future period. The State's internal governing body (*General Assembly*) establishes restrictions on the use of these assets which are reported as fund balance designations. Fund balance designations in the General Fund are established based on the amount of reserves available as measured on the budgetary basis of accounting and authorized carryforwards for continuing General Fund programs. These designations totaled $359.516 million at June 30, 2004. As shown in the table below, the fund balance available to be designated was negative $393.735 million on a modified accrual basis at June 30, 2004 (dollars in thousands):

Unreserved Designated Fund Balance	General Fund
Subsequent year budget	$ 11,732
Disaster relief	8,143
Repairs and renovations	76,797
Higher education	44,482
Agriculture	545
Primary and secondary education	39,872
Economic development programs	41,741
General government programs	10,978
Health and human services programs	92,509
Public safety, corrections, and regulation programs	29,949
Environment and natural resources	2,768
Total designations	$ 359,516
Unreserved fund balance	$ (393,735)

NOTE 11: RETIREMENT PLANS

The State reports ten retirement plans as pension trust funds. Section A of this note describes the seven defined benefit public employee retirement plans and one defined contribution plan administered by the State. The remaining plans, described in Note 12, are defined contribution plans administered by a third party under the auspices of the State. The State may or may not make supplementary contributions to these plans. Although the assets of the administered plans are commingled for investment purposes, each plan's assets may be used only for payment of benefits to the members of that plan and for administrative costs in accordance with the terms of the plan. The plans in this note do not issue separate financial statements, nor are they reported as part of other entities. The financial statements and other required disclosures are presented in Note 15 and in the *Required Supplementary Information* section of this *CAFR*. The State also provides an optional retirement plan for certain university employees and a special separation allowance for eligible sworn law enforcement officers.

A. Plan Descriptions and Contribution Information

1. *TEACHERS ' AND STATE EMPLOYEES' RETIREMENT SYSTEM*

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the reporting entity. Membership is comprised of employees of state agencies and institutions, local boards of education, universities and community colleges and certain proprietary component units. At June 30, 2004, the number of participating local boards of education and component unit employers was 196 as shown below:

Local boards of education	117
Community colleges	58
University of North Carolina System	17
Proprietary component units	4

Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by an actuarially required employer contribution established by legislation. For the period July 1, 2003 through June 30, 2004, the State made the actuarially based required contribution of .22% of covered payroll. Benefit and contribution provisions are established by G.S. 135-5 and 135-8 and may be amended only by the North Carolina General Assembly.

In addition to the actuarially based required contribution for this year, the State's General Fund contributed an additional thirty million dollars to help offset the actuarial impact caused by the underpayment of contributions in fiscal 2001. Actual payments made in relation to the required contributions for the State are shown in *Section D* of this note and in the *Required Supplementary Information* section of this report.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

2. *CONSOLIDATED JUDICIAL RETIREMENT SYSTEM*

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State Judicial System. Membership is comprised of judges, district attorneys and clerks of court. The plan provides retirement, disability and death benefits. Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by employer contributions. For the period July 1, 2003 through June 30, 2004, the State made the actuarially based required contribution of 11.05% of covered payroll. Benefit and contribution provisions are established by G.S. 135-57, 135-58, 135-68 and 135-69 and may be amended only by the North Carolina General Assembly.

In addition to the actuarially based required contribution for this year, the State contributed an additional .87% of payroll to help offset the actuarial impact caused by the underpayment of contributions in fiscal 2001. Actual payments made in relation to the required contributions for the State are shown in *Section D* of this note and in the *Required Supplementary Information* section of this report.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

3. *LEGISLATIVE RETIREMENT SYSTEM*

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide retirement and disability benefits for members of the General Assembly.

The benefit will not be payable while the member is employed in a position making him eligible to participate in either the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System or the Local Governmental Employees' Retirement System. Benefits and administrative expenses are funded by member contributions of 7% of compensation, investment income, and by actuarially based employer contributions. For the period July 1, 2003 through June 30, 2004, there was no actuarially based required contribution and none was made. Benefit and actuarially based contribution provisions are established by G.S. 120-4.21, 120-4.19 and 120-4.20 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

OTHER STATE ADMINISTERED SYSTEMS

The State also administers the following pension and retirement plans for persons who are not considered employees of the State or its component units.

4. FIREMEN'S AND RESCUE SQUAD WORKERS' PENSION FUND

This plan is a defined benefit pension plan established by the State of North Carolina to provide pension benefits for all eligible firemen and rescue squad workers. Membership is composed of both volunteer and locally employed firemen and emergency medical personnel who elect membership. At June 30, 2004, there were 1,488 participating fire and rescue units. This is a special funding situation in that the State is not the employer but is legally obligated to contribute to the plan.

For this fiscal year, in addition to its actuarially required contribution the State made additional contributions of $54,923 to be applied against underpayments in 2001. Actual contributions made in relation to the required contributions for the State are shown in *Section D* of this note and in the *Required Supplementary Information* section of this report.

Benefits and administrative expenses are funded by a $10 monthly contribution by the member, investment income and an actuarially based state appropriation. Benefit and contribution provisions are established by G.S. 58-86 and may be amended only by the North Carolina General Assembly.

5. NATIONAL GUARD PENSION FUND

This plan is a defined benefit plan established by the State of North Carolina to provide pension benefits for members of the North Carolina national guard. This is also a special funding situation, because the State is not the employer but is legally obligated to contribute to the plan.

For this fiscal year, in addition to its actuarially required contribution the State made additional contributions of $1,845,490 to be applied against underpayments in prior years. Actual contributions made in relation to the required contributions for the State are shown in *Section D* of this note and in the *Required Supplementary Information* section of this report.

Benefits and administrative expenses are funded by an actuarially based state appropriation and investment income. Benefit and contribution provisions are established by G.S. 127A-40 and may be amended only by the North Carolina General Assembly.

6. REGISTERS OF DEEDS' SUPPLEMENTAL PENSION FUND

This plan is cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina to provide supplemental pension benefits for all eligible, retired county registers of deeds. Membership is composed of registers who are retired from the Local Governmental Employees' Retirement System or an equivalent local plan and have met the statutory eligibility requirements. At June 30, 2004, there were 100 registers enrolled in the plan with all 100 counties participating. An individual's benefits for the year are calculated as a share of accumulated contributions available for benefits for that year, subject to certain statutory limits. An individual's eligibility is based on minimum years of service as a register with the individual's share increasing with years of service. Because of the statutory limits noted above, not all contributions available for benefits are distributed. The State Treasurer administers the plan and *Section B* of this note describes the accounting and investing for the plan. The State's only cost in the plan is administration.

Benefits and administrative expenses are funded by 4.5% of the receipts collected by each County Commission under Article 1 of Chapter 161 of the General Statutes and investment income. Registers do not contribute. The actuarially required contribution and percentage of that contribution actually made is in the *Required Supplementary Information* section of this report. All benefit and contribution provisions are established by General Statute 161-50 and may be amended only by the North Carolina General Assembly.

NOTES TO THE FINANCIAL STATEMENTS

7. *SHERIFFS' SUPPLEMENTAL PENSION FUND*

This plan is defined contribution plan established by the State of North Carolina to provide supplemental pension benefits for all eligible, retired county sheriffs. Membership is composed of sheriffs who are retired from the Local Governmental Employees' Retirement System and have met the statutory eligibility requirements. At June 30, 2004, there were 82 sheriffs enrolled in the plan with all 100 of the State's counties eligible to participate.

An individual's benefits for the year are calculated as a share of accumulated contributions available for benefits for that year, subject to certain statutory limits. An individual's eligibility is based on minimum years of service as a sheriff with the individual's share increasing with years of service. Because of the statutory limits noted above, not all contributions available for benefits are distributed. The North Carolina Department of Justice administers the plan. If the plan purchases any investments, they are held as part of the State Treasurer's Investment Pool. *Section B* of this note describes the accounting and investing for the plan. The State's only cost in the plan is administration.

Receipts collected by each county's Clerk of Superior Court under General Statute 7A-304(a)(3a), along with investment income, support the plan's benefits and administrative expenses. Sheriffs do not contribute to the plan. For the year ended June 30, 2004, the Clerks remitted $758,910. All benefit and contribution provisions are established by General Statute 143-166 and may be amended only by the North Carolina General Assembly.

8. *LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM*

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina for employees of local governments. Membership is comprised of general employees and local law enforcement officers of participating local governmental entities. At June 30, 2004, the number of participating local governments was 907, as shown below:

Cities	421
Counties	100
Special districts	386

The plan provides retirement benefits nearly identical to the benefits that accrue to members of the Teachers' and State Employees' Retirement System. This plan also provides disability benefits for members who become totally and permanently disabled from performing their usual job. Benefits and administrative expenses are funded by employee contributions of 6% and actuarially based employer contributions. All employers contribute 4.12% of covered payroll for law enforcement officers and 3.65% for general employees and firemen. In addition, employers with an unfunded liability, which is established when the government initially enters the system, must make additional contributions towards that liability. The State's only cost is administrative. Benefit and contribution provisions are established by G.S. 128-27 and 128-30 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains.

The following table summarizes membership information by plan at the actuarial valuation date:

	Teachers' and State Employees'	Judicial	Legislative	Firemen's, Rescue	National Guard	Registers of Deeds'	Local Govern-mental
Employee Groups							
Retirees and beneficiaries currently receiving benefits	123,077	408	235	8,903	2,319	69	34,861
Terminated employees entitled to benefits but not yet receiving them	52,755	56	90	152	6,813	1	16,664
Active plan members	303,768	497	170	32,166	7,281	101	119,755
Total	479,600	961	495	41,221	16,413	171	171,280
Date of Valuation	*12-31-03*	*12-31-03*	*12-31-03*	*6-30-03*	*12-31-03*	*12-31-03*	*12-31-03*

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSET MATTERS

BASIS OF ACCOUNTING

The financial statements of these plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

INVESTMENTS /SECURITIES LENDING

Pursuant to North Carolina General Statutes, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The investment balance of each system represents its share of the fair value of the net assets of the various portfolios within the pool. Additionally, the securities lending balance represents assets occurring from securities lending transactions that result from the systems' participation in the pool. The investments of the State Treasurer and securities lending are fully discussed in Note 3.

No retirement system has investments in any single commercial or industrial organization whose fair value would amount to more than five percent of the system's net assets available for benefits.

C. Actuarial Methods and Assumptions

The latest actuarial valuations are dated December 31, 2003 (June 30, 2003, for Firemen's and Rescue Squad Workers' Fund). The actuarial accrued liability and the schedule of funding progress are presented by system in the *Required Supplementary Information.* The actuarial value of assets for all systems is based on a five-year smoothed market value. Under this method, realized and unrealized gains and losses on investments are smoothed over five years. Below are listed the various actuarial methods and significant assumptions for these valuations that will be used to determine future annual required contributions.

							Actuarial Assumptions	
Retirement System	*Valuation Date*	*Actuarial Cost Method*	*Amortization Method*	*Remaining Amortization Period*	*Period Open/Closed*	*Asset Valuation Method*	*Investment Rate of Return*	*Projected Salary Increase*
Teachers' and State Employees'	12/31/03	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	5.45-12.08%
Consolidated Judicial	12/31/03	Projected unit credit	Level percentage	9 years	Open	5 year smoothed	7.25%	5.63-12.58%
Legislative	12/31/03	Projected unit credit	Level dollar	8 years	Open	5 year smoothed	7.25%	7.50%
Firemen's, Rescue Squad Workers'	6/30/03	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
National Guard	12/31/03	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
Registers of Deeds'	12/31/03	Entry age	Level dollar	N/A	Open	5 year smoothed	7.25%	5.45-12.08%
Local Governmental Employees'	12/31/03	Frozen entry age	Level percentage	Various	Closed	5 year smoothed	7.25%	5.45-12.08%

N/A-Not applicable

NOTES TO THE FINANCIAL STATEMENTS

The valuations for the Teachers' and State Employees' system, Legislative system, and Consolidated Judicial system reflect a 1.70% cost of living increase for retirees in these systems. The Firemen's and Rescue Squad Workers' Fund increased retirement benefits by $3 (from $158 to $161). The Local Governmental Employee's system did not receive a cost of living increase. All of the benefit enhancements listed in this paragraph reflect legislation enacted by the North Carolina General Assembly effective July 1, 2004.

As of this valuation, the unfunded actuarial accrued liability for the Registers of Deeds' system, when amortized over 40 years is less than zero ($0) and produces a negative annual required contribution (ARC). In this situation, common actuarial practice sets the ARC at zero and makes the remaining amortization period not applicable.

The projected investment returns and projected salaries for all systems, except the Legislative, include a 3.75% inflationary factor within the actuarial assumption. The assumption for the Legislative system does not identify an inflationary factor.

CURRENT FISCAL YEAR ASSUMPTIONS

Unless otherwise noted in this footnote or in the required supplementary schedules, the actuarial values, methods and significant assumptions for the current year's required contributions are the same as those presented in the table shown on the prior page. The annual required contributions (ARC) for the fiscal year ended June 30, 2004, were developed from various prior year valuations. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial, Registers of Deeds' and National Guard systems' valuations were as of December 31, 2001, the Legislative system was valued at December 31, 2002, and the Firemen's and Rescue Squad Worker's Fund was valued at June 30, 2002. These valuations used amortization periods of 20 years for the Registers of Deeds', 9 years for Consolidated Judicial, 9 years for National Guard and 9 years for the Firemen's and Rescue Squad Worker's Fund. The Teachers' and State Employees' system, which had used an 11 year amortization in the prior year's valuation, returned to a 9 year amortization period. The Local Governmental Employees' system is an aggregate of numerous employers, and consequently, has various amortization periods. The rate of investment return and projected salary increases used in these valuations assumed essentially the same increases as in the most current valuations reported on the prior page.

For the fiscal year ended June 30, 2004, the Local Governmental Employees' system provided various levels of cost of living adjustments effectively increasing benefits from 3.5% to 9.5%. This system also increased the benefit accrual rate from 1.82% to 1.85%. The Teachers' and State Employees' system, Legislative Retirement system and the Consolidated Judicial system provided a 1.28% cost of living increase for retirees in these systems. The Firemen's and Rescue Squad Workers' Fund increased retirement benefits by $2 (from $156 to $158). All of these benefit enhancements reflect legislation enacted by the North Carolina General Assembly that was effective July 1, 2003. These enhancements were either reflected as liabilities in the December 31, 2002 valuations, or the systems paid for them through actuarial gains.

D. Annual Pension Cost and Net Pension Obligation

The annual pension costs and net pension obligations for the State's single-employer and special funding defined benefit plans for the current fiscal year are as follow (in thousands):

	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund
Annual required contribution	$ 5,583	$ —	$ 6,801	$ 1,176
Interest on net pension obligation	150	(2)	63	125
Adjustment to annual required contribution	(329)	8	(134)	(258)
Annual pension cost	5,404	6	6,730	1,043
Less: Contributions made	6,023	—	6,856	3,021
Increase (decrease) in net pension obligation	(619)	6	(126)	(1,978)
Net pension (asset) obligation beginning of year	2,068	(31)	863	1,725
Net pension (asset) obligation end of year	$ 1,449	$ (25)	$ 737	$ (253)

The following table presents the required three year trend of pension costs for the State's single-employer and special funding defined benefit plans and the annual required contributions (ARC) the State made to the Teachers' and State Employees' Retirement System (the System), a cost-sharing, multiple-employer plan. The State's statutory annual contribution equals its total annual payment to the System and equals the State's pension cost in these financial statements. The State does not make any contributions to the Local Governmental Employees' System; therefore, it does not have any related pension cost.

State of North Carolina's Annual Pension Cost (APC)
and Annual Required Contributions (ARC) as an Employer
For the Years Ended June 30, 2002 through June 30, 2004 (in thousands)

	Teachers' and State Employees'	Judicial	Legislative	Firemen's, Rescue	National Guard
Primary Government:					
2004 (A)	$ 35,762	$ 5,404	$ 6	$ 6,730	$ 1,043
2003	—	5,870	6	6,778	1,083
2002	50,835	6,852	844	9,942	1,542
Component units:					
Universities:					
2004	$ 3,038				
2003	—				
2002	24,829				
Community Colleges:					
2004	$ 1,211				
2003	—				
2002	9,676				
Proprietary Funds:					
2004	$ 38				
2003	—				
2002	333				
Total Primary Government and Component Units:					
2004	$ 40,049	$ 5,404	$ 6	$ 6,730	$ 1,043
2003	-	5,870	6	6,778	1,083
2002	85,673	6,852	844	9,942	1,542
Percentage of APC Contributed:					
2004		112%	0%	102%	290%
2003		102%	0%	101%	0%
2002		124%	114%	101%	58%
Percentage of ARC Contributed:					
2004	100%				
2003	No ARC				
2002	100%				
Net Pension (Asset) Obligation:					
2004		$ 1,449	$ (25)	$ 737	$ (253)
2003		2,068	(31)	863	1,725
2002		2,191	(37)	941	643

(A) - The State's contribution/pension cost for the Teachers' and State Employees' Retirement System equals the actuarially required contribution plus 30 million dollars in additional appropriations mandated by the N.C. General Assembly.

Yearly pension liabilities for the systems are shown in the *Required Supplementary Information* section of this report. Beginning with the accounting transition year of 1997, liabilities were determined in accordance with Governmental Accounting Standards Board Statement No. 27 (GASB 27). As presented here, each system's yearly APC and net pension (asset) obligation were computed retroactively to 1993 in accordance with GASB 27 and contain the cumulative effect of applying that statement.

E. Optional Retirement Plan

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and administrators with faculty rank in universities of the UNC System may join the Program instead of the Teachers' and State Employees' Retirement System. At June 30, 2004, the Plan had 9,985 participants.

Benefits are provided by means of contracts issued and administered by the privately-operated Teachers' Insurance and Annuity Association and the College Retirement Equities Fund (TIAA/CREF), Valid, Fidelity Investments and Lincoln National Life Insurance Company. Participants' eligibility and contributory requirements are established in G.S. 135-5.1. Participants contribute 6% of compensation and the university contributes 6.84%. There is no liability other than the universities' required contributions. The universities contributed $57,667,191 for the 2003-04 fiscal year. Annual covered payroll was $843,087,589 and employer contributions expressed as a percentage of annual covered payroll were 6.84% for the fiscal year ended June 30, 2004. Employee contributions expressed as a percentage of annual covered payroll were 6%, with actual employee contributions of $50,585,256 for the 2003-04 fiscal year.

Participants are vested after five years of service, but the company must return the value of the universities' contributions to the State if termination occurs prior to five years of service. The participant chooses his/her own investment products with the company of choice.

F. Special Separation Allowance

The State provides a special separation allowance (SSA), an agent multiple-employer, defined benefit pension plan, for sworn law enforcement officers as defined by G.S. 135-1(11b) or G.S. 143-166.30(a)(4) that were employed by State agencies and component units and retired on a basic service retirement under the provisions of G.S. 135-5(a). To qualify for the allowance, each retired officer must: (1) have completed 30 or more years of creditable service or have attained 55 years of age and completed five or more years of creditable service; and (2) not have attained 62 years of age; and (3) have completed at least five years of continuous service as a law enforcement officer immediately preceding a service retirement. Each eligible officer is paid an annual separation allowance equal to .85% of the officer's most recent base rate of compensation for each year of creditable service. For the fiscal year ended June 30, 2004, the State and its component units paid $11,439,512 for 873 retired law enforcement officers. These benefits are funded on a pay-as-you-go basis with each employer (the State or component unit) responsible for the benefits to their former employees. There is no statewide administration of the SSA and there is no actuarial valuation performed. Funds for this allowance are appropriated annually in the budget of each affected state agency or paid from the component unit's operations. These benefits are established in G.S. 143-166.41 and may be amended only by the General Assembly.

NOTE 12: DEFERRED COMPENSATION PLANS

IRC Section 457 Plan – General Statute 143B-426.24 authorized the creation of the Board of Trustees of the North Carolina Public Employee Deferred Compensation Plan (the Board). The Board was established as an agency of the State under the Department of Administration to offer the State's permanent employees, university employees, and the employees of certain other component units, a uniform Deferred Compensation Plan (the Plan) in accordance with Internal Revenue Code Section 457. The Plan permits each participating employee to defer a portion of his or her salary until future years by having the funds invested in various instruments that make up the North Carolina Public Employee Deferred Compensation Trust Fund. This fund is held in trust by the Plan for the exclusive benefit of participating employees and their beneficiaries. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board. The Board has delegated the general administration of the Plan to a third party but has retained all statutory authority and fiduciary responsibility for major decisions of the Plan. The Plan is reported in the CAFR as a pension and other employee benefit trust fund. All costs of administering and funding the Plan are the responsibility of the plan participants. The Plan's financial statements are available by contacting the N.C. Department of Administration at 1306 Mail Service Center, Raleigh, NC 24699-1306.

IRC Section 401(k) Plan - Effective January 1, 1985, Chapter 135, Article 5 of the North Carolina General Statutes authorized the creation of the Supplemental Retirement Income Plan of North Carolina (the Plan) in accordance with Internal Revenue Code Section 401(k). All members of the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System, Legislative Retirement System, Local Governmental Employees' Retirement System and University Optional Retirement Program are eligible to enroll in the Plan and may contribute up to 20% (limited to an Internal Revenue maximum dollar amount) of their compensation during the plan fiscal year. Members of the Plan may receive their benefits upon retirement, disability, termination, hardship, or death. All contributions and costs of administering the Plan are the responsibility of the participants.

The Plan is a defined contribution pension plan that is administered by a third party. The administrator prepares financial statements based on the Plan's fiscal year. The audited statements for the year ended December 31, 2003, are presented in this financial report as a pension and other employee benefit trust fund. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The Plan's financial statements are prepared using the accrual basis of accounting. Investments are reported at fair value. Securities and mutual funds are based on published quotations while bank investment contracts are stated at contract value. Notes Receivable represent loans to participants and are reported at outstanding principal balances. Prudential Retirement Services administers the Plan, and the Plan's financial statements are available by contacting the N.C. 401(k) Plan, 150 Fayetteville Street Mall, Suite 1340, Raleigh, NC 27601.

In addition to the voluntary contribution criteria above, G.S. 143-166.30 requires state contributions to the Plan to provide benefits for all law enforcement officers employed by the State and its component units. G.S. 143-166.50 requires local governmental units with law enforcement officers to also contribute at least as much as the State. Participation begins at the date of employment. State agencies and component units are required to contribute monthly to the individual accounts of participants an amount equal to 5% of each officer's monthly salary. The State is also required to contribute to the individual accounts of all officers on a per capita basis in equal shares. State law enforcement officers receive $.50 for each court cost assessed and collected under G.S. 7A-304, while $1.25 of this assessment goes to local law enforcement officers. General Statutes allow law enforcement officers to voluntarily contribute up to 10% of their compensation within any calendar year, but current Internal Revenue Code restrictions limit the actual voluntary contribution a law enforcement officer can make. All contributions are immediately vested in the name of each participant. At December 31, 2003, 45 state agencies and component units along with 493 local governmental units outside our reporting entity contributed the required 5%. In addition, 3 state agencies and 371 local government employers contributed to the Plan on a voluntary basis.

At December 31, 2003, the Plan disclosed the following investments (at fair value) exceeding five percent of the Plan's net assets (in thousands):

Prudential Stable Value Fund	$ 706,106
Fidelity Magellan Fund	706,063
Fidelity Equity-Income Fund	297,562
Spartan U.S. Equity Index Fund	173,611
Fidelity Intermediate Bond Fund	155,413

The Plan also reported total member contributions of $168,856,630. The payrolls for law enforcement officers, on which the required contributions were based for the year ended December 31, 2003, amounted to $133,103,393 for the State, $15,817,514 for universities, and $1,158,644 for the other miscellaneous component units. The required 5% employer's contribution was made by the State for $6,655,169, by universities for $790,875, and by the remaining component units for $57,932. In addition, the State contributed $657,418 for the required court cost assessments.

NOTES TO THE FINANCIAL STATEMENTS

IRC Section 403(b) Plans - Employees of the UNC System and community colleges can participate in tax-sheltered annuity contracts and custodial accounts created under Internal Revenue Code (IRC) Section 403(b). Generally all employees are eligible, but the IRC does allow the establishment of a minimum contribution of $200 and the exclusion from participation of certain classes of employees. Each institution may exclude one or more of these classes if every employee within the institution meeting the class criteria is excluded from participation. The employees' eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the accumulated balances are received or the contributions are withdrawn. Effective January 1, 1989, contributions may be withdrawn by employees only upon separation from service, death, disability, reaching age 59 1/2 or age 55 with qualifying retirement, or due to certain financial hardships. Currently, there is no restriction on the withdrawal of the value of annuity contracts. Custodial accounts established as of December 31, 1988 can be withdrawn only in respect to hardship established as of December 31, 1988. These plans are exclusively for employees of public educational organizations and certain charitable and other non-profit institutions as defined by the IRC. Since all contributions are made voluntarily by employees, all costs are borne by the plans' participants. No direct costs are incurred by the State.

NOTE 13: OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees

The State Health Plan provides postemployment health insurance to former employees of the State, the University of North Carolina System, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity. Those former employees who are eligible to receive health care as an other postemployment benefit are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the Teachers' and State Employees' Retirement System (TSERS), the Consolidated Judicial Retirement System (CJRS), the Legislative Retirement System (LRS), and the University Employees' Optional Retirement Program (UEORP), with five or more years of contributory membership service in the Retirement System prior to disability or retirement. For the fiscal year ended June 30, 2004, the numbers of participants currently eligible to receive health care as an other postemployment benefit are 49,906 TSERS and DIPNC members (excluding LEA members), 287 CJRS members, 141 LRS members, and 1,012 UEORP members. The health insurance plan is the same as for active employees as described in Note 14, except that the coverage becomes secondary when former employees become eligible for Medicare. These former employees are eligible to participate in the self-funded Comprehensive Major Medical Plan (Plan).

The funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. These health care benefits are funded by employer contributions that are established in the biennial appropriation bill by the General Assembly. The State, participating component units and LEAs contributed a monthly amount equal to 3.20% of active employees' salaries to the General Fund's Reserve for Retirees' Health Premium Account (Reserve). The Reserve pays the full cost of coverage for long-term disability beneficiaries and retirees enrolled in the Plan. For the fiscal year ended June 30, 2004, the Reserve paid $2,517 for each Medicare-eligible long-term disability beneficiary and retiree and $3,306 for each non-Medicare-eligible long-term disability beneficiary and retiree. At June 30, 2004, the Reserve had net assets at fair value of $80,923,620. The net assets are available for future benefit payments.

For the fiscal year ended June 30, 2004, contributions on behalf of former employees of the reporting entity were made to the Reserve as follows (dollars in thousands):

Primary government	$	85,545
University of North Carolina System		70,661
Community Colleges		17,615
Certain participating proprietary component units		553
Total contributions	$	174,374

These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

B. Disability Income

As discussed in Note 14, short-term and long-term disability benefits are provided to the eligible members of the Teachers' and State Employees' Retirement System and the University Employees' Optional Retirement Program through the Disability Income Plan of North Carolina (DIPNC). It is reported in this CAFR as a pension and other employee benefit trust fund. Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in the Teachers' and State Employees' Retirement System of North Carolina (Retirement System) or the University Employees' Optional Retirement Program, earned within ninety-six months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from the Retirement System; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from the Retirement System after (1) reaching the age of 65 and completing five years of creditable service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

NOTES TO THE FINANCIAL STATEMENTS

The monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one twelfth of the annual longevity payment to which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of $3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than $10 a month. When an employee qualifies for an unreduced service retirement allowance from the Retirement System, the benefits payable from DIPNC will cease, and the employee will commence retirement under the Teachers' and State Employees' Retirement System or the University Employees' Optional Retirement Program.

Long-term disability income benefits are advance-funded on an actuarially determined basis using the one-year term cost method. Although the DIPNC operates on a calendar year disability income benefits are funded by employer contributions that are established in the Appropriations Bill by the General Assembly and coincide with the state fiscal year. For fiscal year ended June 30, 2004, the State, the University of North Carolina System, community colleges, and certain participating proprietary component units, and LEAs were not required and did not make a contribution to fund the disability benefits.

At December 31, 2003 (the most recent actuarial valuation date), DIPNC had 2,885 members, excluding LEA members, who were currently eligible to receive disability benefits as an other postemployment benefit out of a total of 314,271 active plan participants. Those individuals who are receiving extended short-term disability benefit payments cannot be separated from the number of members currently eligible to receive disability benefits as an other postemployment benefit.

Actuarial Assumptions for the calendar year ended December 31, 2003:

Discount rate	7.25%
Rate of return on investments assumption	7.25%
Projected salary increase assumption	5.75%
Projected social security benefits increase assumption	3.75%
Social security assumption	75%
Actuarially required contribution	NR

NR - No contribution required or made.

The basis for estimating the actuarial liabilities for unpaid claims is discussed in Note 14. The market related actuarial value of the assets of DIPNC at December 31, 2003, was $267,267,012 creating an actuarial deficit of $13,866,305. The actual fair value of the assets for DIPNC at December 31, 2003 was $276,978,783. The assets are available for future other postemployment benefits and benefits for eligible active employees.

These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

NOTE 14: RISK MANAGEMENT AND INSURANCE

A. Public Entity Risk Pool

Public School Insurance Fund

The Public School Insurance Fund (the Fund) is a public entity risk pool reported within the enterprise funds. In accordance with Chapter 115C, Article 38, of the General Statutes, the purpose of the Fund is to insure the Local Education Agencies (LEAs), in order to safeguard the investment made in the public schools of North Carolina. The community colleges, which are component units, can also acquire insurance through the Fund as stated in G.S. 115D-58.11(c). The board of each LEA and the board of trustees of each community college are required to carry extended coverage against fire and lightning damage to the extent of not less than seventy-five percent (75%) of the current insurable value for each insurable building. The boards also are to insure adequately the equipment and contents of said building. The Fund is financed by premiums collected from the LEAs and the community colleges and interest earned on the Fund's cash balance. Each board has to give notice of its election to insure in the Fund at least 30 days prior to such insurance becoming effective and shall furnish to the State Board of Education a full and complete list of all outstanding fire insurance policies. While the said insurance policies remain in effect, the Fund shall act as coinsurer of the properties covered by such insurance. The Fund currently insures 105 out of 117 LEAs and 28 out of 58 community colleges.

Claim liabilities are based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. There are no salvage claims anticipated since any salvage is adjusted in the claim settlement. There are no subrogation claims pending. Since claims are reviewed by adjusters and the actual loss projection is computed in a short time after the claim is reported, the claim adjustment expense associated with the unpaid claim liability will be reflected in the current period. The Fund does consider investment income in determining if a premium deficiency exists.

The only acquisition costs are related to proposal costs and inspection costs for new insurance. Since the Fund can only insure the LEAs and the community colleges, new contracts are immaterial. Since existing contracts are renewed once a year, the Fund's costs are for policy maintenance. Therefore, acquisition costs do not need to be amortized.

The following schedule shows the changes in the reported liability for the past two years (dollars in thousands):

	Fiscal Year	
	2004	2003
Unpaid claims at beginning of year	$ 1,713	$ 1,192
Incurred claims:		
Provision for insured events of the current year	13,365	2,796
Increases (decreases) in provision for insured events of prior years	74	(106)
Total incurred claims	13,439	2,690
Payments:		
Claims attributable to insured events of the current year	10,471	2,218
Claims attributable to insured events of the prior years	734	(49)
Total payments	11,205	2,169
Total unpaid claims at end of the year	$ 3,947	$ 1,713

With the collection of premiums from the insured educational units, payment of valid claims becomes the responsibility of the Fund. All claims greater than $10 million per occurrence are covered by reinsurance policies. Maximum recoverable from reinsurance for any one catastrophic event is $80 million per occurrence. Annual aggregate limits of $15 million apply separately with respect to flood and earthquake. Coverage applies to all "all risk" perils. Boiler and machinery coverage can be purchased under separate contract underwritten by the Fund. Incurred losses are reduced by estimated amounts recoverable under the Fund’s reinsurance policies. Currently, there are no claims for reinsurance.

B. Employee Benefit Plans

1. State Health Plan

In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State provides comprehensive major medical care benefits for employees and retirees of the State and its participating component units, as well as certain of their dependents on a fully contributory basis. This care is also extended to employees and retirees of the Local Education Agencies (LEAs), which are not part of the State's reporting entity. Coverage is self-funded by contributions to the State Health Plan (the Plan), a pension and other employee benefit trust fund. Contributions for employee and retiree coverage are made by the State, its participating component units, and LEAs. Contributions for dependent coverage are made by employees and retirees. As described in Note 13, coverage is also extended to certain individuals as an other postemployment benefit. The Plan has contracted with third parties to process claims.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and copayment requirements. The Plan disallows claims in excess of a lifetime maximum of $5 million.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the Plan's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 161,500	$ 1,320,649	$ 1,325,397	$ 156,752
2003-04	156,752	1,435,865	1,425,945	166,672

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) is provided through the Death Benefit Plan, a pension and other employee benefit trust fund, to all members of the Teachers' and State Employees' Retirement System who have completed at least 12 consecutive months of membership in the System. Membership includes employees of the State, the University of North Carolina system, community colleges, and certain participating proprietary component units and Local Education Agencies (LEAs) which are not part of the reporting entity. The benefit payment is equal to the greater of (1) the compensation on which contributions were made by the member during the calendar year preceding the year in which his/her death occurs or (2) the member's highest twelve month's salary in a row during the twenty-four months prior to his/her death. The benefit is subject to a minimum of $25,000 and to a maximum of $50,000.

Employer contributions are actuarially based and established in the biennial appropriation bill by the General Assembly. For the period July 1, 2003 to June 30, 2004, the State, the University of North Carolina system, community colleges, and certain participating proprietary component units and LEAs were not required to contribute to the Death Benefit Plan.

These benefits are established by Chapter 135, Section 5(l), of the General Statutes and may be amended only by the North Carolina General Assembly. Claims liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported).

Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 1,577	$ 23,921	$ 23,419	$ 2,079
2003-04	2,079	25,195	25,365	1,909

3. Disability Income Plan of North Carolina

Short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), a pension and other employee benefit trust fund, to the eligible members of the Teachers' and State Employees' Retirement System which includes employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity, and the University Employees' Optional Retirement Program. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability, which is determined as the last actual day of service or the day succeeding at least 365 calendar days after the commencement of service, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable. As discussed in Note 13, long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

Claim liabilities for long-term disability benefits are actuarially estimated using the one-year term cost method. These liabilities represent the present value of future claim payments obligated to members who have become disabled. The claim liabilities are separated into the following two classifications: (1) approved claim liabilities are for long-term disabilities that have occurred, have been approved, and are in long-term payment status; and (2) incurred but not reported (IBNR) liabilities are for disabilities that have occurred but are not in payment status. The IBNR liabilities are estimated based on the historical claims experience of DIPNC.

Significant actuarial assumptions used to estimate claim liabilities are presented in Note 13. Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 270,767	$ 65,051	$ 57,154	$ 278,664
2003-04	278,664	56,574	54,105	281,133

C. Other Risk Management and Insurance Activities

1. Automobile, Fire and Other Property Losses

The State is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle, which includes vehicles held by the State's participating component units. The State is self-insured for the first $500,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than $500,000. The liability limits for losses incurring in-state are $500,000 per claimant and $5 million per occurrence. For losses incurring out-of-state, the limits are $1 million per claimant and $5 million per occurrence. Covered losses include those that occur with vehicles that are not on a stationary track or rail, and federal vehicles when the Governor calls out the National Guard.

Agencies of the State and participating component units using state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred. The private insurer processes all claims and sets up a reserve for amounts expected to be paid for claims. Claims are paid by the private insurer after they are approved by the Attorney General's Office. Settled claims have not exceeded coverage in any of the past three fiscal years.

The State Property Fire Insurance Fund (the Fund), an internal service fund of the State, was created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses is free for all operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage. Agencies of the State can purchase extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and "all risk" for buildings and contents through the Fund. For those that elect to receive any of this other coverage, the Fund charges premiums discounted from industry manual rates. The Fund insures losses up to $2.5 million per occurrence. All losses covered by the Fund are subject to a $500 per occurrence deductible except for theft, which carries a $1,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

The Fund purchases excess insurance from private insurers to cover losses over the amounts insured by the Fund. If aggregate uninsured losses sustained by the Fund, in excess of $50,000 per loss, other than flood and earthquake losses and wind losses by named storms, reach $5 million in any one annual period, the Fund’s deductible for the remainder of the annual period is $100,000 per occurrence. Settled claims have not exceeded coverage in any of the past three fiscal years.

Claims of $10,000 or higher are paid when the Council of State approves the request for payment. Claims less than $10,000 are paid without Council of State approval. Claims costs are recognized when they are approved by the Council of State and are outstanding for payment; when known estimates of losses are waiting to be submitted to the Council of State for approval; or when a loss occurs and can be reasonably estimated. Claims payable at June 30, 2004 are disclosed on the balance sheet as claims payable. Changes in the balances of claims liabilities for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 1,099	$ 1,619	$ 1,522	$ 1,196
2003-04	1,196	1,676	1,645	1,227

2. Medical Malpractice Protection

a. *Professional Liability Insurance for State Medical Personnel*

All agencies of the State and participating component units are insured for tort claims up to $500,000 under the authority of the State Tort Claims Act, Chapter 143, Article 31, of the General Statutes. Organizations within the reporting entity carry excess commercial liability insurance to supplement the coverage provided by the State Tort Claims Act; however, claims involving medical malpractice are generally excluded from this coverage. The University of North Carolina at Chapel Hill Medical School (UNC-CH Medical School) and UNC Hospitals participate in the Liability Insurance Trust Fund, which is described in detail below. All other universities purchase commercial liability insurance. Chapter 237, Section 11.33, of the 1999 Session Laws of North Carolina authorized the Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction to provide medical liability coverage on behalf of employees licensed to practice medicine or dentistry; all licensed physicians who are faculty members of the University of North Carolina who work on contract for the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services for incidents that occur in Division programs; and on behalf of medical residents from the University of North Carolina who are in training at institutions operated by the Department of Health and Human Services. The extent of coverage is a maximum of $1 million for each individual incident and does not affect current coverage under the State Tort Claims Act. The Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction purchase commercial professional liability insurance for their medical staff. Settled claims have not exceeded coverage in any of the past three fiscal years.

Insurance coverage varies depending upon the amount of coverage and the type of policy. Typically the amount of primary coverage for medical liability is $1 million per individual, claim, or incidence, and $3 million total or aggregate. Many departments and institutions maintain excess policies to provide additional coverage above that provided by the primary policy for medical liability. The policies are written on a claims made or occurrence basis, with the majority of the policies being claims made. The claims liabilities are not measurable.

b. *Self-Insurance through the Liability Insurance Trust Fund*

The Liability Insurance Trust Fund (Trust Fund) was created by Chapter 116, Article 26, of the General Statutes and the University of North Carolina Board of Governors Resolution of June 9, 1978, to provide medical malpractice protection for program participants and individual health care practitioners working as employees, agents, or officers of the program participants. The program participants are the University of North Carolina Hospitals (UNC Hospitals) and the University of North Carolina at Chapel Hill Physicians and Associates, both of whom are a part of the University of North Carolina system, which is a component unit of the reporting entity. Coverage is self-funded by contributions from participants and investment income. Contributions are based on the actuarially determined funding level for a given plan year.

As of July 1, 2002 through April 30, 2003, the Trust Fund provided coverage on an occurrence basis of $57,000,000 per claim/annual aggregate, provided through a combination of self-insurance through the Trust Fund and commercial excess coverage. The Trust Fund is responsible for the first $7,000,000 for each and every claim, and the next $10,000,000 per claim/annual aggregate for the July 1, 2002-April 30, 2003 policy year. As of May 1, 2003, the Trust Fund provided coverage on an occurrence basis of $7,000,000 per individual for each and every claim, self-insured through the Trust Fund. Effective July 1, 2002 through April 30, 2003, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer. Reinsurance coverage under this treaty provides $40,000,000 of coverage above the Trust Fund's retention applicable to that policy year. For losses occurring during the period May 1, 2003 through June 30, 2004, the Trust Fund retains 100% of the liability.

The Trust Fund purchased a primary policy for dental residents on a claims made basis with $1 million per occurrence and $3 million annual aggregate limits of coverage. In the event the Trust Fund has insufficient funds to pay existing and future claims, it has the authority to borrow necessary amounts up to $30 million. Any such borrowing would be repaid from the assets and revenues of program participants. No borrowings have been made under this authority to date.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of all losses and loss adjustment expenses, including losses and loss adjustment expenses incurred but not yet reported, which are unpaid at the balance sheet date. The claims liabilities of $35,657,865 and $38,085,250 are the present values of the aggregate actuarially determined claims liabilities of $39,177,608 and $39,745,211, discounted at 6% at June 30, 2003 and 4% at June 30, 2004, respectively. These estimates are reviewed annually, and as adjustments become necessary, such adjustments are reflected in current operations. Claims against participants are paid from the corpus of the Trust Fund. Changes in the Trust Fund's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 26,958	$ 16,941	$ 8,241	$ 35,658
2003-04	35,658	18,217	15,790	38,085

3. Public Officers' and Employees' Liability Insurance

In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers' and employees' liability insurance is provided by private insurers for all employees of the State and participating component units except for doctors and dentists. The policy provides $5 million excess insurance over the $500,000 statutory limit payable for any one claim under the State Tort Claims Act. The first $150,000 of an award against a state agency is the responsibility of the state agency's general fund budget code or up to $500,000 if a non-general fund budget code. For general fund budget codes, any award greater than $150,000 but less than $500,000 is funded by proportionate shares of estimated lapse salaries from all agencies general fund budget codes. Since State agencies and component units are responsible for funding any tort claims of $500,000 or less from their budget and/or lapse salaries, total claims liabilities are not measurable. Employers are charged a premium for the excess insurance based on a composite rate. The employers pay the premiums directly to the private insurer. Settled claims have not exceeded coverage in any of the past three fiscal years.

4. Employee Dishonesty and Computer Fraud

Blanket public employee dishonesty and computer fraud insurance is provided for agencies of the State and its component units with a limit of $5 million per occurrence, subject to a $50,000 deductible and a 10% participation in each loss above the deductible. This coverage is placed with a private insurance company and is handled by the North Carolina Department of Insurance. Agencies of the State and its component units are charged premiums by the private insurance company. A small number of State agencies and component units of the State require faithful performance coverage in addition to employee dishonesty coverage. In these instances, separate policies have been purchased. The amounts of coverage and the deductibles vary among these separate policies. Settled claims have not exceeded coverage in any of the past three fiscal years.

5. Statewide Workers' Compensation Program

The Workers' Compensation Program (the Program) was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job. All employees of the State and its component units are included in the Program. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits. Payments of all medical benefits are subject to approval based on a fee schedule established by the North Carolina Industrial Commission (NCIC). Loss of wages and disability benefits are payable based on 66 2/3% of an employee's average weekly salary subject to a statutory compensation rate minimum and maximum established annually by the NCIC. Death benefits are payable for 400 weeks at 66 2/3% of an employee's average weekly salary. In certain instances, death benefits may be extended beyond the 400 weeks.

The responsibility for claiming compensation is on the injured employee. If the injured employee or his representative does not notify the employer within 30 days from the date of injury, the employer can refuse compensation. A claim must be filed with the NCIC by either the employee or the employer within two years from the date of knowledge thereof; otherwise the claim is barred by law and no further compensation is allowable. When an employee is injured, the employer's primary responsibility is to arrange for and provide the necessary treatment for any work-related injury. The employer tries to provide the best possible medical care for injured employees to help them reach maximum medical improvement and return to work as soon as possible.

The State and its component units are self-insured for workers' compensation. A third-party administrator handles workers' compensation claims except for the Department of Transportation. State agencies and participating component units contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act.

Each state agency and participating component unit is responsible for paying claims out of its individual budget. Budgets for workers' compensation for most State agencies and participating component units are based on the prior year's loss experience. Since the related liability is not measurable, claim costs are recognized when paid. The Department of Transportation is the only state agency that sets up a reserve for claims. For the year ended June 30, 2004, workers' compensation costs were recognized as follows (dollars in thousands):

Primary government	$ 63,037
University of North Carolina System	5,620
All other component units	15
Total	$ 68,672

6. Workers' Compensation Fund

The Workers' Compensation Fund (the Fund) is an insurance enterprise reported within the enterprise funds. The Fund is created in the Department of Insurance (the Department) and is administered by the State Fire and Rescue Commission (the Commission) through a service contract with a third-party administrator. In accordance with Chapter 58, Article 87, of the General Statutes, the purpose of the Program is to provide workers' compensation benefits to members of "eligible units," which consist of volunteer fire departments or volunteer rescue/EMS units that are not part of a unit of local government and are exempt from State income tax under G.S. 105-130.11. These eligible units are not part of the reporting entity. Benefits are payable for compensable injuries or deaths which occurred on or after July 1, 1996. The Fund is financed by appropriations made to the Department for this purpose and by per capita fixed dollar amounts for each member of a participating eligible unit's roster. The per capita fixed dollar amount is set annually by the Commission and is paid by the eligible units to the Commission on or before July 1 of each year for credit to the Fund. If payment is not received by July 1, the eligible unit shall not receive workers' compensation coverage for that fiscal year. The appropriation for the fiscal year ended June 30, 2004 was $4.5 million. As of June 30, 2004, the Fund consisted of 1,244 eligible units representing approximately 41,951 members.

The liability for unpaid claims is based on an actuarial determination and represents a reasonable estimate of the ultimate cost of open claims and claim settlement expenses that are unpaid as of the fiscal year end, including incurred but not reported losses. The liability for unpaid claims is continually reviewed, and as adjustments become necessary such adjustments are included in current operations. The Program considers anticipated investment income in determining if a premium deficiency exists. The Program recognizes subrogation from third parties as a reduction to claim and claim settlement expenses incurred. As of June 30, 2004, there was no reduction for subrogation.

Acquisition costs consist of commission payments to independent insurance agents for marketing, promotional and administrative assistance with policy maintenance to eligible units. As coverage is renewed annually, acquisition costs are not amortized.

The Program maintains both specific excess of loss and aggregate reinsurance coverage. The specific excess of loss coverage provides for statutory limits above the Program's retention of $500,000 per occurrence and a $1,500,000 limit for employer's liability above the Program's retention of $500,000 per occurrence. Incurred losses are reduced by estimated amounts recoverable under the Program's excess of loss and aggregate reinsurance policies. As of June 30, 2004, there are claims recoverable from reinsurers in the amount of $1,044,873.

The following schedule shows the changes in the reported liability for the past two fiscal years (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 6,931	$ 5,215	$ 3,813	$ 8,333
2003-04	8,333	6,208	4,755	9,786

7. Health Insurance Program for Children

The Health Insurance Program for Children (the Program) is an insurance program reported within the General Fund. The Program was created by Chapter 108A, Article 2, Part 8, of the General Statutes to provide comprehensive health insurance coverage to uninsured low-income children who are residents of this State, including coverage for dental, hearing, and vision services and supplies.

Coverage is provided from federal funds received, State funds appropriated, and other nonappropriated funds made available for this purpose. All appropriations, allocations, premium receipts, or any other receipts, including earnings on investments, occurring or arising in connection with acute medical care benefits provided under the Program are deposited into the Child Health Insurance Fund (the Fund). Disbursements from the Fund include any and all amounts required to pay the benefits and administrative costs of the Program. For the fiscal year ended June 30, 2004, $49,486,579 was appropriated from the General Fund to the North Carolina Department of Health and Human Services (DHHS) to be used for the Program.

The Program is administered by DHHS. Eligible children are enrolled by the Division of Social Services based on the availability of funds. The North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan (the Plan) is responsible for the administration and processing of claims for benefits under the Program, as provided under Chapter 135, Article 3, Part 5 of the General Statutes. The Plan's self-insured indemnity program shall not incur any financial obligations for the program in excess of the amount of funds that the Plan's self-insured indemnity program receives for the program.

NOTES TO THE FINANCIAL STATEMENTS

Annual enrollment fees, co-payments, and other cost-sharing charges are determined by family income. However, there are no enrollment fees, deductibles, co-payments (except for outpatient prescription drug costs), or other cost-sharing charges for families covered under the Program whose family income is at or below 150% of the federal poverty level. A family's total annual aggregate cost-sharing charges shall not exceed five percent of the family's income for the year involved. The program had an average enrollment of 105,805 children insured during the year.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). The following schedule shows the changes in the claims liability for the Program's past two years of operation (dollars in thousands):

	Beginning of Fiscal Year Liability	*Current-Year Claims and Changes in Estimates*	*Claim Payments*	*Balance at Fiscal Year-End*
2002-03	$ 14,958	$ 150,236	$ 151,576	$ 13,618
2003-04	13,618	198,072	189,356	22,334

NOTE 15: INDIVIDUAL PLAN FINANCIAL STATEMENTS – PENSION AND OTHER EMPLOYEE BENEFIT TRUST FUNDS

Financial statements for Pension and Other Employee Benefit Trust Funds as of and for the fiscal year ended June 30, 2004 are presented below (dollars in thousands).

COMBINING STATEMENT OF PLAN NET ASSETS

June 30, 2004

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	401(k) Supplemental Retirement Income Plan
ASSETS							
Cash and cash equivalents	$ 58,548	$ 2,269	$ 91	$ 509	$ 324	$ 23,748	$ 5
Investments:							
Annuity contracts	—	—	—	—	—	—	706,106
Mutual funds	—	—	—	—	—	—	1,828,490
State Treasurer investment pool	46,760,798	359,679	28,158	274,428	52,519	13,208,923	—
Securities lending collateral	10,095,100	79,065	6,124	59,403	11,539	2,862,805	—
Receivables:							
Accounts receivable	1,726	—	—	—	—	1,068	—
Interest receivable	459	6	—	4	1	139	—
Contributions receivable	49,269	755	—	—	—	33,373	—
Notes receivable	—	—	—	—	—	—	128,244
Capital assets-depreciable, net	—	—	—	—	—	—	—
Total Assets	56,965,900	441,774	34,373	334,344	64,383	16,130,056	2,662,845
Liabilities:							
Accounts payable and accrued liabilities:							
Accounts payable	—	—	—	—	—	—	—
Benefits payable	7,014	1	—	—	3	192	—
Medical claims payable	—	—	—	—	—	—	—
Obligations under securities lending	10,095,100	79,065	6,124	59,403	11,539	2,862,805	—
Due to other funds	—	—	—	2	—	—	—
Deferred revenue	—	—	—	—	—	—	—
Compensated absences	—	—	—	—	—	—	—
Total Liabilities	10,102,114	79,066	6,124	59,405	11,542	2,862,997	—
Net Assets:							
Held in trust for:							
Employees' pension and other benefits	46,863,786	362,708	28,249	274,939	52,841	13,267,059	2,662,845
Total Net Assets	$ 46,863,786	$ 362,708	$ 28,249	$ 274,939	$ 52,841	$ 13,267,059	$ 2,662,845

A schedule of funding progress for each defined benefit plan is presented on page 150.

NOTES TO THE FINANCIAL STATEMENTS

Deferred Compensation	Death Benefit Plan of N.C.	State Health Plan	Disability Income Plan of N.C.	Sheriffs' Pension Fund	Register of Deeds' Supplemental Pension Fund	*Totals*
$ 1,763	$ 4,715	$ 224,340	$ 2,864	$ 991	$ 334	$ 320,501
274,374	—	—	—	—	—	980,480
303,356	—	—	—	—	—	2,131,846
—	235,011	—	244,369	—	21,371	61,185,256
—	135,711	187,562	139,582	747	12,270	13,589,908
180	46	17,221	4,026	—	—	24,267
—	12	700	14	2	1	1,338
1,784	265	—	—	—	284	85,730
—	—	—	—	—	—	128,244
—	—	7	—	—	—	7
581,457	375,760	429,830	390,855	1,740	34,260	78,447,577
49	146	15,969	—	—	—	16,164
—	1,909	—	281,133	—	—	290,252
—	—	166,672	—	—	—	166,672
—	135,711	187,562	139,582	747	12,270	13,589,908
—	—	3	—	—	—	5
—	—	19,284	—	—	—	19,284
—	—	54	—	—	—	54
49	137,766	389,544	420,715	747	12,270	14,082,339
581,408	237,994	40,286	(29,860)	993	21,990	64,365,238
$ 581,408	$ 237,994	$ 40,286	$ (29,860)	$ 993	$ 21,990	$64,365,238

COMBINING STATEMENT OF CHANGES IN PLAN NET ASSETS

For the Fiscal Year Ended June 30, 2004
(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	401(k) Supplemental Retirement Income Plan
Additions:							
Contributions:							
Employer	$ 60,746	$ 6,923	$ —	$ —	$ —	$ 207,326	$ 108,633
Members	669,706	4,003	268	2,639	—	268,970	168,857
Other contributions	—	—	—	6,856	3,021	—	—
Total contributions	730,452	10,926	268	9,495	3,021	476,296	277,490
Investment Income:							
Investment earnings (loss)	5,315,142	40,763	3,227	31,376	5,812	1,479,473	368,949
Less investment expenses	(183,323)	(1,411)	(111)	(1,086)	(208)	(51,183)	—
Net investment income (loss)	5,131,819	39,352	3,116	30,290	5,604	1,428,290	368,949
Other additions:							
Fees, licenses and fines	—	—	—	—	—	4,554	—
Interest earnings on loans	—	—	—	—	—	—	10,410
Miscellaneous	1,940	—	—	52	—	69	—
Total other additions	1,940	—	—	52	—	4,623	10,410
Total additions	5,864,211	50,278	3,384	39,837	8,625	1,909,209	656,849
Deductions:							
Claims and benefits	2,177,632	19,099	1,473	17,181	2,246	493,602	147,294
Refund of contributions	96,479	—	72	498	—	63,255	—
Administrative expenses	8,890	34	11	766	36	3,149	4,156
Other deductions	6	—	—	—	—	—	—
Total deductions	2,283,007	19,133	1,556	18,445	2,282	560,006	151,450
Change in net assets	3,581,204	31,145	1,828	21,392	6,343	1,349,203	505,399
Net assets — July 1	43,282,582	331,563	26,421	253,547	46,498	11,917,856	2,157,446
Net assets — June 30	$ 46,863,786	$ 362,708	$ 28,249	$ 274,939	$ 52,841	$ 13,267,059	$ 2,662,845

NOTES TO THE FINANCIAL STATEMENTS

Deferred Compensation	Death Benefit Plan of N.C.	State Health Plan	Disability Income Plan of N.C.	Sheriffs' Pension Fund	Registers of Deeds' Supplemental Pension Fund	*Totals*
$ —	$ 3,591	$ 1,253,576	$ —	$ 759	$ 3,260	$ 1,644,814
28,719	—	325,595	—	—	—	1,468,757
—	8,721	—	—	—	—	18,598
28,719	12,312	1,579,171	—	759	3,260	3,132,169
79,296	(1,105)	9,998	(1,715)	41	(27)	7,331,230
—	(1,510)	(2,072)	(1,680)	(9)	(125)	(242,718)
79,296	(2,615)	7,926	(3,395)	32	(152)	7,088,512
—	—	18	—	—	—	4,572
—	—	—	—	—	—	10,410
—	—	—	—	—	—	2,061
—	—	18	—	—	—	17,043
108,015	9,697	1,587,115	(3,395)	791	3,108	10,237,724
39,101	25,195	1,435,865	56,574	817	756	4,416,835
—	—	—	—	—	—	160,304
1,809	544	41,473	549	—	12	61,429
—	—	59	—	83	—	148
40,910	25,739	1,477,397	57,123	900	768	4,638,716
67,105	(16,042)	109,718	(60,518)	(109)	2,340	5,599,008
514,303	254,036	(69,432)	30,658	1,102	19,650	58,766,230
$ 581,408	$ 237,994	$ 40,286	$ (29,860)	$ 993	$ 21,990	$ 64,365,238

NOTE 16: SEGMENT INFORMATION

Primary Government. The Town of Butner water and sewer system is administered by the N.C. Department of Health and Human Services. The State issued revenue bonds to finance upgrades to the Town's water treatment plant, wastewater plant, sanitary sewer system, and water distribution system. This system provides water and sewer services to the State facilities in the Town of Butner as well as to other customers in southern Granville County.

Component Unit. The North Carolina Housing Finance Agency's Home Ownership Bond Programs and Rental Bond Programs are initially funded with revenue bond proceeds. These proceeds are used to purchase single family home and rental property mortgage loans which provide the income along with investment earnings to repay the debt.

Condensed financial statements for the Town of Butner water and sewer system and the two segments of the North Carolina Housing Finance Agency as of and for the fiscal year ended June 30, 2004 are presented below (dollars in thousands).

	Town of Butner Water and Sewer	N.C. Housing Finance Agency	
		Home Ownership	Rental
Condensed Statement of Net Assets			
Assets:			
Current assets	$ 6,486	$ 35,864	$ 20,341
Capital assets-nondepreciable	22,354	—	—
Capital assets-depreciable, net	5,572	—	—
Other assets	4,346	1,224,386	172,954
Total assets	38,758	1,260,250	193,295
Liabilities:			
Current liabilities	3,966	33,326	3,846
Noncurrent liabilities	9,200	1,082,011	138,773
Total liabilities	13,166	1,115,337	142,619
Net assets:			
Invested in capital assets, net of related debt	18,696	—	—
Restricted	1,796	144,913	50,676
Unrestricted	5,100	—	—
Total net assets	$ 25,592	$ 144,913	$ 50,676
Condensed Statement of Revenues, Expenses, and Changes in Net Assets			
Operating revenues (pledged against bonds)	3,723	$ 77,686	$ 13,883
Depreciation expense	(642)	—	—
Other operating expenses	(2,372)	(67,177)	(8,584)
Operating income	709	10,509	5,299
Nonoperating revenues (expenses):			
Investment earnings	187	—	—
Interest expense	(49)	—	—
Other nonoperating revenues (expenses)	(31)	—	—
Capital contributions	862	—	—
Transfers out	(289)	(294)	(54)
Change in net assets	1,389	10,215	5,245
Net assets — July 1, as restated	24,203	134,698	45,431
Net assets — June 30	$ 25,592	$ 144,913	$ 50,676
Condensed Statement of Cash Flows			
Net cash provided (used) by:			
Operating activities	$ 1,469	$ 98,062	$ 27,717
Noncapital financing activities	(289)	(88,014)	(18,940)
Capital and related financing activities	(4,884)	—	—
Investing activities	2,779	(8,266)	1,654
Net increase (decrease)	(925)	1,782	10,431
Cash and cash equivalents at July 1	7,667	74,080	8,208
Cash and cash equivalents at June 30	$ 6,742	$ 75,862	$ 18,639

NOTE 17: COMPONENT UNITS — FINANCIAL INFORMATION

GASB Statement No. 39 became effective during the current fiscal year (see Note 20) and accordingly, the financial statements for the University of North Carolina System and Community Colleges include their nongovernmental component unit foundations and similarly affiliated organizations. Financial statements for component units as of and for the fiscal year ended June 30, 2004 are presented below (dollars in thousands).

Statement of Net Assets

	The Golden LEAF, Inc.	University of North Carolina System	Community Colleges	N.C. Housing Finance Agency	State Education Assistance Authority	Other Component Units	Total
ASSETS							
Cash and cash equivalents	$ 459	$ 2,037,099	$ 146,828	$ 141,224	$ 324,111	$ 50,640	$ 2,700,361
Investments	414,725	957,975	33,045	245,313	380,681	18,517	2,050,256
Receivables, net	3	626,387	62,340	15,285	23,169	7,854	735,038
Due from component units	—	53,526	1,583	—	520	204	55,833
Due from primary government	—	100,201	139,845	—	36,356	—	276,402
Inventories	—	55,047	13,638	—	13	1,088	69,786
Prepaid items	24	10,687	1,050	30	1,040	1,023	13,854
Notes receivable, net	—	99,001	1,190	1,154,724	1,624,561	11,191	2,890,667
Endowment investments	—	1,650,480	64,564	—	—	—	1,715,044
Investment in joint venture	—	8,319	—	—	—	—	8,319
Deferred charges	—	11,010	—	—	9,039	612	20,661
Capital assets-nondepreciable	—	1,255,179	286,448	275	—	66,738	1,608,640
Capital assets-depreciable, net	25	3,970,475	913,003	976	6,919	177,427	5,068,825
Total Assets	415,236	10,835,386	1,663,534	1,557,827	2,406,409	335,294	17,213,686
LIABILITIES							
Accounts payable and accrued liabilities	14,455	478,947	43,975	7,622	573	3,773	549,345
Medical claims payable	—	7,308	—	—	—	—	7,308
Interest payable	—	11,321	—	8,446	4,423	11	24,201
Short-term debt	—	23,841	—	—	—	—	23,841
Due to component units	55,833	—	—	—	—	—	55,833
Due to primary government	8,892	1,035	62	3	—	8,210	18,202
Unearned revenue	—	110,992	6,525	606	—	966	119,089
Advance from primary government	—	—	—	—	—	24,242	24,242
Obligations under reverse repurchase agreements	—	127,859	—	—	—	—	127,859
Deposits payable	—	10,909	—	2,308	—	3	13,220
Funds held for others	—	318,109	4,323	—	156,700	260	479,392
Long-term liabilities:							
Due within one year	—	195,891	8,358	28,495	1,008	3,675	237,427
Due in more than one year	—	1,885,732	54,525	1,221,274	1,687,949	20,176	4,869,656
Total Liabilities	79,180	3,171,944	117,768	1,268,754	1,850,653	61,316	6,549,615
NET ASSETS							
Invested in capital assets, net of related debt	25	3,694,999	1,191,398	1,251	6,919	207,096	5,101,688
Restricted for:							
Nonexpendable:							
Higher education	—	948,278	76,706	—	—	—	1,024,984
Expendable:							
Higher education	—	1,430,250	204,922	—	545,549	—	2,180,721
Health and human services	—	—	—	—	—	2,176	2,176
Economic development	—	—	—	278,197	—	—	278,197
Other purposes	—	—	—	—	—	1,529	1,529
Unrestricted	336,031	1,589,915	72,740	9,625	3,288	63,177	2,074,776
Total Net Assets	$ 336,056	$ 7,663,442	$ 1,545,766	$ 289,073	$ 555,756	$ 273,978	$ 10,664,071

NOTES TO THE FINANCIAL STATEMENTS

Statement of Activities

	The Golden LEAF, Inc.	University of North Carolina System	Community Colleges	N.C. Housing Finance Agency	State Education Assistance Authority	Other Component Units	Total
Total expenses	$ 75,445	$ 5,745,387	$ 1,322,475	$ 202,441	$ 137,165	$ 180,710	$ 7,663,623
Program revenues:							
Charges for services	6	3,403,410	237,722	218,945	59,414	43,634	3,963,131
Operating grants and contributions	27,683	819,133	420,874	—	36,479	9,900	1,314,069
Capital grants and contributions	—	49,169	124,617	—	—	77	173,863
Net program (expense) revenue	(47,756)	(1,473,675)	(539,262)	16,504	(41,272)	(127,099)	(2,212,560)
Non-tax general revenues:							
State operating aid	73,226	1,773,357	599,011	5,430	36,356	118,454	2,605,834
State capital aid	—	430,512	174,620	—	—	22,528	627,660
Miscellaneous	—	—	57	13	—	7	77
Total non-tax general revenues	73,226	2,203,869	773,688	5,443	36,356	140,989	3,233,571
Contributions to endowments	—	59,472	4,431	—	—	—	63,903
Change in net assets	25,470	789,666	238,857	21,947	(4,916)	13,890	1,084,914
Net assets — July 1, as restated (Note 21)	310,586	6,873,776	1,306,909	267,126	560,672	260,088	9,579,157
Net assets — June 30	$ 336,056	$ 7,663,442	$ 1,545,766	$ 289,073	$ 555,756	$ 273,978	$ 10,664,071

Significant Balances and Transactions Between Component Units

	The Golden LEAF, Inc.	University of North Carolina System	Community Colleges	N.C. Housing Finance Agency	State Education Assistance Authority	Other Component Units	Total
The Golden LEAF, Inc.:							
Due from (due to) component units	$ (55,833)	$ 53,526	$ 1,583	$ —	$ 520	$ 204	$ —
Grant revenue (expense)	(54,568)	53,120	848	—	513	87	—
UNC System operating aid	—	(18,961)	—	—	18,961	—	—

Intra-Entity Balances — Between Primary Government and Component Units

	Due From Component Units				Due From Primary Government			
	General Fund	Other Governmental Funds	Other Funds	Total	University of North Carolina System	Community Colleges	State Education Assistance Authority	Total
Due To Component Units:								
General Fund	$ —	$ —	$ —	$ —	$ 7,644	$ —	$ —	$ 7,644
Other Governmental Funds	—	—	—	—	92,557	139,845	36,356	268,758
Due To Primary Government:								
The Golden LEAF, Inc.	8,642	250	—	8,892	—	—	—	—
University of North Carolina System	—	22	1,013	1,035	—	—	—	—
Community Colleges	—	36	26	62	—	—	—	—
NC Housing Finance Agency	—	—	3	3	—	—	—	—
Other Component Units	2,432	5,774	4	8,210	—	—	—	—
Total	$ 11,074	$ 6,082	$ 1,046	$ 18,202	$ 100,201	$ 139,845	$ 36,356	$ 276,402

Advances To Component Units/Advances From Primary Government

The balance of $24.242 million advanced to the NC Global TransPark Authority from the Escheats Fund (a special revenue fund) resulted from a $25 million advance for the purposes of the acquisition of real property in prior fiscal years. The advance is due on July 1, 2005, and will be repaid with interest at a variable rate based upon the earnings record of the State Treasurer's Long-Term Investment Fund.

NOTE 18: RELATED ORGANIZATION

MCNC

MCNC (formerly the Microelectronics Center of North Carolina) is a legally separate nonprofit corporation created to foster advanced programs in microelectronics and super-computing, in support of economic development and of North Carolina universities and research institutes. It is managed by a twenty-member board. Six of the members are appointed by the Governor and four serve as a result of their positions with the UNC System, a component unit of the State, one serves as a result of his position with MCNC, one is designated by the board of trustees of Duke University, and one is designated by the board of governors of the Research Triangle Institute. These board members elect the remaining seven members. Any appointed director may be removed from office by the Governor for cause. Any elected director may be removed at will by the Board.

NOTE 19: COMMITMENTS AND CONTINGENCIES

A. No Commitment Debt

The State, by action of the General Assembly, created the North Carolina Medical Care Commission which is authorized to issue tax-exempt bonds and notes to finance construction and equipment projects for nonprofit and public hospitals, nursing homes, continuing care facilities for the elderly and related facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each entity is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2041, the outstanding principal of such bonds and notes as of June 30, 2004, was $4.8 billion with interest rates varying from 1.60 % to 7.57 %.

The North Carolina Capital Facilities Finance Agency is authorized by the State to issue tax-exempt bonds and notes to finance industrial and manufacturing facilities, pollution control facilities for industry (in connection with manufacturing) where there is a favorable impact on employment or pollution control commensurate with the size and cost of the facilities and to finance facilities and structures at private nonprofit colleges and universities, and institutions providing kindergarten, elementary and secondary education. Its authority to issue bonds and notes includes financing private sector capital improvements for activities that constitute a public purpose. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each issue is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2042, the outstanding principal of such bonds and notes as of June 30, 2004, was $1.5 billion with fixed interest rates varying from 2.4% to 7.1% and variable interest rates which can be reset weekly.

B. Litigation

***Hoke County et al. v. State of North Carolina and State Board of Education* — Right to a Sound Basic Education (formerly Leandro).** In 1994, students and boards of education in five counties in the State filed suit in Superior Court requesting a declaration that the public education system of North Carolina, including its system of funding, violates the State constitution by failing to provide adequate or substantially equal educational opportunities, by denying due process of law, and by violating various statutes relating to public education. Five other school boards and students therein intervened, alleging claims for relief on the basis of the high proportion of at-risk and high-cost students in their counties' systems.

The suit is similar to a number of suits in other states, some of which resulted in holdings that the respective systems of public education funding were unconstitutional under the applicable state law. The State filed a motion to dismiss, which was denied. On appeal the North Carolina Supreme Court upheld the present funding system against the claim that it unlawfully discriminated against low wealth counties but remanded the case for trial on the claim for relief based on the Court's conclusion that the constitution guarantees every child the opportunity to obtain a sound basic education. Trial on the claim of one plaintiff-county was held in the fall of 1999. On October 26, 2000 the trial court, in Section Two of a projected three-part ruling, concluded that at-risk children in North Carolina are constitutionally entitled to such pre-kindergarten educational programs as may be necessary to prepare them for higher levels of education and the “sound basic education” mandated by the Supreme Court. On March 26, 2001, the Court issued Section Three of the three-part ruling, in which the judge ordered all parties to investigate certain school systems to determine why they are succeeding without additional funding. The State filed a Notice of Appeal to the Court of Appeals, which resulted in the Court’s decision to re-open the trial and call additional witnesses. That proceeding took place in the fall of 2001. On April 4, 2002 the Court entered Section Four of the ruling, ordering the State to take such actions as may be necessary to remedy the constitutional deficiency for those children who are not being provided with access to a sound basic education and to report to the Court at 90-day intervals remedial actions being implemented. On July 30, 2004, the North Carolina Supreme Court affirmed the majority of the trial court’s orders, thereby directing the executive and legislative branches to take corrective action necessary to ensure that every child has the opportunity to obtain a sound, basic education. The Supreme Court did agree with the State that the trial court exceeded its authority in ordering pre-kindergarten programs for at-risk children. The State is now undertaking measures to respond to the trial court’s directives. The magnitude of State resources which may be ultimately be required cannot be determined at this time, however, the total cost could exceed $100 million.

***N.C. School Boards Association, et al. v. Richard H. Moore, State Treasurer, et. al*. — Use of Administration Payments.** On December 14, 1998, plaintiffs, including county school boards of Wake, Durham, Johnston, Buncombe, Edgecombe and Lenoir Counties, filed suit in Superior Court requesting a declaration that certain payments to State administrative agencies must be distributed to the public schools on the theory that such amounts are civil penalties which under the North Carolina Constitution must be paid to the schools.

On December 14, 2001, the Superior Court of Wake County granted summary judgment in favor of the plaintiffs on all issues, concluding that the funds in dispute are civil fines or penalties required by Article IX, Section 7 of the Constitution to be remitted to the public schools in the county where the violation occurred. The court further determined a three-year statute of limitations to be applicable, making the order retroactive to December 1995. This case was argued in the Court of Appeals in February, 2003. The North Carolina Court of Appeals rendered a decision in September 2003 substantially favorable to the State. Cross appeals have been filed with the North Carolina Supreme Court and oral arguments have been heard. The amount in controversy in this litigation is approximately $84 million.

The North Carolina Attorney General's Office believes that sound legal arguments support the State's position on the outstanding claims.

Southeast Compact Commission — Disposal of Low-level Radioactive Waste. North Carolina and seven other southeastern states created the Southeast Interstate Low-level Radioactive Waste Management Compact to plan and develop a site for the disposal of low-level radioactive waste generated in the member states. North Carolina was assigned responsibility for development of the first disposal site, with costs to be distributed equitably among the Compact members. In 1997 the Compact Commission discontinued funding of the development of the North Carolina site, alleging that the State was not actively pursuing the permitting and development of the proposed site. North Carolina withdrew from the Compact in 1999. The Compact subsequently asked the United States Supreme Court to accept its Complaint against North Carolina demanding the repayment, with interest, of $80 million of Compact payments expended on the permitting of the site, plus $10 million of future lost income, interest and attorney fees. The Supreme Court denied this motion in August 2001. On August 5, 2002 the Compact, with the addition of four member states as plaintiffs, filed a new motion requesting the United States Supreme Court to accept the claim under its original jurisdiction. On June 16, 2003, the Court accepted jurisdiction of the case and the State filed an answer and motion to dismiss on August 21, 2003. On November 17, 2003, the motion to dismiss was denied, and the U.S. Supreme Court appointed a special master with authority to determine when additional pleadings will be filed in the case. The Special Master heard oral arguments on dispositive motions filed by both sides on September 3, 2004.

The North Carolina Attorney General's office believes that sound legal arguments support the State's position on this matter.

Philip Morris USA Inc. v. Tolson **-- Refund of Corporate Income Tax.** On June 13, 2000, Philip Morris filed a complaint in Wake County Superior Court for a refund of approximately $30 million in corporate income taxes paid for 1989 through 1991. An order of the Augmented Tax Review Board in the 1970's allowed it to apportion its income under a modified formula, which included a more favorable property factor. When the law changed in 1989 to move to double weighting of the sales factor, Philip Morris incorporated this change into its formula. The Board's order did not permit double weighting. Philip Morris argued that the principle of in pari materia required incorporation of the amendment, and that failure to allow double weighting violated the equal protection and separation of powers clauses. The Wake County Superior Court recently ruled that Philip Morris was required to use the formula approved by the Board without double weighting the sales factor unless the statutory formula (without the modified property factor) produced a more favorable result. Philip Morris is expected to appeal this ruling

State Employees Association of North Carolina v. State; Stone v. State **– Diversion of Employer's Retirement System Contribution**. On May 22, 2001, SEANC filed an action in Wake County Superior Court demanding repayment of approximately $129 million in employer retirement contributions to the Retirement Systems. The Governor withheld, and subsequently used, the withheld funds under his constitutional authority to balance the state budget. The trial court dismissed the action on May 23, 2001, and the North Carolina Court of Appeals affirmed this dismissal on December 3, 2002. The Supreme Court, on June 13, 2003, reversed the Court of Appeals on issues related to class standing and remanded with instructions to consider procedural issues raised but not addressed by the Court of Appeals.

In June, 2002, the *Stone* case was filed in Wake County Superior Court on behalf of individual state employees and retirees seeking repayment of the withheld employer contribution and a prohibition against future diversions. A class comprised of all members of the Retirement System has been certified and the case is proceeding through class notification and toward trial.

The North Carolina Attorney General's Office believes that sound legal arguments support the state's defense of these cases.

Cabarrus County v. Tolson **– Diversion of Local Government Tax Reimbursements and Shared Revenue.** On September 17, 2002, six counties and three municipalities filed suit against the Secretary of Revenue in Wake County Superior Court, demanding that the State release payments of local tax reimbursements and shared revenues in excess of $200 million and a prohibition against future diversions. Other counties, municipalities and some individuals have moved to be added as plaintiffs. The Governor, in the exercise of his constitutional responsibility to balance the state budget, withheld approximately $211 million in tax revenues designated by statute for payment to local governments. Summary judgment was granted in favor of the State on all issues and Plaintiffs have filed a notice of appeal.

The North Carolina Attorney General's Office believes that sound legal arguments support the defense of this action.

Goldston v. State of North Carolina **– Highway Trust Fund Transfers.** On November 14, 2002, a lawsuit was filed in Wake County Superior Court demanding that $80 million transferred by the Governor from the Highway Trust Fund to the General Fund for purposes of balancing the State budget be returned to the Highway Trust Fund. The suit further alleges that actions of the General Assembly regarding the transfer of funds from the Highway Trust Fund to the General Fund constitute a borrowing by the State of Highway Trust Fund cash surplus and are unlawful and unconstitutional. The lawsuit requests a declaration that taxes collected for purposes of Highway Trust Fund expenditures cannot be used for other purposes. Summary Judgment was granted in favor of the State on all issues and Plaintiff has filed a notice of appeal. The North Carolina Attorney General's Office believes that sound legal arguments support the defense of this action and has filed a motion to dismiss.

Diana Coley, et al. v. State of North Carolina, et al. On April 25, 2003, Plaintiffs filed suit in the Superior Court of Wake County against the State of North Carolina and the Secretary of Revenue challenging the constitutionality of retroactively applying the 2001 increase in the highest rate of North Carolina's state income tax to the entire 2001 tax year. Plaintiffs seek refunds, for themselves and a proposed class of similarly situated taxpayers, of all taxes paid for the year 2001 in excess of the prior 7.75% maximum rate, on the theory that a retroactive midyear tax increase violates the state and federal constitutions. Plaintiffs claim the total amount of taxes involved exceeds $76 million, plus interest. On June 30, 2004, the trial court granted summary judgment in favor of the State on all issues. Plaintiffs are expected to appeal.

Medical Mutual Insurance Corporation of North Carolina v. The Board of Governors of the University of North Carolina and its Constituent Institution, East Carolina University, the East Carolina School of Medicine, et al. On March 18, 2003, Medical Mutual Insurance Corporation of North Carolina (MMICNC) filed this action in Wake County Superior Court against the Board of Governors of the University of North Carolina (UNC), East Carolina University Brody School of Medicine (ECUBSOM), and various doctors. In 2002, in order to raise additional capital, MMICNC demanded that all policy holders, including ECUBSOM, purchase guaranteed capital shares under threat of termination or nonrenewal of policies. In the face of MMICNC's demand, ECUBSOM decided to purchase insurance for almost all of its healthcare professionals from another insurance company. In this lawsuit, MMICNC claims that ECUBSOM's decision not to purchase insurance for all its healthcare professional from MMICNC triggered an obligation to pay a termination fee to MMICNC of approximately $26.7 million. ECUBSOM believes that MMICNC is not entitled to any further payments. The North Carolina Attorney General's office believes that no fee may be owed because of MMICNC's termination of the contract; however, in the event that a fee is owed, the North Carolina Attorney General's Office believes that it would be substantially less than $26.7 million. The suit is pending in Superior Court and related administrative proceedings before the Department of Insurance are ongoing. In August 2004, the trial court entered an order referring the case to arbitration. The parties are also engaged in settlement discussions.

DirecTV, Inc. and EchoStar Satellite Corporation v. State of North Carolina et al. **-- Refund of Sales Tax.** On September 30, 2003, DirecTV and Echostar filed a complaint in Wake County Superior Court for a $32 million refund of state sales tax paid. The legislature recently enacted a provision to impose the sales tax on satellite TV service providers. Plaintiffs claim this tax, which is not imposed on cable television providers, is unconstitutional in that it violates the commerce clause (because it is discriminatory and not fairly related to benefits provided by the state), the equal protection clause and North Carolina's uniformity of taxation constitutional requirement. It is the State's position that although cable providers are not subject to this tax, they are subject to city and county franchise taxes. The tax on satellite companies was enacted to equalize the tax burden on these various forms of entertainment. The case has been designated as exceptional under Rule 2.1 of the North Carolina Rules of Civil Procedure and the parties are currently conducting discovery.

Lessie J. Dunn, et al. v. The State of North Carolina, et al. On February 9, 2004, Plaintiffs, on behalf of a class of all others similarly situated, filed suit in Forsyth County Superior Court alleging that the State's imposition and collection of State income tax on interest received by certain taxpayers on municipal bonds issued by non-North Carolina state and local governments constitutes a violation of the Commerce Clause of the United States Constitution. A similar case recently filed in Ohio was ultimately unsuccessful. The North Carolina Attorney General's Office has filed an answer in the case and discovery is in progress. The Attorney General's Office believes there are sound defenses in this case.

Other Litigation. The State is involved in numerous other claims and legal proceedings, many of which normally recur in governmental operations. A review of the status of outstanding lawsuits involving the State by the North Carolina Attorney General did not disclose other proceedings that are expected to have a material adverse effect on the financial position of the State.

C. Federal Grants

The State receives significant financial assistance from the Federal Government in the form of grants and entitlements, which are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Under the terms of the grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures. Any disallowance as a result of questioned costs could become a liability of the State. As of June 30, 2004, the State is unable to estimate what liabilities may result from such audits except for the $7.5 million settlement balance with the U.S. Department of Justice and the U.S. Department of Health and Human Services which is included in the long-term liabilities footnote (Note 7).

D. Highway Construction

The State may be liable for approximately $81.11 million to contractors for highway construction claims that the State has contested. The State may also be liable for an additional $8.92 million in contested rights-of-way acquisition costs to property owners in condemnation proceedings. These costs have not been included in project-to-date costs. Also, the State is contingently liable for outstanding contractors' claims in the amount of $71.35 million.

E. USDA-Donated Commodities

The State has custodial responsibility for $3.46 million of U.S. Department of Agriculture donated food commodities for which the State is liable in the event of loss.

F. Construction and Other Commitments

At June 30, 2004, the State had commitments of $1.91 billion for construction of highway facilities. Of this amount, $1.3 billion relates to the Highway Fund, and $610 million relates to the Highway Trust Fund. The other commitments for construction and improvements of State government facilities totaled $522.9 million (including $358.6 million for the Department of Environment and Natural Resources, $137.5 million for the Department of Correction, and $14.9 million for the Wildlife Resources Commission).

At June 30, 2004, the University of North Carolina System (component unit) had outstanding construction commitments of $574.3 million (including $124.6 million for North Carolina State University, $67.3 million for University of North Carolina – Chapel Hill, $66.5 million for Appalachian State University, $43.9 million for University of North Carolina – Charlotte, and $41.9 million for UNC Hospitals).

At June 30, 2004, community colleges (component units) had outstanding construction commitments of $159.1 million (including $22.9 million for Central Piedmont Community College, $15.2 million for Guilford Technical Community College, $12.7 million for Fayetteville Technical Community College and $12.5 million for Cape Fear Community College).

At June 30, 2004, The Golden LEAF, Inc. (component unit) had outstanding commitments of $60.2 million.

During the fiscal year, the State entered into a ground lease with the N.C. Aquarium Society in order for the society to renovate and expand the Aquarium at Pine Knoll Shores. The Society entered into a lease back of the renovated facilities to the State starting on July 1, 2006 and ending on July 1, 2025. The lease payments are projected to total $26.745 million over the 20-year period or about $1.337 million annually. The State will manage and maintain this property after the completion of the construction.

G. Tobacco Settlement

In 1998, North Carolina, along with forty-five other states, signed the Master Settlement Agreement (MSA) with the nation's largest tobacco companies to settle existing and potential claims of the states for damages arising from the use of the companies' tobacco products. Under the MSA, the tobacco companies are required to adhere to a variety of marketing, advertising, lobbying, and youth access restrictions, support smoking cessation and prevention programs, and provide payments to the states in perpetuity. The amount that North Carolina will actually receive from this settlement remains uncertain, but projections are that the state will receive approximately $4.6 billion through the year 2025. In the early years of MSA, participating states received initial payments that were distinct from annual payments. The initial payments were made for five years: 1998 and 2000 through 2003. The annual payments began in 2000 and will continue indefinitely. However, these payments are subject to a number of adjustments including an inflation adjustment and a volume adjustment. Some adjustments (e.g., inflation) should result in an increase in the payments while others (e.g., domestic cigarette sales volume) may decrease the payments. Also, future payments may be impacted by continuing and potential litigation against the tobacco industry and changes in the financial condition of the tobacco companies. At year-end, the State recognizes a receivable and revenue for the tobacco settlement based on the underlying domestic shipment of cigarettes (see Note 20). This accrual estimate is based on the projected payment schedule in the MSA adjusted for historical payment trends.

In 1999, the State approved legislation to implement the terms of the MSA in North Carolina. The State created a nonprofit corporation, The Golden LEAF, Inc., to distribute 50 percent of the settlement funds received by the State of North Carolina. The legislation directed that these funds be used for the purposes of providing economic impact assistance to economically affected or tobacco-dependent regions of North Carolina. However, the Foundation's share of the payments may be diverted by the North Carolina General Assembly prior to the funds being received by the North Carolina State Specific Account. The Golden LEAF, Inc. is reported as a discretely presented component unit.

In 2000, the State enacted legislation that established the Health and Wellness Trust Fund and the Tobacco Trust Fund and created commissions charged with managing these funds. Each fund will receive 25 percent of the tobacco settlement payments. The purpose of the Health and Wellness Trust Fund is to finance programs and initiatives to improve the health and wellness of the people of North Carolina. An eighteen-member Health and Wellness Trust Fund Commission will administer the Fund. The primary purpose of the Tobacco Trust Fund is to compensate the tobacco-related segment of North Carolina's economy for the economic hardship it is expected to experience as a result of the MSA. An eighteen-member Tobacco Trust Fund Commission will administer the Fund. The Health and Wellness Trust Fund and Tobacco Trust Fund are reported as special revenue funds.

H. Other Contingencies

As of June 30, 2004, the North Carolina Global TransPark Authority (component unit) had a loan outstanding including accrued interest payable totaling $30 million to the Escheat Fund (special revenue fund). The loan is due on July 1, 2005. The current amount of operating cash held by the Authority is not sufficient to pay the balance due to the Escheat Fund and as such, substantial doubt about the Authority's ability to continue as a going concern exists. In addition, if the Authority declares bankruptcy all funding received to date from the Federal Aviation Administration (FAA) is required to be paid back. As of June 30, 2004, the Authority has received approximately $21.6 million from the FAA.

NOTE 20: CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2004, the State implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

- GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units: an amendment of GASB Statement No. 14.*
- GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues.*

GASB Statement No. 39 amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with a primary government. The standard impacts the University of North Carolina System and community colleges (component units of the State of North Carolina) by requiring them to report their significant, private fund-raising foundations (and similarly affiliated organizations) as component units.

GASB Technical Bulletin No. 2004-1 clarifies recognition guidance for payments made to the State of North Carolina and other settling governments pursuant to the Master Settlement Agreement with the major tobacco companies (see Note 19). This pronouncement clarifies that settling governments should recognize a receivable and revenue for the tobacco settlement based on the underlying domestic shipment of cigarettes.

NOTE 21: FUND EQUITY RECLASSIFICATIONS AND RESTATEMENTS

The following table reconciles the beginning fund equity as previously reported to the beginning fund equity as restated (dollars in thousands). The adjustments in the "GASB 39 Implementation" column and the "Technical Bulletin 2004-1 Implementation" column are due to the State's adoption of new GASB pronouncements as discussed in Note 20, Changes In Financial Accounting and Reporting. The adjustments in the "Fund Reclassifications" column result from reclassification of the mail service center from the General Fund to an internal service fund. The amounts in the "Other Adjustments" column are due primarily to the correction of errors related to prior periods.

	July 1, 2003 Fund Equity as Previously Reported	GASB 39 Implementation	Technical Bulletin 2004-1 Implementation	Fund Reclassifications	Other Adjustments	July 1, 2003 Fund Equity as Restated
Primary Government						
Major Governmental Funds:						
General Fund	$ (166,955)	$ —	$ —	$ (184)	$ —	$ (167,139)
Highway Fund	299,920	—	—	—	—	299,920
Highway Trust Fund	208,172	—	—	—	—	208,172
Other Governmental Funds:						
Special Revenue Funds	2,121,391	—	—	—	(3,395)	2,117,996
Capital Projects Funds	116,740	—	—	—	—	116,740
Permanent Funds	59,915	—	—	—	—	59,915
Total Governmental Funds	2,639,183	—	—	(184)	(3,395)	2,635,604
Internal Service Funds	208,028	—	—	651	(92)	208,587
Government-wide adjustments:						
Capital assets	23,637,457	—	—	(546)	(6,447)	23,630,464
Unavailable deferred revenues	247,047	—	—	—	(8,850)	238,197
Long-term debt	(4,377,444)	—	—	79	3,948	(4,373,417)
Accrued interest payable	(43,780)	—	—	—	—	(43,780)
Accrued tobacco settlement receivable	—	—	72,493	—	—	72,493
Pension assets	31	—	—	—	—	31
Total Government-wide adjustments	19,463,311	—	72,493	(467)	(11,349)	19,523,988
Total Governmental Activities	$ 22,310,522	$ —	$ 72,493	$ —	$ (14,836)	$ 22,368,179
Business-type Activities - Enterprise Funds:						
Unemployment Compensation Fund	$ 277,480	$ —	$ —	$ —	$ —	$ 277,480
EPA Revolving Loan Fund	581,678	—	—	—	—	581,678
Other enterprise funds	99,166	—	—	—	276	99,442
Total Business-type Activities - Enterprise Funds	$ 958,324	$ —	$ —	$ —	$ 276	$ 958,600
Component Units						
The Golden LEAF, Inc.	$ 310,586	$ —	$ —	$ —	$ —	$ 310,586
University of North Carolina System	6,243,741	625,513	—	—	4,522	6,873,776
Community Colleges	1,234,541	87,482	—	—	(15,114)	1,306,909
NC Housing Finance Agency	267,126	—	—	—	—	267,126
State Education Assistance Authority	560,672	—	—	—	—	560,672
Other component units	249,077	—	—	—	11,011	260,088
Total Component Units	$ 8,865,743	$ 712,995	$ —	$ —	$ 419	$ 9,579,157

NOTE 22: SUBSEQUENT EVENTS

Primary Government

General Obligation Highway and Refunding Bonds

On September 15, 2004, the State sold $682.26 million of general obligation bonds consisting of $300 million Highway Bonds Series 2004 and $382.26 million Refunding Bonds Series 2004 Bonds. These bonds are dated September 1, 2004 and will bear interest from that date. Interest on the Highway Bonds will be payable semiannually on each May 1 and November 1, commencing May 1, 2005. The Highway Bonds will mature from May 1, 2006 to 2020, inclusive, and were issued at coupon rates ranging from 3.00% to 5.00%. The Highway Bonds were issued for the purpose of providing funds to reimburse the State for capital costs of (i) urban loops, (ii) highways in the Intrastate System, and (iii) projects constituting a part of the State secondary highway system resulting in the paving of unpaved roads. Interest on the Refunding Bonds will be payable semiannually on each March 1 and September 1, commencing March 1, 2005. The Refunding Bonds will mature from March 1, 2005 to 2015, inclusive, and were issued at coupon rates ranging from 3.00% to 5.50%. The Refunding Bonds were issued for the purpose of providing funds to refund in advance of their maturities (1) the $12 million outstanding aggregate amount of the State's Clean Water Bonds, Series 1995A maturing on and after June 1, 2006, (2) the $60 million outstanding aggregate amount of the State's Capital Improvement Bonds, Series 1997 maturing on and after June 1, 2007, (3) the $159.5 million outstanding aggregate principal amount of the State's Public School Building Bonds, Series 1997A maturing on and after March 1, 2008, (4) the $99.925 million outstanding aggregate principal amount of the State's Highway Bonds, Series 1997A maturing on and after May 1, 2008, and (5) the $57 million outstanding aggregate principal amount of the State's Public Improvement Bonds, Series 1999A maturing on and after March 1, 2010.

Lease-Purchase Revenue Bonds

On October 28, 2004, the State through the North Carolina Infrastructure Finance Corporation (Corporation), a blended component unit of the State, sold $53,640,000 Lease-Purchase Revenue Bonds, Series 2004, (Bonds) the proceeds of which will be used to provide funds, together with any other available funds, for the purposes of (1) acquiring privately-owned correctional facilities in Avery County and Pamlico County which have been leased by the State since 1998, (2) paying the costs of design, construction drawings and solicitation of bids for youth development centers (collectively, the *"Projects"*) and (3) paying certain costs incurred in connection with the execution and delivery of the Bonds. The Bonds are limited obligations of the Corporation, payable solely from the lease payments and additional payments made by the State pursuant to a lease-purchase agreement dated as of November 1, 2004 (the *"Agreement")* between the State and the Corporation. The State's obligations under the Agreement are subject to appropriation.

No deficiency judgment may be rendered against the State in any action for breach of any contractual obligation under the governing documents, and the taxing power of the State or any agency, department or commission of the State is not pledged directly or indirectly to secure any moneys due to the owners of the 2004 Bonds.

Tax Anticipation Notes

The State is authorized by the Constitution to borrow in anticipation of the collection of taxes due and payable within the current fiscal year an amount not exceeding 50% of such taxes. In September 2004, the State issued $300 million in tax anticipation notes with a maturity date of June 30, 2005. The State will use unemployment tax receipts to repay these notes. An initial $260 million was drawn against the note in September and an additional $20 million was drawn in October, making the total outstanding balance on the note $280 million. Of the funds drawn, $230 million was used to repay advances from the Federal Unemployment Account (see Federal Repayable Advances below) and the remainder is to be used to pay unemployment benefits, as needed.

Federal Repayable Advances

On September 29, 2004, the State used $230 million of the proceeds of tax anticipation notes mentioned above to repay the Federal Unemployment Account (FUA) (see note 6, Short-term Debt). Of these funds, $223.8 million was directed to repay advances used to finance an operating deficit in the State's unemployment compensation fund. The remaining $6.2 million was deposited with the FUA to cover current and future benefits. These advances were repaid in full by September 29, 2004, in accordance with the policy that advances taken from January 1 to September 30, which are repaid in full on or before September 30, are considered cash flow advances and do not accrue interest provided that the State does not take additional advances from October 1 through December 31 (of same calendar year). The State does not plan to take additional FUA advances through December 31, 2004.

NOTES TO THE FINANCIAL STATEMENTS

Hurricanes

North Carolina was impacted by six tropical weather systems in the 2004 Hurricane Season. In August, Hurricanes Alex, Bonnie, and Charley caused flooding and widespread power outages in eastern North Carolina. In September, Hurricanes Frances, Ivan, and Jeanne devastated central and western North Carolina with torrential rainfall that spawned flash flooding and numerous debris flows, including mudslides and rock falls. Only Hurricanes Frances and Ivan have met the criteria necessary to achieve a Federal Disaster Declaration, while Hurricanes Alex, Bonnie, Charley, and Jeanne met the criteria necessary for a State Disaster Declaration. Preliminary estimates indicate that these storms caused over $230 million in damages that are eligible for state and federal governmental assistance. The State's share is estimated to be approximately $90 million.

Component Units

University of North Carolina at Chapel Hill, Unsecured Loans

On September 22, 2004, the Kenan-Flagler Business School Foundation, which is part of the University reporting entity, closed a $20 million unsecured line of credit with Wachovia Bank, N.A. This credit facility is to be used to fund the expansion of the Paul J. Rizzo Business Conference Center and will expire on September 22, 2006. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 1.20%. There is an availability fee due each year on the anniversary date of the line of credit and is calculated as .125% of the difference between the commitment amount and the average balance outstanding for the year leading up to the anniversary date.

On October 1, 2004, the UNC-CH Foundation, which is also part of the University reporting entity, refinanced its $35 million unsecured loan with Bank of America. The purpose of the refinance was to increase the commitment to $47.3 million to provide additional funding for a Student Family Housing Project, and the facility will mature on October 1, 2005. The outstanding balance under the credit facility accrues interest at the LIBOR Rate plus .40%.

Bond Purchase Agreement

On July 14, 2004, the North Carolina Housing Finance Agency, a major component unit of the State, signed a bond purchase agreement under the 1998 Home Ownership Trust Indenture for Series 19A and 19B bonds in the amount of $65 million. The Agency delivered these bonds on August 18, 2004. Also, in July 2004, Standard & Poor's downgraded the 1993 Multifamily Resolution to AA- due to the downgrade of the Investment Agreement provider JP Morgan Chase.

Required Supplementary Information

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS
ALL DEFINED BENEFIT PENSION TRUST FUNDS

June 30, 2004

(Expressed in Thousands)

Retirement System	Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b) - (a) NOTE 1	Funded Ratio (a) / (b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
Teachers' and State Employees'	12-31-03	$ 45,117,508	$ 41,733,701	$ (3,383,807)	108.1%	$ 10,082,153	(33.6)%
	12-31-02	43,226,837	39,863,983	(3,362,854)	108.4%	9,734,448	(34.6)%
	12-31-01	42,104,086	37,713,663	(4,390,423)	111.6%	9,494,603	(46.2)%
	12-31-00 A	39,773,747	35,248,770	(4,524,977)	112.8%	9,001,354	(50.3)%
	12-31-99 A	36,119,250	32,787,108	(3,332,142)	110.2%	8,437,649	(39.5)%
	12-31-98 A	31,847,438	30,354,222	(1,493,216)	104.9%	7,994,826	(18.7)%
Consolidated Judicial	12-31-03	$ 340,857	$ 316,649	$ (24,208)	107.6%	$ 49,465	(48.9)%
	12-31-02	323,384	301,031	(22,353)	107.4%	48,432	(46.2)%
	12-31-01	311,221	285,692	(25,529)	108.9%	47,773	(53.4)%
	12-31-00	291,807	269,181	(22,626)	108.4%	43,546	(52.0)%
	12-31-99 B	259,706	241,303	(18,403)	107.6%	43,037	(42.8)%
	12-31-98	226,712	225,944	(768)	100.3%	40,926	(1.9)%
Legislative	12-31-03	$ 26,327	$ 20,046	$ (6,281)	131.3%	$ 3,692	(170.1)%
	12-31-02	25,304	19,243	(6,061)	131.5%	3,668	(165.2)%
	12-31-01	24,231	18,551	(5,680)	130.6%	3,691	(153.9)%
	12-31-00	22,314	17,733	(4,581)	125.8%	3,785	(121.0)%
	12-31-99	19,674	16,795	(2,879)	117.1%	3,719	(77.4)%
	12-31-98	17,885	15,975	(1,910)	112.0%	3,615	(52.8)%
Firemen's, Rescue Squad Workers'	6-30-03	$ 249,925	$ 260,707	$ 10,782	95.9%	N/A	N/A
	6-30-02	239,918	249,316	9,398	96.2%	N/A	N/A
	6-30-01	225,276	230,796	5,520	97.6%	N/A	N/A
	6-30-00 B	202,751	240,335	37,584	84.4%	N/A	N/A
	6-30-99	175,245	196,569	21,324	89.2%	N/A	N/A
	6-30-98	158,332	190,451	32,119	83.1%	N/A	N/A
National Guard	12-31-03	$ 51,316	$ 58,752	$ 7,436	87.3%	N/A	N/A
	12-31-02	46,769	58,943	12,174	79.3%	N/A	N/A
	12-31-01	46,314	52,235	5,921	88.7%	N/A	N/A
	12-31-00	43,886	49,495	5,609	88.7%	N/A	N/A
	12-31-99 B	39,445	47,731	8,286	82.6%	N/A	N/A
	12-31-98	34,090	43,065	8,975	79.2%	N/A	N/A
Registers of Deeds' ***NOTE 2***	12-31-03	$ 20,439	$ 11,886	$ (8,553)	172.0%	$ 5,178	(165.2)%
	12-31-02	16,325	11,673	(4,652)	139.9%	4,767	(97.6)%
	12-31-01	12,887	11,648	(1,239)	110.6%	4,736	(26.2)%
	12-31-99	9,227	10,859	1,632	85.0%	4,406	37.0%
	12-31-98	7,780	10,002	2,222	77.8%	4,060	54.7%
Local Governmental Employees'	12-31-03	$ 12,364,380	$ 12,455,503	$ 91,123	99.3%	$ 3,898,476	2.3%
	12-31-02	11,393,460	11,462,706	69,246	99.4%	3,746,396	1.9%
	12-31-01	10,764,032	10,836,460	72,428	99.3%	3,597,769	2.0%
	12-31-00	9,892,805	9,967,548	74,743	99.3%	3,344,615	2.2%
	12-31-99 B	8,818,583	8,885,530	66,947	99.2%	3,117,204	2.2%
	12-31-98	7,625,281	7,687,973	62,692	99.2%	2,929,544	2.1%

NOTE 1 a negative UAAL denotes excess actuarial asset

NOTE 2 No valuation was done for 12-30-0

A- For 12-31-98, legislation directed the 5-yer smoothed market value to be capped at 77% of actual market valu The 2001 Session of the General Assembly removed this cap. These asset values were adjusted or restated for the effects of these changes.

B- This is an actuarial change in computing 5-year smoothed market asset valuation.

N/A - Not applicable

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 117.

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYERS AND OTHER CONTRIBUTING ENTITIES
ALL DEFINED BENEFIT PENSION TRUST FUNDS

For the Six-Year Period 1999 to 2004 (July 1 to June 30)

(Expressed in Thousands)

Retirement System	*State Fiscal Year*	*Annual Required Contribution*	*Percentage Contributed*	
Teachers' and State Employees'	2004	$ 23,135	100%	Note 1
	2003	—	NR	
	2002	196,003	100%	
	2001	513,907	76%	
	2000	735,393	100%	
	1999	630,049	100%	
Consolidated Judicial	2004	$ 5,583	100%	Note 1
	2003	5,993	100%	
	2002	7,003	100%	
	2001	9,071	75%	
	2000	8,435	100%	
	1999	7,263	100%	
Legislative	2004	$ —	NR	
	2003	—	NR	
	2002	858	97%	
	2001	861	71%	
	2000	811	100%	
	1999	770	104%	
Firemen's, Rescue Squad Workers'	2004	$ 6,801	100%	Note 1
	2003	6,856	100%	
	2002	10,027	100%	
	2001	12,105	92%	
	2000	12,105	100%	
	1999	12,105	100%	
National Guard	2004	$ 1,176	100%	Note 1
	2003	1,132	0%	
	2002	1,542	58%	
	2001	2,075	100%	
	2000	2,545	100%	
	1999	2,533	100%	
Registers of Deeds'	2004	$ 286	1158%	
	2003	1,722	197%	
	2002	1,722	128%	
	2001	1,826	98%	
	2000	1,739	87%	
Local Governmental Employees'	2004	$ 208,092	100%	
	2003	233,753	100%	
	2002	192,170	100%	
	2001	179,238	100%	
	2000	168,201	100%	
	1999	157,764	100%	

NR- No contribution was required or made.
Note1- Additional contributions not related to the ARC are described in the system narratives in Note 11.

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 117.

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED FUND BALANCE — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)
GENERAL FUND

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Budgeted Amounts			*Variance with*
	Original	***Final***	***Actual***	***Final Budget***
Revenues:				
Taxes:				
Individual income	$ 7,427,043	$ 7,427,043	$ 7,509,898	$ 82,855
Corporate income	711,584	711,584	776,965	65,381
Sales and use	4,056,912	4,056,912	4,222,202	165,290
Franchise	448,637	448,637	445,294	(3,343)
Insurance	439,100	439,100	423,405	(15,695)
Beverage	177,637	177,637	182,393	4,756
Inheritance	107,700	107,700	128,479	20,779
Other	143,352	143,352	142,091	(1,261)
Non-Tax:				
Fees, licenses and fines	138,270	138,270	139,034	764
Investment income	113,900	113,900	78,345	(35,555)
Disproportionate share receipts	100,000	100,000	97,144	(2,856)
Federal funds for fiscal relief	136,859	136,859	136,859	—
Other	315,653	315,653	261,775	(53,878)
Transfers in	268,801	268,801	268,801	—
Departmental:				
Federal funds	7,334,712	8,814,136	8,072,257	(741,879)
Local funds	812,822	870,281	846,602	(23,679)
Inter-agency grants and allocations	7,558	35,459	29,797	(5,662)
Intra-governmental transactions	699,706	1,715,458	1,620,637	(94,821)
Sales and services	59,126	79,224	74,815	(4,409)
Rental and lease of property	6,918	7,146	6,906	(240)
Fees, licenses and fines	200,535	219,518	215,826	(3,692)
Contributions, gifts and grants	23,623	161,422	154,756	(6,666)
Miscellaneous	76,702	98,591	88,908	(9,683)
Universities	742,562	818,115	785,667	(32,448)
Total Revenues	24,549,712	27,404,798	26,708,856	(695,942)
Expenditures:				
Current:				
General government	639,974	467,894	454,517	13,377
Primary and secondary education	7,010,488	7,563,598	7,184,184	379,414
Higher education	862,141	929,360	885,600	43,760
Health and human services	11,211,034	12,990,297	12,670,230	320,067
Environment and natural resources	305,567	363,137	327,834	35,303
Economic development	130,677	199,244	193,035	6,209
Public safety, corrections, and regulation	1,552,054	2,031,323	1,822,305	209,018
Transportation	11,430	11,430	11,165	265
Agriculture	70,261	81,660	75,894	5,766
Capital outlay	27,601	27,601	27,601	—
Debt service	403,286	390,179	385,385	4,794
Universities	2,522,757	2,626,852	2,566,517	60,335
Total Expenditures	24,747,270	27,682,575	26,604,267	1,078,308
Excess revenues over (under) expenditures	(197,558)	(277,777)	104,589	382,366
Transfers from reserves	108,797	108,797	188,184	79,387
Transfers to reserves	—	—	(253,938)	(253,938)
Unreserved fund balances (budgetary basis) at July 1, 2003	250,544	250,544	250,544	—
Unreserved fund balances (budgetary basis) at June 30, 2004	$ 161,783	$ 81,564	$ 289,379	$ 207,815

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

BUDGETARY REPORTING

A. General Fund Budgetary Process

The State of North Carolina operates on a biennial budget cycle with separate annual departmental certified budgets adopted by the General Assembly on the cash basis of accounting for the General Fund.

The accompanying budgetary comparison schedule discloses the annual original budget and final budget for the General Fund. Actual amounts in the schedule are presented on the budgetary basis. Since the budgetary basis differs from generally accepted accounting principles (GAAP), a reconciliation between the budgetary basis and the GAAP basis is presented in section C below.

The legal level of budgetary control is essentially at the object level. However, departments and institutions may make changes at their discretion within the budget of each purpose between and among objects for supplies and materials, current obligations and services, fixed charges and other expenses, and capital outlay. Also, Chapter 116, Article 1, Part 2A of the General Statutes authorized the sixteen universities within the University of North Carolina System to apply for special responsibility status, which sets the legal level of budgetary control at the institution's budget code level. A budget code is a convention used in the State's accounting system to distinguish the type of fund and the responsible department or institution. Budget codes are also used to segregate certain purposes within departments or institutions. Institutions with special responsibility status must still have certain budget revisions, primarily those associated with unanticipated revenues, approved by the Office of State Budget and Management (OSBM). Additionally, universities must maintain programs and services in accordance with the guidelines established by the Board of Governors of the consolidated University of North Carolina System. All sixteen universities have applied for and received special responsibility status.

Generally, unexpended appropriations at the end of the fiscal year lapse and are reappropriated in the next fiscal year. However, in certain circumstances the OSBM will allow a department to carry forward appropriations for specifically identified expenditures that will be paid in the next fiscal year. This is accomplished by the department writing a check to itself and recording a budgetary expenditure. The check is deposited in the next fiscal year as a budgetary receipt.

A detailed listing of appropriation and departmental budget information is available for public inspection in the separately published "Budgetary Compliance Report" prepared by the Office of the State Controller, 3512 Bush Street, Raleigh, NC 27609-7509 and through the Office of State Budget and Management, 116 West Jones Street, Raleigh, NC 27603-8005.

B. Special Fund Budgetary Process

The major special revenue funds, which are the Highway Fund and Highway Trust Fund, do not have annual appropriated budgets.

C. Reconciliation of Budget/GAAP Reporting Differences

The *Schedule of Revenues, Expenditures and Changes in Unreserved Fund Balances – Budget and Actual (Budgetary Basis – Non-GAAP) – General Fund*, presents comparisons of the legally adopted budget (which is more fully described in section A, above) with actual data on a budgetary basis. Accounting principles applied to develop data on a budgetary basis differ significantly from those principles used to present financial statements in conformity with generally accepted accounting principles (GAAP). The following describes the major differences between budgetary financial data and GAAP financial data.

Entity differences. Certain funds not included in the annual budgetary statements but which have the characteristics of governmental funds are presented in the General Fund for GAAP purposes.

Basis differences. Budgetary funds are accounted for on the cash basis of accounting, while under GAAP the governmental funds use the modified accrual basis. Accrued revenues and expenditures are recognized in the GAAP financial statements.

Timing differences. A significant variance between budgetary practices and GAAP is the authorized carryforward of appropriated funds, which is described in section A.

The following table presents a reconciliation of resulting entity, basis, and timing differences in the fund balances (budgetary basis) at June 30, 2004 to the fund balances on a modified accrual basis (GAAP). Amounts are expressed in thousands.

Notes to Required Supplemental Information

	General Fund
Unreserved fund balance (budgetary basis), June 30, 2004	$ 289,379
Reserved fund balance (budgetary basis),	
Savings	267,057
Repairs and renovation	76,797
Budgetary shortfall	11,732
Disproportionate share	1,511
Disaster relief	8,143
One North Carolina fund	1,083
Retirees' health premium	52,785
Fund balance (budgetary basis)	$ 708,487
Reconciling Adjustments:	
Entity Differences:	
Primary government:	
Other	190,456
Basis Differences:	
Accrued revenues:	
Taxes receivable	759,276
Accounts receivable	298,643
Federal funds, net	522,919
Other receivables	124,875
Less:	
Tax refunds payable	(1,056,880)
Deferred revenue	(586,920)
Total accrued revenues	61,913
Accrued expenditures:	
Medical claims payable	(740,093)
Accounts payable and accrued liabilities	(493,091)
Other payables	(163,430)
Total accrued expenditures	(1,396,614)
Other Adjustments:	
Notes receivable	1,240
Inventories	54,689
Investments	57
Timing Differences:	
Authorized carryforward for specific encumbrances	31,987
Authorized carryforward for designated programs	151,498
Fund balance (GAAP basis) June 30, 2004	($196,287)

D. Budgetary Reserves

The North Carolina General Assembly has established several accounts in the General Fund as reserved fund balances for budgetary purposes. Funds that are transferred to these accounts from the unreserved credit balance of the General Fund can be used only for their intended purposes and on a budgetary basis are not available for appropriation.

Savings Reserve Account (G.S. 143-15.2 through 143-15.3B). One-fourth of any unreserved credit balance (budgetary basis) remaining in the General Fund at the end of each fiscal year will be transferred to the Savings Reserve account until the account contains funds equal to 5% of the amount appropriated the preceding year for the General Fund operating budget. Session Law 2004-88, House Bill 1352, Section 8(a) directs the State Controller for the 2003-2004 fiscal year, not to transfer funds from the unreserved credit balance to the Savings Reserve. However, in accordance with Session Law 2004-124, House Bill 1414, Section 2.2(a), $116.7 million was transferred to the Savings Reserve Account from the unreserved credit balance on June 30, 2004. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $267.1 million.

Retirees' Health Premiums Reserve. This reserve account was established to receive and temporarily retain employer contributions for retirees' health insurance premiums made by all State agencies and universities and by local governments that have employees who are members of the State Health Plan. Since a significant portion of the funding for this account is from sources outside the reporting entity and legally restricted for a specific future use, it is reported as reserved fund balance for GAAP purposes. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $52.8 million.

Repairs and Renovations Reserve Account (G.S. 143-15.2 through 143-15.3B). This reserve account provides for a portion of the State's continuing capital needs. The reserve balance is based on 3% of the estimated replacement value of all State buildings supported from the General Fund. The funds in this account shall be used only for the repair and renovation of State facilities and related infrastructure that are supported from the General Fund. Session Law 2004-88, House Bill 1352, Section 8(b) directs the State Controller for the 2003-2004 fiscal year, not to transfer funds from the unreserved credit balance to the Repair and Renovations Reserve Account. However, in accordance with Session Law 2004-184, Senate Bill 3, Section 1 and 2.2(f) the State Controller was directed to transfer $76.8 million from the unreserved credit balance to the Repairs and Renovations Reserve Account on June 30, 2004. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $76.8 million.

Disproportionate Share Reserve Account (1997 General Assembly, Senate Bill 352, Section 11). Disproportionate share payments are Medicaid payments made to hospitals which serve a disproportionate share of indigent patients. This account was established to reserve for future appropriation any excess collection of disproportionate share revenues above those budgeted as departmental receipts or non-tax revenues. As the fiscal year 2003-2004 actual collection of disproportionate share revenue of $97.1 million was less than the budgeted amount of $100 million, no funds were transferred to this reserve in fiscal year 2003-2004. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $1.5 million.

Disaster Relief Reserve. The 1996 Second Extra Session, Section 7.9, Chapter 18 of House Bill 53 authorized the Director of Budget to create the Disaster Relief Reserve. During fiscal year 2003-2004 $31.8 million was transferred to the Disaster Relief Reserve to fund recovery from the effects of Hurricane Isabel. This $31.8 million was funded from required agency, university, and community college transfers. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $8.1 million.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

Easley Executive Order No. 22 Reserve. On June 27, 2002, Governor Easley signed Executive Order Number 22. This executive order became effective July 1, 2002 and ordered that the Office of State Budget and Management (OSBM), as directed by the Governor, take any steps necessary to insure that a deficit not be incurred for the fiscal year 2002-03. Therefore, in anticipation of total expenditures exceeding total receipts for fiscal year 2003-03, the Governor directed the transfer of the Disaster Relief Reserve balance to the Easley Executive Order No. 22 Reserve. During the fiscal year 2003-2004 transfers in the amount of $108.8 million to General Fund availability and $40 million to fund disaster relief programs were made from this reserve. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $11.7 million.

One North Carolina Fund Reserve. Section 12.4(d) of Session Law 2003-284 states that funds appropriated to the One North Carolina Industrial Recruitment Competitive Fund for fiscal year 2002-2003 that are unexpended and unencumbered as of June 30, 2003 shall not revert to the General Fund and shall remain available for future use. However, funds in the One North Carolina Industrial Recruitment Competitive Fund for fiscal year 2002-2003 were not carried forward to fiscal year 2003-2004 due to credit balance funds that were budgeted by the General Assembly for fiscal year 2003-2004. The Office of State Budget and Management, after consultation with Joint Legislative Commission on Governmental Operations on November 4, 2003, established the One North Carolina Reserve. This reserve was funded by a transfer from the unexpended legislative increase appropriation of $1.5 million. During the fiscal year 2003-2004 $400 thousand was expended to satisfy contractual obligations of the One North Carolina Reserve. At the end of the fiscal year 2003-2004 the remaining balance of this reserve was $1.1 million.

The following schedule summarizes current year changes in the budgetary reserve accounts. Amounts are expressed in thousands.

General Fund Reserved Fund Balance	Balance June 30, 2003	Transfers from General Fund Unreserved Fund Balance	Transfers to General Fund Unreserved Fund Balance	Balance June 30, 2004
Savings	$ 150,000	$ 117,057	$ —	$ 267,057
Retirees' health premium	26,314	26,471	—	52,785
Repairs and renovations	15,000	76,797	(15,000)	76,797
Disproportionate share	1,511	—	—	1,511
Disaster relief	—	31,809	(23,666)	8,143
Executive order #22	160,529	—	(148,797)	11,732
One North Carolina fund	—	1,804	(721)	1,083
Total	$ 353,354	$ 253,938	$ (188,184)	$ 419,108

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Combining Fund Statements and Schedules

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NONMAJOR GOVERNMENTAL FUNDS

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS

June 30, 2004 *Exhibit C-1*

(Dollars in Thousands)

	Special Revenue Funds	Capital Projects Funds	Permanent Funds	*Total Nonmajor Governmental Funds*
ASSETS				
Cash and cash equivalents	$ 1,921,581	$ 300,205	$ 438	$ 2,222,224
Investments	477,761	—	—	477,761
Securities lending collateral	792,821	—	31,035	823,856
Receivables, net:				
Taxes receivable	4,646	—	—	4,646
Accounts receivable	23,903	196	—	24,099
Intergovernmental receivable	6,035	2,312	—	8,347
Interest receivable	5,154	—	4	5,158
Due from fiduciary funds	1	—	—	1
Due from other funds	148,808	443	—	149,251
Due from component units	6,082	—	—	6,082
Inventories	28,874	—	—	28,874
Prepaid items	132	—	—	132
Advances to component units	24,242	—	—	24,242
Notes receivable, net	281,301	—	—	281,301
Securities held in trust	37,215	—	—	37,215
Endowment investments	—	—	55,211	55,211
Total Assets	$ 3,758,556	$ 303,156	$ 86,688	$ 4,148,400
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable and accrued liabilitie				
Accounts payable	$ 77,764	$ 20,088	$ —	$ 97,852
Accrued payroll	846	25	—	871
Intergovernmental payable	5,326	512	—	5,838
Claims payable	27,590	—	—	27,590
Obligations under securities lending	792,821	—	31,035	823,856
Due to fiduciary funds	47	—	—	47
Due to other funds	144,785	42	—	144,827
Due to component units	268,758	—	—	268,758
Deferred revenue	14,153	—	—	14,153
Deposits payable	8	859	—	867
Funds held for others	37,320	—	—	37,320
Total Liabilities	1,369,418	21,526	31,035	1,421,979
Fund Balances:				
Reserved	449,521	171,235	53,273	674,029
Unreserved	1,939,617	110,395	2,380	2,052,392
Total Fund Balances	2,389,138	281,630	55,653	2,726,421
Total Liabilities and Fund Balances	$ 3,758,556	$ 303,156	$ 86,688	$ 4,148,400

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR GOVERNMENTAL FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit C-2*

(Dollars in Thousands)

	Special Revenue Funds	Capital Projects Funds	Permanent Funds	*Total Nonmajor Governmental Funds*
Revenues:				
Taxes:				
Individual income tax	$ 493	$ —	$ —	$ 493
Corporate income tax	60,120	—	—	60,120
Sales and use tax	23,366	—	—	23,366
Gasoline tax	30,324	—	—	30,324
Insurance tax	9,570	—	—	9,570
Other taxes	132,758	—	—	132,758
Federal funds	323,364	12,680	—	336,044
Local funds	16,521	—	—	16,521
Investment earnings	34,052	1,086	(297)	34,841
Interest earnings on loans	5,801	—	—	5,801
Sales and services	132,522	64	87	132,673
Rental and lease of property	3,119	38	—	3,157
Fees, licenses, and fines	186,307	—	1,945	188,252
Contributions, gifts, and grants	36,113	63,467	36	99,616
Funds escheated	55,330	—	—	55,330
Miscellaneous	29,069	684	—	29,753
Total revenues	1,078,829	78,019	1,771	1,158,619
Expenditures:				
Current:				
General government	46,720	—	—	46,720
Primary and secondary education	174,784	—	—	174,784
Higher education	649,912	6,779	3	656,694
Health and human services	74,647	—	2	74,649
Economic development	349,889	—	—	349,889
Environment and natural resources	352,085	—	355	352,440
Public safety, corrections, and regulation	345,028	127	—	345,155
Agriculture	8,075	—	—	8,075
Capital outlay	—	385,506	—	385,506
Debt service:				
Principal retirement	290	—	—	290
Interest and fees	913	—	—	913
Debt issuance costs	810	2,822	—	3,632
Total expenditures	2,003,153	395,234	360	2,398,747
Excess revenues over (under) expenditures	(924,324)	(317,215)	1,411	(1,240,128)
Other Financing Sources (Uses):				
Bonds issued	759,155	218,405	—	977,560
Certificates of participation issued	125,000	158,955	—	283,955
Premium on debt issued	63,633	20,037	—	83,670
Sale of capital assets	2,186	31	—	2,217
Transfers in	626,618	92,022	—	718,640
Transfers out	(385,802)	(7,345)	(5,673)	(398,820)
Total other financing sources (uses)	1,190,790	482,105	(5,673)	1,667,222
Net change in fund balances	266,466	164,890	(4,262)	427,094
Fund balances — July 1, as restated	2,117,996	116,740	59,915	2,294,651
Increase (decrease) in reserve for related assets	4,676	—	—	4,676
Fund balances — June 30	$ 2,389,138	$ 281,630	$ 55,653	$ 2,726,421

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Nonmajor Special Revenue Funds

The special revenue funds are maintained to account for those financial resources which are restricted by legal, regulatory or administrative action to finance particular functions or activities of the State.

The following are included in the nonmajor special revenue funds:

Escheat Fund
Health and Wellness Trust Fund
Tobacco Trust Fund
Clean Water Funds
Public School Bond Fund
Higher Education and Public Improvement Bond Funds
Public School Building Capital Fund
Clean Water Management Trust Fund
NC Infrastructure Finance Corporation
Natural Gas Funds
Prison Enterprises Fund
Educational Materials and School Buses Fund
Employment Security Commission Funds
Highway Patrol Fund
Employment and Training Administration Fund
Leaking Petroleum Underground Storage Tank Cleanup Fund
Wetlands Restoration Funds
Wildlife Resources Commission Fund
Natural Heritage Trust Fund
Wireless 911 Fund
Parks and Recreation Trust Fund
Departmental Funds

COMBINING BALANCE SHEET
NONMAJOR SPECIAL REVENUE FUNDS

June 30, 2004

(Dollars in Thousands)

	Escheat Fund	Health and Wellness Trust Fund	Tobacco Trust Fund	Clean Water Funds	Public School Bond Fund	Higher Education and Public Improvement Bond Funds	Public School Building Capital Fund	Clean Water Management Trust Fund
ASSETS								
Cash and cash equivalents	$ 44,080	$ 91,882	$ 6,444	$ 61,111	$ 30,454	$ 787,336	$ 74,714	$ 105,767
Investments	473,930	—	—	—	—	—	—	—
Securities lending collateral	288,010	69,334	4,862	28,942	—	—	75,834	79,909
Receivables, net:								
Taxes receivable	—	—	—	—	—	—	—	—
Accounts receivable	—	—	16	—	—	75	—	—
Intergovernmental receivable	—	—	—	—	—	—	—	—
Interest receivable	109	234	—	789	22	675	244	254
Due from fiduciary funds	—	—	—	—	—	—	—	—
Due from other funds	—	—	—	—	—	138,347	—	—
Due from component units	5,774	—	—	—	—	—	—	—
Inventories	—	—	—	—	—	—	—	—
Prepaid items	—	—	—	—	—	—	—	—
Advances to component units	24,242	—	—	—	—	—	—	—
Notes receivable, net	—	—	—	116,908	—	—	—	—
Securities held in trust	—	—	—	—	—	—	—	—
Total Assets	$ 836,145	$ 161,450	$ 11,322	$ 207,750	$ 30,476	$ 926,433	$ 150,792	$ 185,930
LIABILITIES AND FUND BALANCES								
Liabilities:								
Accounts payable and accrued liabilities								
Accounts payable	$ 70	$ 594	$ 1	$ —	$ —	$ —	$ —	$ 282
Accrued payroll	—	—	—	—	—	—	—	—
Intergovernmental payable	—	—	—	51	—	—	—	175
Claims payable	27,590	—	—	—	—	—	—	—
Obligations under securities lending	288,010	69,334	4,862	28,942	—	—	75,834	79,909
Due to fiduciary funds	—	—	—	—	—	—	—	—
Due to other funds	—	1	—	—	—	138,347	—	8
Due to component units	36,356	—	—	—	—	231,766	—	—
Deferred revenue	8,442	—	—	—	—	—	—	—
Deposits payable	—	—	—	—	—	—	—	—
Funds held for others	—	—	—	—	—	—	—	—
Total Liabilities	360,468	69,929	4,863	28,993	—	370,113	75,834	80,374
Fund Balances:								
Reserved for:								
Inventories	—	—	—	—	—	—	—	—
Investments	—	—	—	—	—	—	—	—
Notes receivable	—	—	—	116,908	—	—	—	—
Prepaid items	—	—	—	—	—	—	—	—
Capital projects	—	—	—	—	—	—	—	—
Loan and grant commitments	—	—	—	15,215	—	—	—	64,416
Other purposes	—	—	—	—	—	—	—	—
Unreserved:								
Undesignated	475,677	91,521	6,459	46,634	30,476	556,320	74,958	41,140
Total Fund Balances	475,677	91,521	6,459	178,757	30,476	556,320	74,958	105,556
Total Liabilities and Fund Balances	$ 836,145	$ 161,450	$ 11,322	$ 207,750	$ 30,476	$ 926,433	$ 150,792	$ 185,930

Exhibit C-3

NC Infrastructure Finance Corporation	Natural Gas Funds	Prison Enterprises Fund	Educational Materials and School Buses Fund	Employment Security Commission Funds	Highway Patrol Fund	Employment and Training Administration Fund	Leaking Petroleum Underground Storage Tank Cleanup Fund	Wetlands Restoration Funds
$ 122,669	$ 69,010	$ 20,888	$ 60,608	$ 13,963	$ 13,180	$ 37	$ 4,713	$ 52,231
—	—	—	—	—	—	—	—	—
—	52,066	—	—	—	2,314	—	2,919	36,773
—	—	—	—	—	—	—	3,194	—
—	—	1,683	172	832	691	1	31	36
—	—	848	1,374	738	—	—	—	—
—	163	—	—	—	—	—	7	117
—	—	1	—	—	—	—	—	—
—	—	7,154	—	—	5	—	—	—
—	—	58	—	—	—	—	—	—
—	—	11,962	8,335	315	4,022	—	—	—
—	—	—	—	132	—	—	—	—
—	—	—	—	—	—	—	—	—
—	140,618	—	—	—	—	—	795	—
—	—	—	—	—	—	—	—	—
$ 122,669	$ 261,857	$ 42,594	$ 70,489	$ 15,980	$ 20,212	$ 38	$ 11,659	$ 89,157
$ —	$ 8,131	$ 3,385	$ 28,107	$ 3,859	$ 1,381	$ 14	$ 20,579	$ 1,334
—	—	32	—	188	105	—	—	—
—	—	—	28	286	—	—	8	—
—	—	—	—	—	—	—	—	—
—	52,066	—	—	—	2,314	—	2,919	36,773
—	—	—	—	—	—	—	—	—
—	—	103	—	624	112	3	3,000	11
—	—	—	—	—	—	—	—	—
—	—	20	—	—	663	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	60,197	3,540	28,135	4,957	4,575	17	26,506	38,118
—	—	11,962	8,335	315	4,022	—	—	—
—	—	—	—	—	—	—	—	—
—	140,618	—	—	—	—	—	795	—
—	—	—	—	132	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
122,669	61,042	27,092	34,019	10,576	11,615	21	(15,642)	51,039
122,669	201,660	39,054	42,354	11,023	15,637	21	(14,847)	51,039
$ 122,669	$ 261,857	$ 42,594	$ 70,489	$ 15,980	$ 20,212	$ 38	$ 11,659	$ 89,157

Continued

COMBINING BALANCE SHEET
NONMAJOR SPECIAL REVENUE FUNDS

June 30, 2004 — *Exhibit C-3*

(Dollars in Thousands)

	Wildlife Resources Commission Fund	Natural Heritage Trust Fund	Wireless 911 Fund	Parks and Recreation Trust Fund	Departmental Funds	*Total Nonmajor Special Revenue Funds*
ASSETS						
Cash and cash equivalents	$ 16,952	$ 15,344	$ 22,206	$ 28,506	$ 279,486	$ 1,921,581
Investments	—	—	—	—	3,831	477,761
Securities lending collateral	11,324	10,543	16,703	—	113,288	792,821
Receivables, net:						
Taxes receivable	—	—	—	—	1,452	4,646
Accounts receivable	482	354	5,779	116	13,635	23,903
Intergovernmental receivable	1,075	—	—	—	2,000	6,035
Interest receivable	30	32	51	—	2,427	5,154
Due from fiduciary funds	—	—	—	—	—	1
Due from other funds	—	—	—	—	3,302	148,808
Due from component units	—	—	—	—	250	6,082
Inventories	1,504	—	—	—	2,736	28,874
Prepaid items	—	—	—	—	—	132
Advances to component units	—	—	—	—	—	24,242
Notes receivable	—	—	—	—	22,980	281,301
Securities held in trust	—	—	—	—	37,215	37,215
Total Assets	$ 31,367	$ 26,273	$ 44,739	$ 28,622	$ 482,602	$ 3,758,556
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable and accrued liabilities						
Accounts payable	$ 860	$ —	$ 193	$ 1	$ 8,973	$ 77,764
Accrued payroll	206	—	—	—	315	846
Intergovernmental payable	—	—	3,662	—	1,116	5,326
Claims payable	—	—	—	—	—	27,590
Obligations under securities lending	11,324	10,543	16,703	—	113,288	792,821
Due to fiduciary funds	—	—	—	—	47	47
Due to other funds	250	—	1,473	443	410	144,785
Due to component units	—	—	—	—	636	268,758
Deferred revenue	—	—	—	—	5,028	14,153
Deposits payable	—	—	—	—	8	8
Funds held for others	—	—	—	—	37,320	37,320
Total Liabilities	12,640	10,543	22,031	444	167,141	1,369,418
Fund Balances:						
Reserved for:						
Inventories	1,504	—	—	—	2,736	28,874
Investments	—	—	—	—	14	14
Notes receivable	—	—	—	—	22,980	281,301
Prepaid items	—	—	—	—	—	132
Capital projects	—	—	—	—	6	6
Loan and grant commitments	—	8,768	—	11,418	5	99,822
Other purposes	17,223	—	—	—	22,149	39,372
Unreserved:						
Undesignated	—	6,962	22,708	16,760	267,571	1,939,617
Total Fund Balances	18,727	15,730	22,708	28,178	315,461	2,389,138
Total Liabilities and Fund Balances	$ 31,367	$ 26,273	$ 44,739	$ 28,622	$ 482,602	$ 3,758,556

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COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR SPECIAL REVENUE FUNDS

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Escheat Fund	Health and Wellness Trust Fund	Tobacco Trust Fund	Clean Water Funds	Public School Bond Fund	Higher Education and Public Improvement Bond Funds	Public School Building Capital Fund	Clean Water Management Trust Fund
Revenues:								
Taxes:								
Individual income tax	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Corporate income tax	—	—	—	—	—	—	57,620	—
Sales and use tax	—	—	—	—	—	—	—	—
Gasoline tax	—	—	—	—	—	—	—	—
Insurance tax	—	—	—	—	—	—	—	—
Other taxes	—	—	—	—	—	—	—	—
Federal funds	—	—	—	—	—	—	—	—
Local funds	—	—	—	—	—	—	—	—
Investment earnings	(61)	3,980	326	1,610	293	5,626	3,723	4,770
Interest earnings on loans	—	—	—	4,606	—	—	—	—
Sales and services	—	—	—	—	—	—	—	—
Rental and lease of property	—	—	—	—	—	—	—	—
Fees, licenses, and fines	—	—	—	—	—	—	—	—
Contributions, gifts, and grants	—	—	—	—	—	—	—	—
Funds escheated	55,330	—	—	—	—	—	—	—
Miscellaneous	3	—	—	—	—	—	—	—
Total revenues	55,272	3,980	326	6,216	293	5,626	61,343	4,770
Expenditures:								
Current:								
General government	6,189	—	—	—	15	278	—	—
Primary and secondary education	—	—	—	—	25,291	—	37,718	—
Higher education	36,356	—	—	—	—	612,120	—	—
Health and human services	—	9,866	—	—	—	—	—	—
Economic development	—	—	—	31,375	—	—	—	—
Environment and natural resources	—	—	—	57,671	—	—	—	75,097
Public safety, corrections, and regulation	—	—	—	—	—	—	—	—
Agriculture	—	—	2,967	—	—	—	—	—
Debt service:								
Principal retirement	—	—	—	—	—	—	—	—
Interest and fees	—	—	—	—	—	—	—	—
Debt issuance costs	—	—	—	—	—	—	—	—
Total expenditures	42,545	9,866	2,967	89,046	25,306	612,398	37,718	75,097
Excess revenues over (under) expenditures	12,727	(5,886)	(2,641)	(82,830)	(25,013)	(606,772)	23,625	(70,327)
Other Financing Sources (Uses):								
Bonds issued	—	—	—	15,255	—	707,900	—	—
Certificates of participation issued	—	—	—	—	—	—	—	—
Premium on debt issued	—	—	—	225	—	57,932	—	—
Sale of capital assets	—	—	—	—	—	—	—	—
Transfers in	—	37,645	37,627	84,995	28,301	—	110	60,760
Transfers out	(5,178)	(31,644)	(37,147)	(17,838)	(4,630)	(121,350)	(1,796)	(86)
Total other financing sources (uses)	(5,178)	6,001	480	82,637	23,671	644,482	(1,686)	60,674
Net change in fund balances	7,549	115	(2,161)	(193)	(1,342)	37,710	21,939	(9,653)
Fund balances — July 1, as restated	468,128	91,406	8,620	178,950	31,818	518,610	53,019	115,209
Increase (decrease) in reserve for related assets	—	—	—	—	—	—	—	—
Fund balances — June 30	$ 475,677	$ 91,521	$ 6,459	$ 178,757	$ 30,476	$ 556,320	$ 74,958	$ 105,556

Exhibit C-4

NC Infrastructure Finance Corporation	Natural Gas Funds	Prison Enterprises Fund	Educational Materials and School Buses Fund	Employment Security Commission Funds	Highway Patrol Fund	Employment and Training Administration Fund	Leaking Petroleum Underground Storage Tank Cleanup Fund	Wetlands Restoration Funds
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	19,799	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	159,062	3	89,488	—	—
—	—	—	—	14,593	158	—	—	—
40	2,447	—	—	—	97	—	168	1,968
—	—	—	—	—	—	—	15	—
—	—	75,562	5,223	—	787	—	—	—
—	—	—	1,467	—	—	—	—	—
—	—	—	—	3,888	1,780	—	5,673	54,492
—	—	—	—	6,972	586	—	—	—
—	—	—	—	—	—	—	—	—
—	—	513	—	1,032	214	2	—	—
40	2,447	76,075	6,690	185,547	3,625	89,490	25,655	56,460
244	—	—	—	—	—	—	—	—
—	—	—	76,666	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	9,004	—	—	190,680	—	89,453	—	—
—	—	—	—	—	—	—	35,305	44,253
—	—	70,942	—	—	162,026	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
810	—	—	—	—	—	—	—	—
1,054	9,004	70,942	76,666	190,680	162,026	89,453	35,305	44,253
(1,014)	(6,557)	5,133	(69,976)	(5,133)	(158,401)	37	(9,650)	12,207
—	36,000	—	—	—	—	—	—	—
125,000	—	—	—	—	—	—	—	—
5,406	70	—	—	—	—	—	—	—
—	—	171	460	—	1,296	—	—	—
—	—	291	75,086	8,862	163,598	—	6,058	—
(24,945)	(343)	(3,185)	(696)	(118)	(1,681)	(107)	(3,915)	(2,860)
105,461	35,727	(2,723)	74,850	8,744	163,213	(107)	2,143	(2,860)
104,447	29,170	2,410	4,874	3,611	4,812	(70)	(7,507)	9,347
18,222	172,490	35,163	34,897	7,384	10,992	91	(7,340)	41,692
—	—	1,481	2,583	28	(167)	—	—	—
$ 122,669	$ 201,660	$ 39,054	$ 42,354	$ 11,023	$ 15,637	$ 21	$ (14,847)	$ 51,039

Continued

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR SPECIAL REVENUE FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit C-4*

(Dollars in Thousands)

	Wildlife Resources Commission Fund	Natural Heritage Trust Fund	Wireless 911 Fund	Parks and Recreation Trust Fund	Departmental Funds	*Total Nonmajor Special Revenue Funds*
Revenues:						
Taxes:						
Individual income tax	$ —	$ —	$ —	$ —	$ 493	$ 493
Corporate income tax	—	—	—	—	2,500	60,120
Sales and use tax	15,039	—	—	—	8,327	23,366
Gasoline tax	1,525	—	—	—	9,000	30,324
Insurance tax	—	—	—	—	9,570	9,570
Other taxes	—	13,735	40,925	41,204	36,894	132,758
Federal funds	9,728	—	—	—	65,083	323,364
Local funds	216	—	—	—	1,554	16,521
Investment earnings	646	521	1,814	—	6,084	34,052
Interest earnings on loans	—	—	—	—	1,180	5,801
Sales and services	2,869	—	388	—	47,693	132,522
Rental and lease of property	20	—	—	—	1,632	3,119
Fees, licenses, and fines	18,352	3,195	—	622	98,305	186,307
Contributions, gifts, and grants	1,063	—	—	—	27,492	36,113
Funds escheated	—	—	—	—	—	55,330
Miscellaneous	109	—	—	—	27,196	29,069
Total revenues	49,567	17,451	43,127	41,826	343,003	1,078,829
Expenditures:						
Current:						
General government	—	—	—	—	39,994	46,720
Primary and secondary education	—	—	—	—	35,109	174,784
Higher education	—	—	—	—	1,436	649,912
Health and human services	—	—	—	—	64,781	74,647
Economic development	—	—	—	—	29,377	349,889
Environment and natural resources	50,385	11,326	—	23,766	54,282	352,085
Public safety, corrections, and regulation	—	—	35,422	—	76,638	345,028
Agriculture	—	—	—	—	5,108	8,075
Debt service:						
Principal retirement	290	—	—	—	—	290
Interest and fees	913	—	—	—	—	913
Debt issuance costs	—	—	—	—	—	810
Total expenditures	51,588	11,326	35,422	23,766	306,725	2,003,153
Excess revenues over (under) expenditures	(2,021)	6,125	7,705	18,060	36,278	(924,324)
Other Financing Sources (Uses):						
Bonds issued	—	—	—	—	—	759,155
Certificates of participation issued	—	—	—	—	—	125,000
Premium on debt issued	—	—	—	—	—	63,633
Sale of capital assets	117	—	—	—	142	2,186
Transfers in	3,124	200	—	—	119,961	626,618
Transfers out	(1,974)	(297)	(35,588)	(2,233)	(88,191)	(385,802)
Total other financing sources (uses)	1,267	(97)	(35,588)	(2,233)	31,912	1,190,790
Net change in fund balances	(754)	6,028	(27,883)	15,827	68,190	266,466
Fund balances — July 1, as restated	19,061	9,702	50,591	12,351	246,940	2,117,996
Increase (decrease) in reserve for related assets	420	—	—	—	331	4,676
Fund balances — June 30	$ 18,727	$ 15,730	$ 22,708	$ 28,178	$ 315,461	$ 2,389,138

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COMBINING SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP) NONMAJOR SPECIAL REVENUE FUNDS

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Employment and Training Administration Fund				Clean Water Funds			
	Budgeted Amounts			*Variance with Final Budget*	*Budgeted Amounts*			*Variance with Final Budget*
Revenues:	*Original*	*Final*	*Actual*		*Original*	*Final*	*Actual*	
Departmental:								
Federal funds	$ 78,802	$ 176,730	$ 89,494	$ (87,236)	$ —	$ —	$ —	$ —
Local funds	—	—	—	—	—	—	—	—
Inter-agency grants and allocations	—	—	—	—	—	—	—	—
Intra-governmental transactions	12	16	2	(14)	1,950	320	320	—
Sales and services	—	—	—	—	—	—	—	—
Sale, rental and lease of property	—	—	—	—	—	—	—	—
Fees, licenses and fines	—	—	—	—	—	—	—	—
Contributions, gifts and grants	—	—	—	—	—	—	—	—
Miscellaneous	—	—	2	2	—	40	473	433
Total revenues	78,814	176,746	89,498	(87,248)	1,950	360	793	433
Expenditures:								
Current:								
General government	—	—	—	—	—	—	—	—
Health and human services	—	—	—	—	—	—	—	—
Environment and natural resources	—	—	—	—	—	—	—	—
Economic development	78,814	176,831	89,586	87,245	3,378	6,255	2,008	4,247
Public safety and corrections	—	—	—	—	—	—	—	—
Debt service:								
Principal retirement	—	—	—	—	—	—	—	—
Interest and fees	—	—	—	—	—	—	—	—
Total expenditures	78,814	176,831	89,586	87,245	3,378	6,255	2,008	4,247
Excess revenues over (under) expenditures	$ —	$ (85)	(88)	$ (3)	$ (1,428)	$ (5,895)	(1,215)	$ 4,680
Unreserved fund balances (budgetary basis) at July 1, 2003			88				8,755	
Restatements			—				—	
Unreserved fund balances (budgetary basis) at June 30, 2004			$ —				$ 7,540	

Exhibit C-5

Employment Security Commission Funds				Highway Patrol Fund			
Budgeted Amounts			**Variance with Final**	**Budgeted Amounts**			**Variance with Final**
Original	**Final**	**Actual**	*Budget*	**Original**	**Final**	**Actual**	*Budget*
$ 118,314	$ 159,306	$ 158,984	$ (322)	$ —	$ 1,720	$ 3	$ (1,717)
8,600	15,195	15,194	(1)	—	158	158	—
2,715	6,788	6,787	(1)	—	1,227	549	(678)
30,287	20,072	20,071	(1)	137,523	181,359	163,972	(17,387)
—	—	—	—	1,544	1,582	802	(780)
—	—	—	—	3,384	3,384	1,470	(1,914)
—	—	—	—	—	—	737	737
—	—	—	—	—	35	39	4
1,550	1,205	1,205	—	1	1	20	19
161,466	202,566	202,241	(325)	142,452	189,466	167,750	(21,716)
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
161,466	202,566	202,550	16	—	—	—	—
—	—	—	—	142,452	189,466	165,805	23,661
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
161,466	202,566	202,550	16	142,452	189,466	165,805	23,661
$ —	$ —	(309)	$ (309)	$ —	$ —	1,945	$ 1,945
		3,185				8,422	
		—				—	
		$ 2,876				$ 10,367	

Continued

COMBINING SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP) NONMAJOR SPECIAL REVENUE FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit C-5*

(Dollars in Thousands)

	Wildlife Resources Commission Fund				Departmental Funds			
	Budgeted Amounts			*Variance with Final Budget*	*Budgeted Amounts*			*Variance with Final Budget*
Revenues:	*Original*	*Final*	*Actual*		*Original*	*Final*	*Actual*	
Departmental:								
Federal funds	7,415	$ 9,754	$ 9,497	$ (257)	$ 44,804	$ 125,544	$ 67,987	$ (57,557)
Local funds	—	215	215	—	110	$ 160	11	(149)
Inter-agency grants and allocations	266	876	643	(233)	1,270	6,308	1,660	(4,648)
Intra-governmental transactions	36,206	42,109	42,222	113	71,050	117,858	112,224	(5,634)
Sales and services	1,497	1,996	2,866	870	4,655	4,618	2,536	(2,082)
Sale, rental and lease of property	208	126	138	12	87	87	106	19
Fees, licenses and fines	17,217	18,207	18,214	7	76,720	84,205	75,433	(8,772)
Contributions, gifts and grants	27	172	92	(80)	444	3,229	406	(2,823)
Miscellaneous	28	100	627	527	1,212	1,716	2,618	902
Total revenues	62,864	73,555	74,514	959	200,352	343,725	262,981	(80,744)
Expenditures:								
Current:								
General government	—	—	—	—	56,728	138,301	64,335	73,966
Health and human services	—	—	—	—	44,198	45,711	45,093	618
Environment and natural resources	63,256	77,380	74,103	3,277	38,955	53,331	36,504	16,827
Economic development	—	—	—	—	29,222	60,150	29,579	30,571
Public safety and corrections	—	—	—	—	31,124	38,524	37,691	833
Debt service								
Principal retirement	—	290	290	—	—	—	—	—
Interest and fees	—	913	913	—	—	—	—	—
Total expenditures	63,256	78,583	75,306	3,277	200,227	336,017	213,202	122,815
Excess revenues over (under) expenditures	$ (392)	$ (5,028)	(792)	$ 4,236	$ 125	$ 7,708	49,779	$ 42,071
Unreserved fund balances (budgetary basis) at July 1, 2003			17,743				94,441	
Restatements			—				306	
Unreserved fund balances (budgetary basis) at June 30, 2004			$ 16,951				$ 144,526	

Exhibit C-5

Totals - Budgeted Special Revenue Funds			
Budgeted Amounts			Variance with Final
Original	Final	Actual	Budget
$ 249,335	$ 473,054	$ 325,965	$ (147,089)
8,710	15,728	15,578	(150)
4,251	15,199	9,639	(5,560)
277,028	361,734	338,811	(22,923)
7,696	8,196	6,204	(1,992)
3,679	3,597	1,714	(1,883)
93,937	102,412	94,384	(8,028)
471	3,436	537	(2,899)
2,791	3,062	4,945	1,883
647,898	986,418	797,777	(188,641)
56,728	138,301	64,335	73,966
44,198	45,711	45,093	618
102,211	130,711	110,607	20,104
272,880	445,802	323,723	122,079
173,576	227,990	203,496	24,494
—	290	290	—
—	913	913	—
# 649,593	989,718	748,457	241,261
$ (1,695)	$ (3,300)	49,320	$ 52,620
		132,634	
		306	
		$ 182,260	

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Nonmajor Capital Projects Funds

The Capital Projects funds are maintained to account for those financial resources received and used for the acquisition, construction or improvement of major governmental general fixed assets which are financed principally by transfers from the General Fund or general obligation bonds.

The following activities are included in the nonmajor capital projects funds:

Capital Projects Fund
State Capital Facilities Legislative Bond Fund of 1991
State Prison and Youth Services Facilities Bond Fund
NC Infrastructure Finance Corporation

COMBINING BALANCE SHEET
NONMAJOR CAPITAL PROJECTS FUNDS

June 30, 2004 *Exhibit C-6*

(Dollars in Thousands)

	Capital Projects Fund	State Capital Facilities Legislative Bond Fund of 1991	State Prison and Youth Services Facilities Bond Fund	NC Infrastructure Finance Corporation	*Total Nonmajor Capital Projects Funds*
ASSETS					
Cash and cash equivalents	$ 127,891	$ —	$ —	$ 172,314	$ 300,205
Receivables, net:					
Accounts receivable	196	—	—	—	196
Intergovernmental receivable	2,312	—	—	—	2,312
Due from other funds	443	—	—	—	443
Total Assets	$ 130,842	$ —	$ —	$ 172,314	$ 303,156
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable and accrued liabilities					
Accounts payable	$ 6,866	$ —	$ —	$ 13,222	$ 20,088
Accrued payroll	25	—	—	—	25
Intergovernmental payable	512	—	—	—	512
Due to other funds	42	—	—	—	42
Deposits payable	859	—	—	—	859
Total Liabilities	8,304	—	—	13,222	21,526
Fund Balances:					
Reserved for:					
Capital projects	28,607	—	—	142,628	171,235
Unreserved:					
Undesignated	93,931	—	—	16,464	110,395
Total Fund Balances	122,538	—	—	159,092	281,630
Total Liabilities and Fund Balances	$ 130,842	$ —	$ —	$ 172,314	$ 303,156

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR CAPITAL PROJECTS FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit C-7*

(Dollars in Thousands)

	Capital Projects Fund	State Capital Facilities Legislative Bond Fund of 1991	State Prison and Youth Services Facilities Bond Fund	NC Infrastructure Finance Corporation	*Total Nonmajor Capital Projects Funds*
Revenues:					
Federal funds	$ 12,630	$ —	$ —	$ 50	$ 12,680
Investment earnings	—	—	23	1,063	1,086
Sales and services	64	—	—	—	64
Rental and lease of property	38	—	—	—	38
Contributions, gifts, and grants	63,467	—	—	—	63,467
Miscellaneous	684	—	—	—	684
Total revenues	76,883	—	23	1,113	78,019
Expenditures:					
Current:					
Higher education	—	—	—	6,779	6,779
Public safety, corrections, and regulation	—	—	127	—	127
Capital outlay	128,871	—	—	256,635	385,506
Debt service:					
Debt issuance costs	—	—	—	2,822	2,822
Total expenditures	128,871	—	127	266,236	395,234
Excess revenues over (under) expenditures	(51,988)	—	(104)	(265,123)	(317,215)
Other Financing Sources (Uses):					
Bonds issued	—	—	—	218,405	218,405
Certificates of participation issued	—	—	—	158,955	158,955
Premium on debt issued	—	—	—	20,037	20,037
Sale of capital assets	31	—	—	—	31
Transfers in	63,619	—	—	28,403	92,022
Transfers out	(2,837)	(3)	(2,724)	(1,781)	(7,345)
Total other financing sources (uses)	60,813	(3)	(2,724)	424,019	482,105
Net change in fund balances	8,825	(3)	(2,828)	158,896	164,890
Fund balances — July 1	113,713	3	2,828	196	116,740
Fund balances — June 30	$ 122,538	$ —	$ —	$ 159,092	$ 281,630

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Nonmajor Permanent Funds

Permanent funds should be used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs—that is, for the benefit of the government or its citizenry.

The following are included in nonmajor permanent funds:

Wildlife Endowment Fund
Departmental Funds

COMBINING BALANCE SHEET
NONMAJOR PERMANENT FUNDS

June 30, 2004 *Exhibit C-8*

(Dollars in Thousands)

	Wildlife Endowment Fund	Departmental Funds	*Total Nonmajor Permanent Funds*
ASSETS			
Cash and cash equivalents	$ 195	$ 243	$ 438
Receivables, net:			
Interest receivable	3	1	4
Securities lending collateral	30,852	183	31,035
Endowment investments	54,636	575	55,211
Total Assets	$ 85,686	$ 1,002	$ 86,688
LIABILITIES AND FUND BALANCES			
Liabilities:			
Obligations under securities lending	30,852	183	31,035
Total Liabilities	30,852	183	31,035
Fund Balances:			
Reserved for:			
Wildlife endowment	52,520	—	52,520
Loan and grant commitments	—	753	753
Unreserved:			
Undesignated	2,314	66	2,380
Total Fund Balances	54,834	819	55,653
Total Liabilities and Fund Balances	$ 85,686	$ 1,002	$ 86,688

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR PERMANENT FUNDS

For the Fiscal Year Ended June 30, 2004

Exhibit C-9

(Dollars in Thousands)

	Wildlife Endowment Fund	Departmental Funds	*Total Nonmajor Permanent Funds*
Revenues:			
Investment earnings	$ (302)	$ 5	$ (297)
Sales and services	87	—	87
Fees, licenses, and fines	1,945	—	1,945
Contributions, gifts, and grants	36	—	36
Total revenues	1,766	5	1,771
Expenditures:			
Current:			
Higher education	—	3	3
Health and human services	—	2	2
Environment and natural resources	355	—	355
Total expenditures	355	5	360
Excess revenues over (under) expenditures	1,411	—	1,411
Other Financing Sources (Uses):			
Transfers out	(5,673)	—	(5,673)
Total other financing sources (uses)	(5,673)	—	(5,673)
Net change in fund balances	(4,262)	—	(4,262)
Fund balances — July 1	59,096	819	59,915
Fund balances — June 30	$ 54,834	$ 819	$ 55,653

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PROPRIETARY FUNDS

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Nonmajor Enterprise Funds

Enterprise funds may be used to report any activity for which a fee is charged to external users for goods or services.

The following activities are included in the nonmajor enterprise funds:

Public School Insurance
Town of Butner Water and Sewer
North Carolina State Fair
USS North Carolina Battleship Commission
Agricultural Farmers Market
Workers' Compensation
Departmental Funds

COMBINING STATEMENT OF NET ASSETS
NONMAJOR ENTERPRISE FUNDS

June 30, 2004 *Exhibit D-1*

(Dollars in Thousands)

	Public School Insurance	Town of Butner Water and Sewer	North Carolina State Fair	USS North Carolina Battleship Commission	Agricultural Farmers Market	Workers' Compensation	Departmental Funds	*Total Nonmajor Enterprise Funds*
ASSETS								
Current Assets:								
Cash and cash equivalents	$ 4,703	$ 2,607	$ 5,334	$ 820	$ 958	$ 10,954	$ 1,452	$ 26,828
Investments	22,588	—	—	—	—	12,434	—	35,022
Restricted investments	—	2	—	—	—	—	—	2
Securities lending collateral	16,247	3,524	—	—	—	14,809	—	34,580
Receivables:								
Accounts receivable, net	—	184	68	132	9	2	12	407
Interest receivable	11	11	—	—	—	24	—	46
Premiums receivable	737	—	—	—	—	—	—	737
Inventories	—	158	53	251	6	—	17	485
Prepaid items	1,731	—	—	88	—	26	—	1,845
Total current assets	46,017	6,486	5,455	1,291	973	38,249	1,481	99,952
Noncurrent Assets:								
Restricted/designated cash and cash equivalents	—	4,135	—	—	—	—	—	4,135
Investments	—	—	—	40	—	—	—	40
Restricted investments	—	93	—	3,252	—	—	—	3,345
Deferred charges	—	118	—	—	—	—	—	118
Capital assets-nondepreciable	—	22,354	1,379	2,276	1,087	—	—	27,096
Capital assets-depreciable, net	—	5,572	7,635	634	6,592	—	1,823	22,256
Total noncurrent assets	—	32,272	9,014	6,202	7,679	—	1,823	56,990
Total Assets	46,017	38,758	14,469	7,493	8,652	38,249	3,304	156,942
LIABILITIES								
Current Liabilities:								
Accounts payable and accrued liabilities:								
Accounts payable	92	58	173	38	28	45	48	482
Accrued payroll	—	—	66	8	7	—	11	92
Claims payable	3,947	—	—	—	—	9,786	—	13,733
Obligations under securities lending	16,247	3,524	—	—	—	14,809	—	34,580
Interest payable	—	35	—	—	—	—	—	35
Due to other funds	3	1	20	—	1	—	—	25
Deferred revenue	2,874	2	556	3	—	991	128	4,554
Deposits payable	—	75	—	—	—	—	—	75
Bonds payable - current	—	255	—	—	—	—	—	255
Compensated absences - current	5	16	14	15	6	—	6	62
Total current liabilities	23,168	3,966	829	64	42	25,631	193	53,893
Noncurrent Liabilities:								
Bonds payable, net	—	9,070	—	—	—	—	—	9,070
Compensated absences	60	130	140	61	60	—	63	514
Total noncurrent liabilities	60	9,200	140	61	60	—	63	9,584
Total Liabilities	23,228	13,166	969	125	102	25,631	256	63,477
NET ASSETS								
Invested in capital assets, net of related debt	—	18,696	9,014	2,910	7,679	—	1,823	40,122
Restricted for:								
Capital outlay	—	1,796	—	3,252	—	—	—	5,048
Unrestricted	22,789	5,100	4,486	1,206	871	12,618	1,225	48,295
Total Net Assets	$ 22,789	$25,592	$ 13,500	$ 7,368	$ 8,550	$ 12,618	$ 3,048	$ 93,465

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS NONMAJOR ENTERPRISE FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit D-2*

(Dollars in Thousands)

	Public School Insurance	Town of Butner Water and Sewer	North Carolina State Fair	USS North Carolina Battleship Commission	Agricultural Farmers Market	Workers' Compensation	Departmental Funds	*Total Nonmajor Enterprise Funds*
Operating Revenues:								
Sales and services	$ —	$ —	$ 206	$ 684	$ 44	$ —	$ 152	$ 1,086
Sales and services used as security for bonds, net	—	3,672	—	—	—	—	—	3,672
Rental and lease earnings	—	8	3,217	—	570	—	818	4,613
Fees, licenses and fines	—	14	8,538	1,463	589	—	945	11,549
Insurance premiums	10,647	—	—	—	—	2,612	—	13,259
Miscellaneous	—	29	—	85	—	—	—	114
Total operating revenues	10,647	3,723	11,961	2,232	1,203	2,612	1,915	34,293
Operating Expenses:								
Personal services	472	1,362	3,281	993	649	—	801	7,558
Supplies and materials	3	166	638	43	50	—	234	1,134
Services	87	620	3,533	850	322	633	527	6,572
Cost of goods sold	—	—	—	316	—	—	142	458
Depreciation/amortization	—	642	472	95	281	—	62	1,552
Claims	13,439	—	—	—	—	6,208	—	19,647
Insurance and bonding	3,121	12	110	18	34	884	34	4,213
Other	6	212	922	70	90	—	110	1,410
Total operating expenses	17,128	3,014	8,956	2,385	1,426	7,725	1,910	42,544
Operating income (loss)	(6,481)	709	3,005	(153)	(223)	(5,113)	5	(8,251)
Nonoperating Revenues (Expenses):								
Noncapital gifts	—	—	143	—	—	—	70	213
Investment earnings (loss)	179	187	—	277	—	362	—	1,005
Interest and fees	—	(49)	—	—	—	—	—	(49)
Insurance recoveries	—	1	—	—	—	—	—	1
Gain (loss) on sale of equipment	—	3	—	—	—	—	—	3
Miscellaneous	(210)	(35)	5	—	3	(174)	1	(410)
Total nonoperating revenues (expenses)	(31)	107	148	277	3	188	71	763
Income (loss) before contributions and transfers	(6,512)	816	3,153	124	(220)	(4,925)	76	(7,488)
Capital contributions	—	862	—	30	—	—	—	892
Transfers in	—	—	952	—	277	4,500	85	5,814
Transfers out	—	(289)	(4,904)	—	(2)	—	—	(5,195)
Change in net assets	(6,512)	1,389	(799)	154	55	(425)	161	(5,977)
Net assets — July 1, as restated	29,301	24,203	14,299	7,214	8,495	13,043	2,887	99,442
Net assets — June 30	$ 22,789	$ 25,592	$ 13,500	$ 7,368	$ 8,550	$ 12,618	$ 3,048	$ 93,465

COMBINING STATEMENT OF CASH FLOWS
NONMAJOR ENTERPRISE FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit D-3*

(Dollars in Thousands)

	Public School Insurance	Town of Butner Water and Sewer	North Carolina State Fair	USS North Carolina Battleship Commission	Agricultural Farmers Market	Workers' Compensation	Departmental Funds	*Total Nonmajor Enterprise Funds*
Cash Flows from Operating Activities:								
Receipts from customers	$ 11,108	$ 3,214	$12,168	$ 2,180	$ 1,205	$ 2,138	$ 1,891	$ 33,904
Receipts from other funds	—	572	—	—	—	—	—	572
Payments to suppliers	(2,449)	(577)	(5,204)	(1,334)	(473)	(1,488)	(1,000)	(12,525)
Payments to employees	(448)	(1,334)	(3,253)	(962)	(632)	—	(769)	(7,398)
Payments for benefits and claims	(11,205)	—	—	—	—	(4,756)	—	(15,961)
Payments to other funds	—	(247)	—	—	—	—	—	(247)
Other receipts (payments)	(1)	(159)	5	—	3	—	1	(151)
Net cash flows provided (used) by operating activities	(2,995)	1,469	3,716	(116)	103	(4,106)	123	(1,806)
Cash Provided From (Used For) Noncapital Financing Activities:								
Transfers from other funds	—	—	458	—	12	4,500	—	4,970
Transfers to other funds	—	(289)	(4,904)	—	(2)	—	—	(5,195)
Gifts	—	—	143	—	—	—	70	213
Total cash provided from (used for) noncapital financing activities	—	(289)	(4,303)	—	10	4,500	70	(12)
Cash Provided From (Used For) Capital Financing Activities:								
Acquisition and construction of capital assets	—	(5,052)	(22)	(42)	(131)	—	(39)	(5,286)
Proceeds from the sale of capital assets	—	5	61	—	—	—	—	66
Capital contributions	—	862	—	30	—	—	—	892
Principal paid on capital debt	—	(245)	—	—	—	—	—	(245)
Interest paid on capital debt	—	(412)	—	—	—	—	—	(412)
Payment to bond escrow agent	—	(43)	—	—	—	—	—	(43)
Insurance recoveries	—	1	—	—	—	—	—	1
Total cash provided from (used for) capital financing activities	—	(4,884)	39	(12)	(131)	—	(39)	(5,027)
Cash Provided From (Used For) Investment Activities:								
Proceeds from the sale/maturities of non-State Treasurer investments	—	2,634	—	9,488	—	—	—	12,122
Purchase of non-State Treasurer investments	—	—	—	(9,356)	—	—	—	(9,356)
Purchase into State Treasurer investment pool	(3,372)	—	—	—	—	—	—	(3,372)
Investment earnings (loss)	247	145	—	(68)	—	388	—	712
Total cash provided from (used for) investment activities	(3,125)	2,779	—	64	—	388	—	106
Net increase (decrease) in cash and cash equivalents	(6,120)	(925)	(548)	(64)	(18)	782	154	(6,739)
Cash and cash equivalents at July 1	10,823	7,667	5,882	884	976	10,172	1,298	37,702
Cash and cash equivalents at June 30	$ 4,703	$ 6,742	$ 5,334	$ 820	$ 958	$ 10,954	$ 1,452	$ 30,963
Reconciliation of Operating Income to Net Cash Provided From (Used For) Operating Activities:								
Operating income (loss)	$ (6,481)	$ 709	$ 3,005	$ (153)	$ (223)	$ (5,113)	$ 5	$ (8,251)
Adjustments to reconcile operating income to net cash flows from operating activities:								
Depreciation/amortization	—	642	472	95	281	—	62	1,552
Restatements and adjustments to cash	—	(280)	549	—	—	6	—	275
Nonoperating miscellaneous income (expense)	—	—	5	—	3	—	1	9
(Increases) decreases in assets:								
Receivables	906	374	50	(51)	2	26	(5)	1,302
Inventories	—	3	(3)	(61)	2	—	30	(29)
Prepaid items	701	—	—	(2)	—	(1)	—	698
Increases (decreases) in liabilities:								
Accounts payable and accrued liabilities	2,300	(4)	28	28	24	1,475	25	3,876
Due to other funds	(1)	1	18	—	1	—	—	19
Compensated absences	24	26	26	28	13	—	23	140
Deferred revenue	(444)	(1)	(392)	—	—	(499)	(18)	(1,354)
Deposits payable	—	(1)	(42)	—	—	—	—	(43)
Total cash provided from (used for) operations	$ (2,995)	$ 1,469	$ 3,716	$ (116)	$ 103	$ (4,106)	$ 123	$ (1,806)
Noncash Investing, Capital, and Financing Activities:								
Noncash distributions from the State Treasurer Long-Term Investment Portfolio and/or other agents	$ 2,046	$ 12	$ —	$ —	$ —	$ 1,022	$ —	$ 3,080
Transferred assets	—	—	494	—	265	—	85	844
Change in construction in progress as a result of accrual of accounts payable	—	(874)	—	—	—	—	—	(874)
Assets acquired through the assumption of a liability	16,247	3,524	—	—	—	14,809	—	34,580
Change in fair value of investments	(2,143)	—	—	344	—	(1,215)	—	(3,014)

Internal Service Funds

The internal service funds are maintained to account for the operations of State agencies that provide services to other State agencies, component units, or other governmental units on a cost reimbursement basis.

The following activities are included in the internal service funds:

Office of the State Controllerr:
Worker's Compensation Program

Department of Administration:
Motor Fleet Management
Mail Service Center
Temporary Solutions
Surplus Property

Office of the Governor:
Computing Services
State Telecommunications Services

Department of Insurance:
State Property Fire Insurance

COMBINING STATEMENT OF NET ASSETS
INTERNAL SERVICE FUNDS

June 30, 2004

(Dollars in Thousands)

	Workers' Compensation Program	State Property Fire Insurance	Motor Fleet Management	Mail Service Center	Temporary Solutions
ASSETS					
Current Assets:					
Cash and cash equivalents	$ 445	$ 14,303	$ 7,734	$ 2	$ 1,301
Investments	—	19,485	—	—	—
Securities lending collateral	—	21,790	—	—	—
Receivables:					
Accounts receivable, net	2,408	—	1,074	549	1,104
Interest receivable	—	41	—	—	—
Premiums receivable	—	141	—	—	—
Due from fiduciary funds	—	—	—	—	—
Due from other funds	1,139	—	5,348	6	28
Due from component units	—	—	582	—	—
Inventories	—	—	167	81	—
Prepaid items	—	—	—	—	—
Total current assets	3,992	55,760	14,905	638	2,433
Noncurrent Assets:					
Capital assets-nondepreciable	—	—	418	—	—
Capital assets-depreciable, net	—	—	66,716	458	2
Total noncurrent assets	—	—	67,134	458	2
Total Assets	3,992	55,760	82,039	1,096	2,435
LIABILITIES					
Current Liabilities:					
Accounts payable and accrued liabilities:					
Accounts payable	—	—	2,940	24	—
Accrued payroll	—	—	14	36	480
Claims payable	—	1,227	—	—	—
Obligations under securities lending	—	21,790	—	—	—
Due to other funds	—	—	10	798	1
Deferred revenue	—	2,256	—	—	—
Compensated absences - current	—	25	14	18	2
Total current liabilities	—	25,298	2,978	876	483
Noncurrent Liabilities:					
Compensated absences	—	179	131	166	12
Total noncurrent liabilities	—	179	131	166	12
Total Liabilities	—	25,477	3,109	1,042	495
NET ASSETS					
Invested in capital assets, net of related debt	—	—	67,134	458	2
Unrestricted	3,992	30,283	11,796	(404)	1,938
Total Net Assets	$ 3,992	$ 30,283	$ 78,930	$ 54	$ 1,940

Exhibit E-1

Computing Services	State Telecommu-nications Services	Surplus Property	*Totals*
$ 19,384	$ 5,491	$ 2,324	$ 50,984
—	—	—	19,485
—	—	—	21,790
3,116	5,708	20	13,979
—	—	—	41
—	—	—	141
—	2	—	2
5,597	6,502	795	19,415
3	461	—	1,046
15	—	1	264
11,908	297	—	12,205
40,023	18,461	3,140	139,352
2,861	—	19	3,298
15,261	5,743	119	88,299
18,122	5,743	138	91,597
58,145	24,204	3,278	230,949
164	123	1,362	4,613
56	9	2	597
—	—	—	1,227
—	—	—	21,790
163	59	382	1,413
—	—	—	2,256
215	90	8	372
598	281	1,754	32,268
1,684	692	77	2,941
1,684	692	77	2,941
2,282	973	1,831	35,209
18,122	5,743	138	91,597
37,741	17,488	1,309	104,143
$ 55,863	$ 23,231	$ 1,447	$ 195,740

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS INTERNAL SERVICE FUNDS

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Workers' Compensation Program	State Property Fire Insurance	Motor Fleet Management	Mail Service Center	Temporary Solutions
Operating Revenues:					
Sales and services	$ 33,852	$ —	$ 28,890	$ 3,541	$ 9,312
Rental and lease earnings	—	—	—	—	—
Insurance premiums	—	16,203	—	—	—
Miscellaneous	—	12	47	1	—
Total operating revenues	33,852	16,215	28,937	3,542	9,312
Operating Expenses:					
Personal services	—	1,487	1,794	2,714	9,248
Supplies and materials	—	20	8,470	152	3
Services	33,718	130	2,211	588	63
Cost of goods sold	—	—	1,403	—	—
Depreciation/amortization	—	—	17,183	38	2
Claims	—	1,676	—	—	—
Insurance and bonding	—	12,719	2,223	—	—
Other	—	62	216	60	37
Total operating expenses	33,718	16,094	33,500	3,552	9,353
Operating income (loss)	134	121	(4,563)	(10)	(41)
Nonoperating Revenues (Expenses):					
Investment earnings	—	779	—	—	—
Insurance recoveries	—	—	145	—	—
Gain (loss) on sale of equipment	—	—	405	—	—
Miscellaneous	—	(285)	1	—	—
Total nonoperating revenues (expenses)	—	494	551	—	—
Income (loss) before contributions and transfers	134	615	(4,012)	(10)	(41)
Transfers in	57	—	—	36	—
Transfers out	—	—	(20)	(1)	—
Change in net assets	191	615	(4,032)	25	(41)
Net assets — July 1, as restated	3,801	29,668	82,962	29	1,981
Net assets — June 30	$ 3,992	$ 30,283	$ 78,930	$ 54	$ 1,940

Exhibit E-2

Computing Services	State Telecommunications Services	Surplus Property	*Totals*
$ 62,346	$ 71,536	$ 1,819	$ 211,296
56	—	—	56
—	—	—	16,203
—	208	224	492
62,402	71,744	2,043	228,047
18,172	9,833	1,207	44,455
612	93	59	9,409
9,096	49,612	640	96,058
296	—	154	1,853
7,753	2,744	52	27,772
—	—	—	1,676
97	43	19	15,101
26,059	9,322	40	35,796
62,085	71,647	2,171	232,120
317	97	(128)	(4,073)
—	—	—	779
—	—	—	145
(109)	(98)	—	198
1	1	—	(282)
(108)	(97)	—	840
209	—	(128)	(3,233)
41	2	—	136
(7,514)	(2,198)	(17)	(9,750)
(7,264)	(2,196)	(145)	(12,847)
63,127	25,427	1,592	208,587
$ 55,863	$ 23,231	$ 1,447	$ 195,740

COMBINING STATEMENT OF CASH FLOWS
INTERNAL SERVICE FUNDS

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Workers' Compensation Program	State Property Fire Insurance	Motor Fleet Management	Mail Service Center	Temporary Solutions
Cash Flows From Operating Activities:					
Receipts from customers	$ 6,885	$ 4,069	$ 4,712	$ 977	$ 9,121
Receipts from other funds	25,900	11,772	28,947	2,514	—
Payments to suppliers	(33,718)	(12,931)	(10,571)	(272)	(24)
Payments to employees	—	(1,443)	(1,764)	(2,682)	(9,267)
Payments for benefits and claims	—	(1,038)	—	—	—
Payments to other funds	—	(607)	(3,524)	(477)	(42)
Other receipts (payments)	—	—	(169)	(59)	(37)
Net cash flows provided (used) by operating activities	(933)	(178)	17,631	1	(249)
Cash Provided From (Used For) Noncapital Financing Activities:					
Transfers from other funds	57	—	—	36	—
Transfers to other funds	—	—	(20)	(1)	—
Total cash provided from (used for) noncapital financing activities	57	—	(20)	35	—
Cash Provided From (Used For) Capital Financing Activities:					
Acquisition and construction of capital assets	—	—	(22,516)	(34)	—
Proceeds from the sale of capital assets	—	—	3,410	—	—
Insurance recoveries	—	—	145	—	—
Total cash provided from (used for) capital financing activities	—	—	(18,961)	(34)	—
Cash Provided From (Used For) Investment Activities:					
Investment earnings	—	654	—	—	—
Total cash provided from (used for) investment activities	—	654	—	—	—
Net increase (decrease) in cash and cash equivalents	(876)	476	(1,350)	2	(249)
Cash and cash equivalents at July 1	1,321	13,827	9,084	—	1,550
Cash and cash equivalents at June 30	$ 445	$ 14,303	$ 7,734	$ 2	$ 1,301
Reconciliation of Operating Income to Net Cash Provided From (Used For) Operating Activities:					
Operating income (loss)	$ 134	$ 121	$ (4,563)	$ (10)	$ (41)
Adjustments to reconcile operating income to net cash flows from operating activities:					
Depreciation/amortization	—	—	17,183	38	2
Nonoperating miscellaneous income (expense)	—	—	1	—	—
(Increases) decreases in assets:					
Receivables	72	(141)	4,706	(46)	(190)
Due from other funds	(1,139)	—	230	(3)	(1)
Due from fiduciary funds	—	—	—	—	—
Due from component units	—	—	(167)	—	—
Inventories	—	—	(16)	(81)	—
Prepaid items	—	—	—	—	—
Increases (decreases) in liabilities:					
Accounts payable and accrued liabilities	—	31	1,119	29	(9)
Due to other funds	—	—	(877)	58	—
Compensated absences	—	44	15	16	(10)
Deferred revenue	—	(233)	—	—	—
Total cash provided from (used for) operations	$ (933)	$ (178)	$ 17,631	$ 1	$ (249)
Noncash Investing, Capital, and Financing Activities:					
Noncash distributions from the State Treasurer Long-Term Investment Portfolio and/or other agents	$ —	$ 1,601	$ —	$ —	$ —
Assets acquired through the assumption of a liability	—	21,790	—	—	—
Change in fair value of investments	—	(1,749)	—	—	—

Exhibit E-3

Computing Services	State Telecommu-nications Services	Surplus Property	*Totals*
$ 1,284	$ 23,898	$ 694	$ 51,640
60,188	48,389	1,068	178,778
(37,496)	(56,661)	(282)	(151,955)
(17,816)	(9,744)	(1,209)	(43,925)
—	—	—	(1,038)
(1,696)	(550)	(249)	(7,145)
(1,668)	133	183	(1,617)
2,796	5,465	205	24,738
41	2	—	136
(7,514)	(2,198)	(17)	(9,750)
(7,473)	(2,196)	(17)	(9,614)
(6,804)	(2,756)	(49)	(32,159)
—	—	—	3,410
—	—	—	145
(6,804)	(2,756)	(49)	(28,604)
—	—	—	654
—	—	—	654
(11,481)	513	139	(12,826)
30,865	4,978	2,185	63,810
$ 19,384	$ 5,491	$ 2,324	$ 50,984
$ 317	$ 97	$ (128)	$ (4,073)
7,753	2,744	52	27,772
2	2	—	5
(2,321)	1,841	24	3,945
1,182	(965)	(81)	(777)
1	—	—	1
207	(125)	—	(85)
93	—	(1)	(5)
(4,871)	1,866	—	(3,005)
(42)	(102)	384	1,410
130	8	(43)	(724)
345	99	(2)	507
—	—	—	(233)
$ 2,796	$ 5,465	$ 205	$ 24,738
$ —	$ —	$ —	$ 1,601
—	—	—	21,790
—	—	—	(1,749)

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FIDUCIARY FUNDS

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PRIVATE PURPOSE TRUST FUNDS

Private purpose trust funds account for resources held in trust in which the principal and income benefit individuals, private organizations, or other governments.

The following activities are included in the private purpose trust funds:

Deposits of Insurance Carriers Fund
Administrative Office of the Courts Trust Fund
Departmental Funds

COMBINING STATEMENT OF FIDUCIARY NET ASSETS
PRIVATE PURPOSE TRUST FUNDS

June 30, 2004 *Exhibit F-1*

(Dollars in Thousands)

	Deposits of Insurance Carriers Fund	Administrative Office of the Courts Trust Fund	Departmental Funds	*Totals*
ASSETS				
Cash and cash equivalents	$ 394	$ 98,038	$ 335	$ 98,767
Investments:				
U.S. Government securities	—	2,285	—	2,285
State and municipal securities	—	1,027	—	1,027
Certificates of deposit	—	60,686	—	60,686
Securities lending collateral	299	—	253	552
Receivables:				
Interest receivable	1	—	1	2
Sureties	950,194	—	—	950,194
Total Assets	950,888	162,036	589	1,113,513
Liabilities:				
Obligations under securities lending	299	—	253	552
Total Liabilities	299	—	253	552
Net Assets:				
Held in trust for:				
Individuals, organizations and other governments	950,589	162,036	336	1,112,961
Total Net Assets	$ 950,589	$ 162,036	$ 336	$ 1,112,961

COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
PRIVATE PURPOSE TRUST FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit F-2*

(Dollars in Thousands)

	Deposits of Insurance Carriers Fund	Administrative Office of the Courts Trust Fund	Departmental Funds	*Totals*
Additions:				
Contributions:				
Trustee deposits	$ 303,476	$ 114,567	$ 2	$ 418,045
Total contributions	303,476	114,567	2	418,045
Investment Income:				
Investment earnings	16	1,785	13	1,814
Less investment expenses	(3)	—	(3)	(6)
Net investment income	13	1,785	10	1,808
Total additions	303,489	116,352	12	419,853
Deductions:				
Payments in accordance with trust arrangements	20,112	117,672	—	137,784
Administrative expenses	3	—	—	3
Total deductions	20,115	117,672	—	137,787
Change in net assets	283,374	(1,320)	12	282,066
Net assets — July 1	667,215	163,356	324	830,895
Net assets — June 30	$ 950,589	$ 162,036	$ 336	$ 1,112,961

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AGENCY FUNDS

Agency funds account for resources held by the State in a purely custodial capacity for individuals, private organizations, or other governments.

The following activities are included in the agency funds:

Local Sales Tax Collections
Clerks of Court
Intra-Entity Investment Fund Deposits
Other Agency Funds

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES AGENCY FUNDS

For the Fiscal Year Ended June 30, 2004

(Dollars in Thousands)

	Balance, July 1, 2003	Additions	Deductions	Balance, June 30, 2004
Local Sales Tax Collections				
ASSETS				
Cash and cash equivalents	$ 500,432	$ 2,103,819	$ 2,206,208	$ 398,043
Receivables:				
Taxes receivable	106,500	58,600	—	165,100
Due from other funds	6,349	694	—	7,043
Total Assets	$ 613,281	$ 2,163,113	$ 2,206,208	$ 570,186
LIABILITIES				
Accounts payable and accrued liabilities:				
Intergovernmental payables	$ 613,281	$ 2,163,113	$ 2,206,208	$ 570,186
Total Liabilities	$ 613,281	$ 2,163,113	$ 2,206,208	$ 570,186
Clerks of Court				
ASSETS				
Cash and cash equivalents	$ 90,459	$ 1,056,652	$ 1,060,689	$ 86,422
Receivables:				
Accounts receivable	772	4,646	4,580	838
Sureties	34,906	47,621	32,287	50,240
Total Assets	$ 126,137	$ 1,108,919	$ 1,097,556	$ 137,500
LIABILITIES				
Accounts payable and accrued liabilities:				
Intergovernmental payables	$ 5,119	$ 120,070	$ 118,484	$ 6,705
Funds held for others	121,018	369,251	359,474	130,795
Total Liabilities	$ 126,137	$ 489,321	$ 477,958	$ 137,500
Intra-Entity Investment Fund Deposits				
ASSETS				
Cash and cash equivalents	$ 2,189,116	$ 141,649	$ —	$ 2,330,765
Investments:				
State Treasurer investment pool	62,970	—	17,779	45,191
Securities lending collateral	1,815,881	—	36,131	1,779,750
Receivables:				
Interest receivable	6,641	—	1,072	5,569
Total Assets	$ 4,074,608	$ 141,649	$ 54,982	$ 4,161,275
LIABILITIES				
Obligations under securities lending	1,815,881	—	36,131	1,779,750
Funds held for others	2,258,727	122,798	—	2,381,525
Total Liabilities	$ 4,074,608	$ 122,798	$ 36,131	$ 4,161,275

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES AGENCY FUNDS

For the Fiscal Year Ended June 30, 2004 *Exhibit F-3*

(Dollars in Thousands)

	Balance, July 1, 2003	Additions	Deductions	Balance, June 30, 2004
Other Agency Funds				
ASSETS				
Cash and cash equivalents	$ 27,244	$ 978,238	$ 977,118	$ 28,364
Investments:				
Certificates of deposit	462	—	—	462
Securities lending collateral	21,412	—	6,293	15,119
Receivables:				
Accounts receivable	84	—	73	11
Intergovernmental receivables	1,051	—	97	954
Interest receivable	2	—	—	2
Due from other funds	—	47	—	47
Inventories	301	—	—	301
Total Assets	$ 50,556	$ 978,285	$ 983,581	$ 45,260
LIABILITIES				
Accounts payable and accrued liabilities:				
Accounts payable	$ 1,034	$ 6,832	$ 7,812	$ 54
Intergovernmental payables	5,246	129,985	128,115	7,116
Obligations under securities lending	21,412	—	6,293	15,119
Deposits payable	1,738	3,457	3,414	1,781
Funds held for others	21,126	82,922	82,858	21,190
Total Liabilities	$ 50,556	$ 223,196	$ 228,492	$ 45,260
Total Agency Funds				
ASSETS				
Cash and cash equivalents	$ 2,807,251	$ 4,280,358	$ 4,244,015	$ 2,843,594
Investments:				
Certificates of deposit	462	—	—	462
State Treasurer investment pool	62,970	—	17,779	45,191
Securities lending collateral	1,837,293	—	42,424	1,794,869
Receivables:				
Taxes receivable	106,500	58,600	—	165,100
Accounts receivable	856	4,646	4,653	849
Intergovernmental receivables	1,051	—	97	954
Interest receivable	6,643	—	1,072	5,571
Due from other funds	6,349	741	—	7,090
Inventories	301	—	—	301
Sureties	34,906	47,621	32,287	50,240
Total Assets	$ 4,864,582	$ 4,391,966	$ 4,342,327	$ 4,914,221
LIABILITIES				
Accounts payable and accrued liabilities:				
Accounts payable	$ 1,034	$ 6,832	$ 7,812	$ 54
Intergovernmental payables	623,646	2,413,168	2,452,807	584,007
Obligations under securities lending	1,837,293	—	42,424	1,794,869
Deposits payable	1,738	3,457	3,414	1,781
Funds held for others	2,400,871	574,971	442,332	2,533,510
Total Liabilities	$ 4,864,582	$ 2,998,428	$ 2,948,789	$ 4,914,221

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COMPONENT UNITS

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NONMAJOR COMPONENT UNITS – DISCRETELY PRESENTED

Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on the State. The State has applied the criteria outlined in GASB Statement No. 14, The Financial Reporting Entity, in determining financial accountability. These component units are included in the financial reporting entity because of the significance of their operational or financial relationships with the State.

Nonmajor component units are comprised of the following entities:

N.C. State Ports Authority
N.C. Agricultural Finance Authority
N.C. Global TransPark Authority
N.C. Partnership for Children, Inc.
Regional Economic Development Commissions
North Carolina Railroad Company
N.C. Phase II Tobacco Certification Entity, Inc.

COMBINING STATEMENT OF NET ASSETS
NONMAJOR COMPONENT UNITS

June 30, 2004 — *Exhibit G-1*

(Dollars in Thousands)

	N.C. State Ports Authority	N.C. Agricultural Finance Authority	N.C. Global TransPark Authority	N.C. Partnership for Children, Inc.	Regional Economic Development Commissions	North Carolina Railroad Company	N.C. Phase II Tobacco Certification Entity, Inc.	Total
ASSETS								
Cash and cash equivalents	$ 2,414	$ 4,330	$ 15,671	$ 403	$ 2,770	$ 24,335	$ 717	$ 50,640
Investments	3,261	—	10,362	4,738	156	—	—	18,517
Receivables, net	4,409	280	227	2,474	355	109	—	7,854
Due from component units	—	—	—	—	204	—	—	204
Inventories	1,087	1	—	—	—	—	—	1,088
Prepaid items	916	—	—	52	6	48	1	1,023
Notes receivable, net	—	11,191	—	—	—	—	—	11,191
Deferred charges	612	—	—	—	—	—	—	612
Capital assets-nondepreciable	33,172	172	17,022	—	505	15,867	—	66,738
Capital assets-depreciable, net	120,186	—	51,624	141	188	5,268	20	177,427
Total Assets	166,057	15,974	94,906	7,808	4,184	45,627	738	335,294
LIABILITIES								
Accounts payable and accrued liabilities	2,486	153	372	123	161	472	6	3,773
Interest payable	11	—	—	—	—	—	—	11
Due to primary government	—	1	5,777	2,432	—	—	—	8,210
Unearned revenue	711	—	21	—	234	—	—	966
Advance from primary government	—	—	24,242	—	—	—	—	24,242
Deposits payable	—	—	—	—	—	3	—	3
Funds held for others	—	—	—	191	—	—	69	260
Long-term liabilities:								
Due within one year	3,527	4	60	—	84	—	—	3,675
Due in more than one year	18,596	37	1,334	209	—	—	—	20,176
Total Liabilities	25,331	195	31,806	2,955	479	475	75	61,316
NET ASSETS								
Invested in capital assets, net of related debt	132,239	172	52,696	141	693	21,135	20	207,096
Restricted for:								
Expendable:								
Health and human services	—	—	—	2,176	—	—	—	2,176
Other purposes	1,513	—	16	—	—	—	—	1,529
Unrestricted	6,974	15,607	10,388	2,536	3,012	24,017	643	63,177
Total Net Assets	$ 140,726	$ 15,779	$ 63,100	$ 4,853	$ 3,705	$ 45,152	$ 663	$ 273,978

COMBINING STATEMENT OF ACTIVTIES
NONMAJOR COMPONENT UNITS

For the Fiscal Year Ended June 30, 2004 *Exhibit G-2*

(Dollars in Thousands)

	N.C. State Ports Authority	N.C. Agricultural Finance Authority	N.C. Global TransPark Authority	N.C. Partnership for Children, Inc.	Regional Economic Development Commissions	North Carolina Railroad Company	N.C. Phase II Tobacco Certification Entity, Inc.	Total
Total expenses	$ 33,471	$ 2,765	$ 7,287	$ 114,951	$ 5,335	$ 13,495	$ 3,406	$ 180,710
Program revenues:								
Charges for services	29,246	779	779	—	18	12,812	—	43,634
Operating grants and contributions	202	2,411	1,703	661	1,407	233	3,283	9,900
Capital grants and contributions	—	—	77	—	—	—	—	77
Net program (expense) revenue	(4,023)	425	(4,728)	(114,290)	(3,910)	(450)	(123)	(127,099)
Non-tax general revenues:								
State operating aid	—	—	1,600	112,941	3,913	—	—	118,454
State capital aid	—	—	—	—	—	22,528	—	22,528
Miscellaneous	—	—	—	—	7	—	—	7
Total non-tax general revenues	—	—	1,600	112,941	3,920	22,528	—	140,989
Change in net assets	(4,023)	425	(3,128)	(1,349)	10	22,078	(123)	13,890
Net assets — July 1, as restated	144,749	15,354	66,228	6,202	3,695	23,074	786	260,088
Net assets — June 30	$ 140,726	$ 15,779	$ 63,100	$ 4,853	$ 3,705	$ 45,152	$ 663	$ 273,978

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STATISTICAL SECTION

REVENUES BY SOURCE AND EXPENDITURES BY FUNCTION
ALL GOVERNMENTAL FUND TYPES
GAAP BASIS
LAST TEN FISCAL YEARS

(Dollars in Thousands)

		2004	2003	2002	2001	2000
Revenues — By Source						
Taxes		$ 15,961,629	$ 15,394,024	$ 14,894,796	$ 15,147,177	$ 14,569,104
Federal funds		10,089,075	8,672,065	8,459,344	7,924,893	7,253,282
Local funds		657,954	586,638	702,076	760,607	511,350
Investment earnings	[1] [3]	160,846	320,023	335,082	487,824	500,854
Interest earnings on loans		5,801	7,165	47,421	5,789	5,356
Sales and services		210,161	184,739	194,548	97,686	94,751
Rental and lease of property		27,848	22,175	24,359	43,046	25,059
Fees, licenses and fines		1,035,303	915,380	864,912	896,435	1,046,042
Tobacco settlement		146,452	173,256	175,836	140,272	—
Contributions, gifts, and grants		150,731	90,486	93,802	122,871	79,554
Funds escheated		55,330	41,369	90,181	N/A	N/A
Federal funds for fiscal relief		136,859	136,859	N/A	N/A	N/A
Miscellaneous		196,937	147,777	145,887	165,349	147,816
Total revenues	[4]	$ 28,834,926	$ 26,691,956	$ 26,028,244	$ 25,791,949	$ 24,233,168
Expenditures — By Function						
Current:						
General government	[1]	$ 711,327	$ 691,267	$ 809,398	$ 1,035,440	$ 1,229,513
Education	[1] [5]	N/A	N/A	N/A	6,964,812	6,674,757
Primary and secondary education	[5]	7,223,143	6,863,338	6,802,662	N/A	N/A
Higher education	[5]	3,140,698	2,813,629	2,519,624	N/A	N/A
Health and human services	[1] [2]	11,722,721	10,583,184	10,398,386	9,617,423	8,411,025
Economic development	[1]	532,674	484,298	498,644	453,931	428,819
Environment and natural resources	[1] [2]	581,726	534,405	574,871	459,170	371,238
Public safety, corrections, and regulation	[1]	2,073,338	1,998,576	2,070,166	1,948,423	1,999,894
Transportation	[1]	3,389,042	2,967,551	2,992,187	2,820,290	2,598,605
Agriculture	[1]	81,488	81,857	122,337	88,623	143,936
Retiree tax judgements		—	—	—	58,679	440,000
Capital outlay		385,506	104,379	126,011	155,228	159,241
Debt service		425,972	321,529	328,712	281,463	264,877
Total expenditures	[4]	$ 30,267,635	$ 27,444,013	$ 27,242,998	$ 23,883,482	$ 22,721,905

All governmental fund types consist of the General Fund, special revenue funds, capital projects funds, and permanent funds. Years prior to 2002 do not include permanent funds............

Major Revenues by Source 1995 - 2004

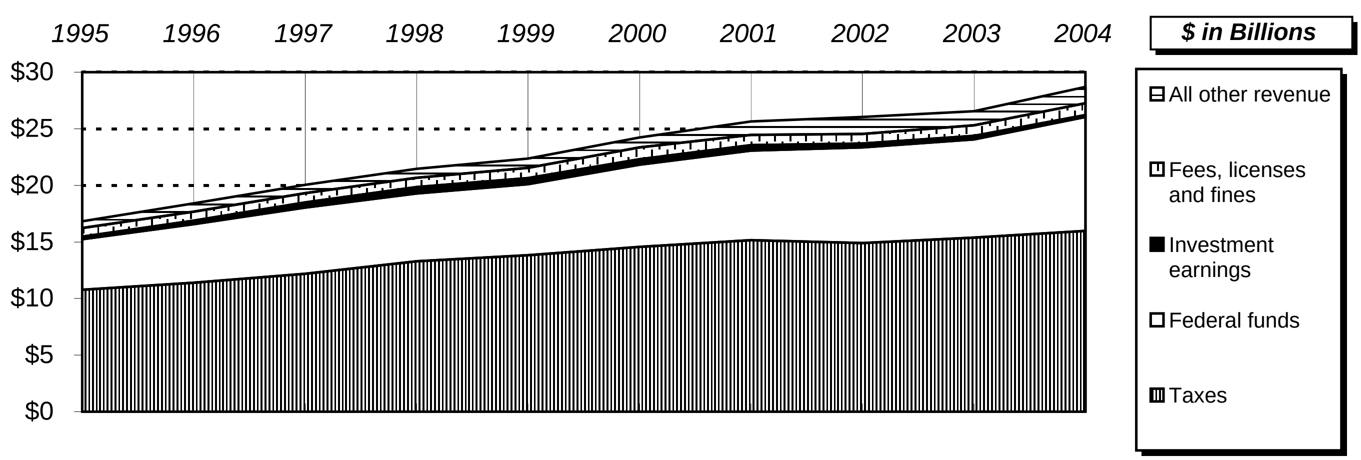


Table 1

1999	1998	1997	1996	1995
$ 13,817,577	$ 13,287,609	$ 12,177,605	$ 11,390,198	$ 10,773,352
6,297,196	5,983,003	5,857,680	5,192,921	4,458,959
469,539	462,879	427,306	469,023	325,613
529,028	575,901	454,678	290,536	245,388
6,665	5,676	4,280	1,361	121
92,237	84,087	76,130	82,511	46,686
26,913	26,321	24,738	23,641	13,888
895,892	826,491	814,690	793,622	749,277
N/A	N/A	N/A	N/A	N/A
71,787	61,189	31,805	21,512	38,012
N/A	N/A	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A
172,103	148,794	182,247	141,647	169,276
$ 22,378,937	$ 21,461,950	$ 20,051,159	$ 18,406,972	$ 16,820,572
$ 1,039,855	$ 1,115,763	$ 921,406	$ 769,518	$ 787,164
6,253,838	5,416,486	4,775,741	4,499,257	4,441,966
N/A	N/A	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A
7,665,461	7,300,262	6,822,624	6,244,976	5,211,388
370,124	321,613	294,787	261,340	273,101
354,025	332,803	668,402	576,272	591,007
1,670,703	1,578,985	1,613,757	1,331,964	1,209,576
2,508,886	2,384,455	2,205,494	1,908,076	1,871,233
72,562	68,573	65,421	63,174	62,257
399,000	400,000	—	—	—
182,793	203,605	147,194	173,118	167,249
227,630	170,039	131,249	150,471	141,031
$ 20,744,877	$ 19,292,584	$ 17,646,075	$ 15,978,166	$ 14,755,972

[1] Fiscal years prior to 1997 do not reflect the implementation of GASB Statement 28, *Accounting and Financial Reporting for Securities Lending Transactions*. The impact of GASB Statement 28 is to gross-up investment earnings by the amount of fees charged for securities lending and to increase current expenditures in the amount of fees charged.

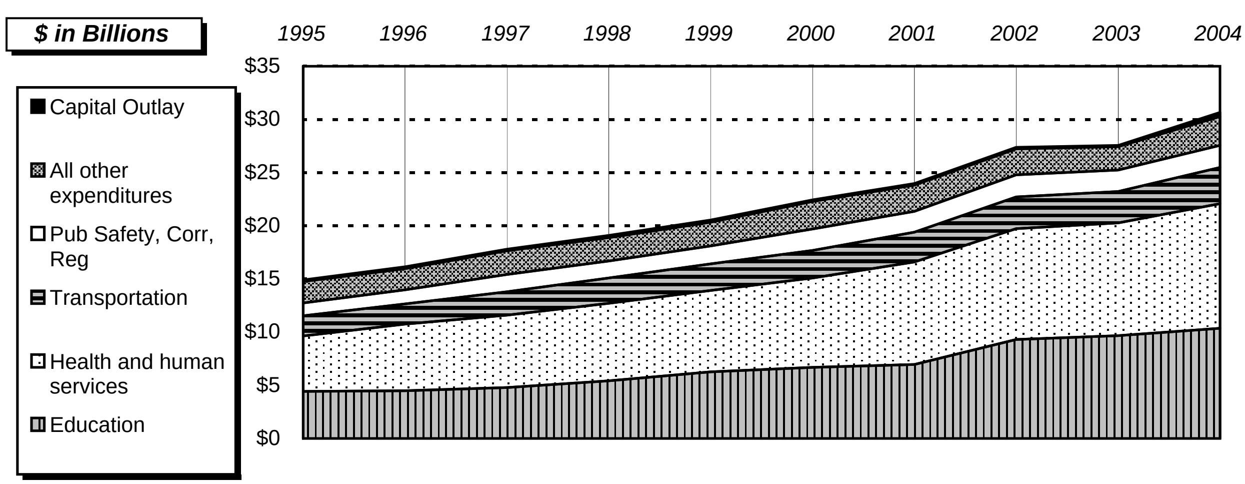
[2] In fiscal years prior to 1998, health expenditures were included in the environment, health and natural resources expenditure function. In the 1998 fiscal year, health expenditures were shifted and are now reflected in the health and human services function.

[3] Fiscal years prior to 1998 do not reflect the implementation of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

[4] Fiscal years prior to 2001 do not reflect the implementation of GASB Statement No. 33, *Accounting for NonexchangeTransactions*. This statement provided new rules on the timing of recognition of nonexchange transactions involving financial or capital resources.

[5] Fiscal years prior to 2002 do not reflect the implementation of GASB - Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (as amended by Statement No. 37),
This statement establishes new financial reporting requirements for state and local governments throughout the United States.

Major Expenditures by Function 1995 - 2004



SCHEDULE OF REVENUES BY SOURCE — GENERAL FUND
GAAP BASIS
LAST TEN FISCAL YEARS

(Dollars in Thousands)

		2004	2003	2002	2001	2000
TAX REVENUES						
Individual income tax		$ 7,404,956	$ 7,126,655	$ 7,219,794	$ 7,605,542	$ 7,097,514
Corporate income tax		699,441	922,936	548,046	712,161	989,280
Sales and use tax		4,268,292	4,020,923	3,766,285	3,429,532	3,361,189
Franchise tax		560,502	583,781	592,259	746,687	557,544
Beverage tax		213,271	198,848	200,593	198,646	193,003
Insurance tax		423,405	408,873	340,785	305,791	273,367
Piped natural gas		64,327	63,219	64,852	64,854	52,025
Intangible tax		—	—	—	4	20
Inheritance tax		129,579	112,605	104,799	123,094	162,997
Soft drink tax		—	—	2	48	144
Tobacco products tax		44,126	41,899	41,500	42,137	43,104
License tax		42,418	44,565	44,432	43,874	42,595
Real estate conveyance tax		—	—	—	—	—
Gift tax		16,615	19,328	13,392	20,254	25,084
Other taxes		13,571	12,508	17,479	11,152	10,292
Total tax revenues		13,880,503	13,556,140	12,954,218	13,303,776	12,808,158
NON-TAX REVENUES						
Federal Funds:						
Departmental revenues		8,769,925	7,564,627	7,266,016	6,777,503	6,156,189
Federal Funds for Fiscal Relief:						
Federal funds for fiscal relief		136,859	136,859	—	—	—
Local Funds:						
Departmental revenues		636,900	562,498	682,310	737,063	482,387
Investment Earnings:						
Income from General Fund investments	[2]	76,415	103,786	129,924	163,479	204,083
Income from securities lending	[1]	21,305	30,604	44,659	111,490	112,011
Departmental revenues		2,613	4,745	4,217	10,022	7,300
Other investment earnings		3	5	9,531	320	251
		100,336	139,140	188,331	285,311	323,645
Sales and Services:						
Departmental revenues		76,010	61,316	61,031	68,736	69,793
Other non-tax revenues		182	198	228	405	276
		76,192	61,514	61,259	69,141	70,069
Rental and Lease of Property:						
Proceeds from rental and lease of property		102	92	546	573	1,035
Departmental revenues		6,620	6,140	6,556	16,989	7,218
		6,722	6,232	7,102	17,562	8,253
Fees, Licenses and Fines:						
Court fines and fees		138,878	126,381	109,575	111,012	97,808
Secretary of State service fees		40,638	36,807	31,357	29,584	24,255
Banking and investment fees		4,758	4,485	4,336	10,914	4,029
Self insurer fees (Industrial Commission)		13,777	13,512	6,795	7,098	6,360
Probation supervision fees		16,748	14,339	10,833	10,453	10,605
Department of Insurance fees		25,147	21,198	22,854	20,210	18,433
DWI service and restoration fees		8,709	7,332	5,822	5,706	5,703
Departmental revenues		62,578	41,747	41,540	40,422	38,300
Other non-tax revenues		4,388	4,161	4,124	4,065	4,181
		315,621	269,962	237,236	239,464	209,674
Tobacco settlement						
Tobacco settlement		146,452	173,256	175,836	140,272	—
Contributions, Gifts and Grants:						
Departmental revenues		50,140	29,702	33,658	53,425	15,452
Other non-tax revenues		234	1	30	—	2
		50,374	29,703	33,688	53,425	15,454
Miscellaneous:						
Local sales and use tax administration		13,989	12,495	11,774	11,568	10,973
Sales tax refunds		14,456	7,908	11,120	11,494	15,514
Departmental revenues		123,852	95,753	89,489	123,230	108,555
Other non-tax revenue		2,083	315	6,307	914	866
		154,380	116,471	118,690	147,206	135,908
Total non-tax revenues		10,393,761	9,060,262	8,770,468	8,466,947	7,401,579
Total Revenues	[3]	$ 24,274,264	$ 22,616,402	$ 21,724,686	$ 21,770,723	$ 20,209,737

Table 2

1999	1998	1997	1996	1995
$ 6,586,153	$ 6,124,709	$ 5,454,571	$ 4,975,387	$ 4,617,197
920,583	999,759	869,717	878,028	833,135
3,342,157	3,272,774	3,134,877	2,947,537	2,701,114
567,497	567,869	534,622	495,008	457,952
182,970	155,352	151,064	138,653	170,033
291,202	283,828	259,286	242,188	235,455
—	—	—	—	—
31	217	—	11,509	128,608
163,608	144,203	132,195	113,416	109,883
11,463	22,338	30,980	39,619	36,176
44,694	47,304	46,797	46,394	44,936
27,202	38,209	41,280	44,962	53,431
1,215	894	1,064	19,510	16,349
19,243	20,722	12,566	11,043	8,592
10,973	1,501	1,516	1,388	1,421
12,168,991	11,679,679	10,670,535	9,964,642	9,414,282
5,361,839	5,174,406	5,169,286	4,613,915	3,780,032
—	—	—	—	—
436,609	436,347	403,145	445,443	299,156
248,657	252,162	224,260	202,277	163,783
112,531	136,955	105,722	—	—
4,416	58,415	10,257	11,070	7,923
81	137	241	249	317
365,685	447,669	340,480	213,596	172,023
70,036	67,214	58,744	63,345	24,414
350	319	—	—	—
70,386	67,533	58,744	63,345	24,414
786	1,811	1,342	1,265	499
5,773	4,255	4,651	4,404	7,288
6,559	6,066	5,993	5,669	7,787
99,986	93,252	99,819	90,456	88,023
20,099	19,257	17,344	14,838	12,911
4,332	3,031	3,337	3,432	3,760
4,128	3,556	3,460	3,038	2,768
11,166	11,778	10,859	10,002	9,690
18,205	1,096	6,001	961	936
5,936	6,050	5,949	5,426	5,342
110,664	103,296	104,002	101,364	106,360
2,652	3,358	4,075	5,292	5,432
277,168	244,674	254,846	234,809	235,222
—	—	—	—	—
17,511	13,205	14,145	8,574	4,065
101	1	—	—	—
17,612	13,206	14,145	8,574	4,065
10,293	10,060	9,178	8,661	6,669
10,406	10,936	13,301	11,585	14,217
130,518	115,529	151,906	112,430	129,224
844	744	455	471	1,534
152,061	137,269	174,840	133,147	151,644
6,687,919	6,527,170	6,421,479	5,718,498	4,674,343
$ 18,856,910	$ 18,206,849	$ 17,092,014	$ 15,683,140	$ 14,088,625

[1] Fiscal years prior to 1997 do not reflect the implementation of GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*. The impact of GASB Statement No. 28 is to gross-up investment earnings by the amount of fees charged for securities lending and to increase current expenditures in the amount of fees charged. Prior to 1997, securities lending fees are netted against securities lending income.

[2] Fiscal years prior to 1998 do not reflect the implementation of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

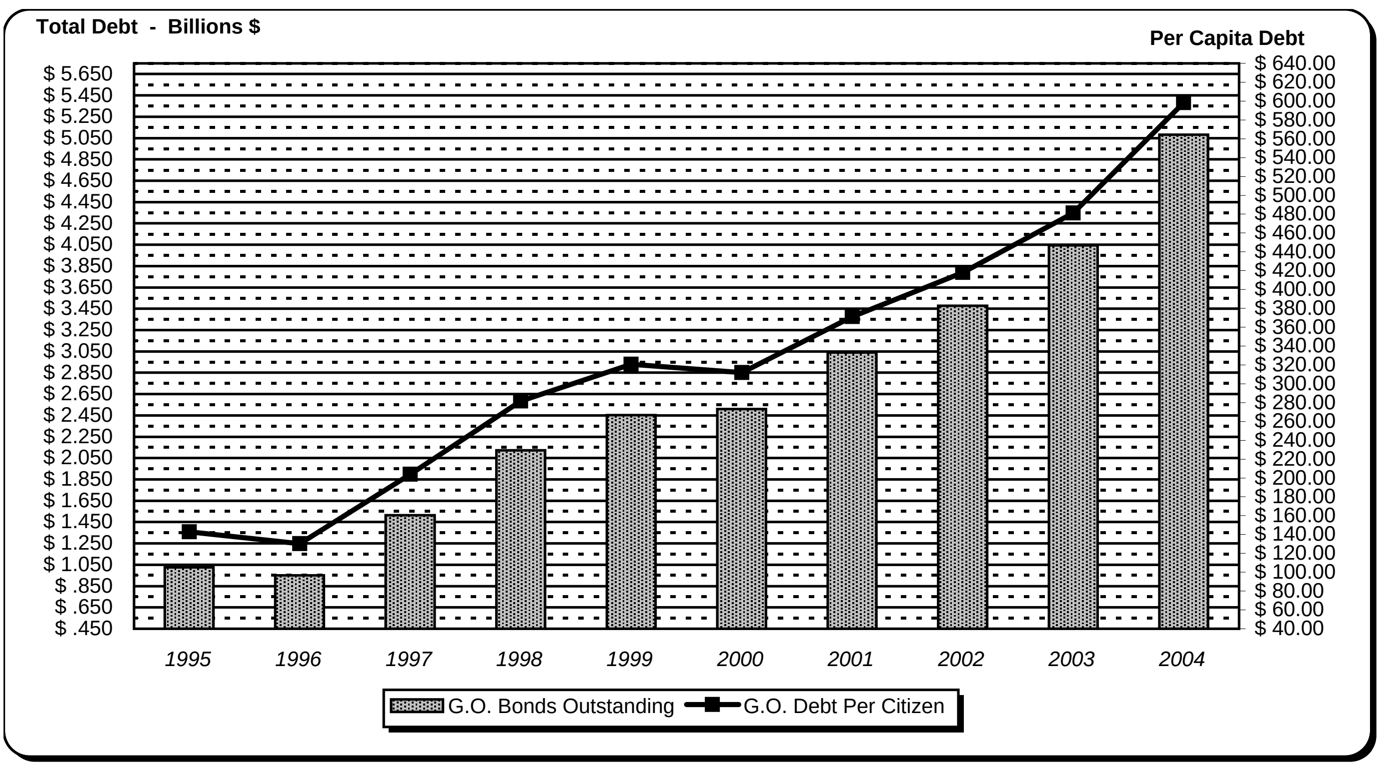
[3] Fiscal years prior to 2001 do not reflect the implementation of GASB Statement No. 33, *Accounting for Nonexchange Transactions*. This statement provided new rules on the timing of recognition of nonexchange transactions involving financial or capital resources.

GENERAL OBLIGATION BONDS DEBT RATIOS

For the Fiscal Years 1995-2004 *Table 3*

Fiscal Year Ended June 30	General Obligation Debt Per Capita: N.C. Population	General Obligation Bonds Outstanding	G.O. Debt per Citizen	Ratio of Annual Debt Service To General Expenditures: Debt Service Expenditures	Total General Expenditures	Ratio
2004	8,495,524 [1]	$ 5,081,969,000	$ 598.19	$ 425,972,000	$ 30,267,635,000	1.41%
2003	8,407,248	$ 4,045,603,000	$ 481.20	$ 321,529,000	$ 27,444,013,000	1.17%
2002	8,320,146	$ 3,477,953,000	$ 418.02	$ 328,712,000	$ 27,242,998,000	1.21%
2001	8,186,268	$ 3,038,693,000	$ 371.19	$ 281,463,000	$ 23,883,482,000	1.18%
2000	8,049,313	$ 2,509,986,000	$ 311.83	$ 264,877,000	$ 22,721,905,000	1.17%
1999	7,647,934	$ 2,451,973,000	$ 320.61	$ 227,630,000	$ 20,744,877,000	1.10%
1998	7,545,735	$ 2,123,944,000	$ 281.48	$ 170,039,000	$ 19,292,584,000	0.88%
1997	7,428,579	$ 1,514,477,000	$ 203.87	$ 131,249,000	$ 17,646,075,000	0.74%
1996	7,307,565	$ 951,082,000	$ 130.15	$ 150,741,000	$ 15,978,166,000	0.94%
1995	7,185,327	$ 1,025,167,000	$ 142.68	$ 141,031,000	$ 14,755,972,000	0.96%

Total General Obligation Debt and Long-Term Debt Per Capita



[1] Since the 2004 population estimates are not available, the Office of State Controller used the growth rate of the previous year to project the 2004 amount.

Source: Population - *U.S. Department of Commerce, Bureau of the Census, and N.C. Office of State Planning*

REVENUE BOND COVERAGE

For the Fiscal Years 1995-2004 *Table 4*

(Dollars in Thousands)

Fiscal Year Ended June 30	Gross Revenues [1]	Direct Operating Expenses [1]	Net Revenue Available for Debt Service	Principal	Interest	Total	Coverage [2]
PRIMARY GOVERNMENT:							
			Enterprise Funds				
2004	$ 3,800	$ 3,014	$ 786	$ 245	$ 419	$ 664	1.18
2003	4,192	2,341	1,851	235	434	669	2.77
2002	4,005	2,276	1,729	100	431	531	3.26
2001	3,813	2,427	1,386	—	47	47	29.49
2000	—	—	—	—	—	—	—
1999	—	—	—	—	—	—	—
1998	—	—	—	—	—	—	—
1997	—	—	—	—	—	—	—
1996	—	—	—	—	—	—	—
1995	1,963	1,981	(18)	111	—	111	(.16)
COMPONENT UNITS:							
			Proprietary Funds				
2004	$ 422,429	$ 22,281	$ 400,148	$ 25,245	$87,358	$112,603	3.55
2003	361,644	19,520	342,124	22,465	97,759	120,224	2.85
2002	295,751	17,301	278,450	17,902	114,070	131,972	2.11
2001	253,162	18,537	234,625	16,962	122,348	139,310	1.68
2000	193,365	15,755	177,610	17,025	96,605	113,630	1.56
1999	172,096	14,298	157,798	13,435	87,468	100,903	1.56
1998	186,851	12,414	174,437	11,910	73,743	85,653	2.04
1997	105,826	10,624	95,202	10,696	69,182	79,878	1.19
1996	79,683	3,293	76,390	20,520	52,347	72,867	1.05
1995	78,248	3,972	74,276	12,487	53,662	66,149	1.12
			University Funds				
2004	$1,888,382	$1,596,790	$ 291,592	$ 55,192	$53,694	$108,886	2.68
2003	1,766,355	1,485,390	280,965	49,130	53,622	102,752	2.73
2002	1,712,116	1,453,645	258,471	48,330	55,042	103,372	2.50
2001	1,563,249	1,305,655	257,594	44,733	48,875	93,608	2.75
2000	1,127,769	943,685	184,084	36,975	45,821	82,796	2.22
1999	1,201,023	1,000,455	200,568	30,268	47,663	77,931	2.57
1998	1,154,699	881,246	273,453	27,348	44,050	71,398	3.83
1997	1,089,199	880,855	208,344	25,321	44,153	69,474	3.00
1996	999,627	772,898	226,729	22,883	36,777	59,660	3.80
1995	938,473	725,744	212,729	19,089	38,211	57,300	3.71

[1] - Represents actual fund receipts and disbursements securing the applicable bonds.

[2] - Ideally, the coverage number would be 1.00 or higher, indicating that Net Revenues Available exceeds Debt Service Requirements.

SCHEDULE OF GENERAL OBLIGATION BONDS PAYABLE

June 30, 2004
(Dollars in Thousands)

		Payable from General Fund Revenues						
	Total General Obligation Bonds	*Total General Fund*	Capital Improve-ment Series 1989 5-1-89 6.5 - 6.9% [*]	Prison and Youth Services Facilities Series B 10-1-93 2.5 - 4.5%	Prison and Youth Services Facilities Refunding Series C 10-15-93 4.2 - 4.8%	Capital Improve-ment Series 1994A 2-1-94 4.6 - 4.75%	Clean Water Series 1994A 10-1-94 5.7 - 5.8%	Clean Water Series 1995A 6-1-95 5.0 - 5.25%
Bonds Authorized and Issued:								
Ch. 1048, 1987 session law	$ 20,499	$ 20,499	$ 20,499	$ —	$ —	$ —	$ —	$ —
Ch. 935, 1989 session law..	87,500	87,500	—	87,500	—	—	—	—
Ch. 542, 1993 session law..	695,000	695,000	—	—	—	400,000	40,000	60,000
Ch. 631, 1995 session law..	1,800,000	1,800,000	—	—	—	—	—	—
General Statute Ch. 142.....	976,440	976,440	—	—	67,475	—	—	—
Ch. 590, 1995 session law..	650,000	—	—	—	—	—	—	—
Ch. 132, 1998 session law..	682,955	682,955	—	—	—	—	—	—
Ch. 3, 2000 session law......	1,822,800	1,822,800	—	—	—	—	—	—
Total bonds authorized and issued......................	6,735,194	6,085,194	20,499	87,500	67,475	400,000	40,000	60,000
Accretion............................	14,876	14,876	14,876	—	—	—	—	—
Bonds retired......................	905,665	805,615	27,540	47,800	14,805	155,500	16,000	21,000
Partial defeasances............	863,270	863,270	—	39,700	52,670	244,500	24,000	24,000
Bonds outstanding— June 30, 2004............	$ 4,981,135	$ 4,431,185	$ 7,835	$ —	$ —	$ —	$ —	$ 15,000
Bond Maturity As Follows:								
2004-05..........................	274,261	239,586	1,786	—	—	—	—	3,000
2005-06..........................	281,160	246,485	1,670	—	—	—	—	3,000
2006-07..........................	280,821	246,146	1,561	—	—	—	—	3,000
2007-08..........................	280,782	246,107	1,457	—	—	—	—	3,000
2008-09..........................	279,721	245,046	1,361	—	—	—	—	3,000
2009-10..........................	280,225	245,550	—	—	—	—	—	—
2010-11..........................	280,630	245,955	—	—	—	—	—	—
2011-12..........................	281,360	246,685	—	—	—	—	—	—
2012-13..........................	282,360	247,810	—	—	—	—	—	—
2013-14..........................	281,915	247,315	—	—	—	—	—	—
2014-15..........................	281,315	246,715	—	—	—	—	—	—
2015-16..........................	281,185	246,585	—	—	—	—	—	—
2016-17..........................	278,715	244,115	—	—	—	—	—	—
2017-18..........................	281,865	247,265	—	—	—	—	—	—
2018-19..........................	281,065	246,465	—	—	—	—	—	—
2019-20..........................	216,900	186,500	—	—	—	—	—	—
2020-21..........................	130,500	130,500	—	—	—	—	—	—
2021-22..........................	111,500	111,500	—	—	—	—	—	—
2022-23..........................	104,455	104,455	—	—	—	—	—	—
2023-24..........................	81,500	81,500	—	—	—	—	—	—
2024-25..........................	79,400	79,400	—	—	—	—	—	—
2025-26..........................	16,500	16,500	—	—	—	—	—	—
2026-27..........................	16,500	16,500	—	—	—	—	—	—
2027-28..........................	16,500	16,500	—	—	—	—	—	—
Total Bonds Outstanding....	$ 4,981,135	$ 4,431,185	$ 7,835	$ —	$ —	$ —	$ —	$ 15,000

[*] Capital Appreciation Bonds

Table 5

Payable from General Fund Revenues

Capital Improve-ment Series 1997	Public School Building Series 1997A	Public School Building Series 1998A	Public School Building Series 1999	Clean Water Refunding Series 1999	Public Improvement Series 1999A	Public Improvement Series 1999B	Public Improvement Series 1999C	Public Improvement Series 2000A
1-1-97	3-1-97	4-1-98	4-1-99	4-1-99	9-1-99	9-1-99	10-1-99	9-1-00
4.8-5.1%	5.1-5.2%	4.75-5.0%	4.5-5.0%	2.9-5.0%	5.0-5.4%	6.7-6.75%	4.5-4.7%	5.0-5.1%
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
—	—	—	—	—	—	—	—	—
195,000	—	—	—	—	—	—	—	—
—	450,000	450,000	450,000	—	—	—	—	295,000
—	—	—	—	25,905	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	177,400	20,000	2,600	5,000
—	—	—	—	—	—	—	—	—
195,000	450,000	450,000	450,000	25,905	177,400	20,000	2,600	300,000
—	—	—	—	—	—	—	—	—
57,000	72,000	80,000	92,500	1,330	24,000	11,400	1,500	36,000
54,000	137,500	43,500	—	—	59,400	—	—	72,000
$ 84,000	$ 240,500	$ 326,500	$ 357,500	$ 24,575	$ 94,000	$ 8,600	$ 1,100	$ 192,000
12,000	27,000	16,000	18,500	2,190	6,000	2,850	375	12,000
12,000	27,000	16,000	18,500	2,160	6,000	2,850	375	12,000
12,000	27,000	16,000	18,500	2,135	6,000	2,900	350	12,000
12,000	31,500	16,000	18,500	2,110	9,500	—	—	12,000
12,000	32,000	22,000	18,500	2,080	9,500	—	—	12,000
12,000	32,000	29,500	18,500	2,050	9,500	—	—	12,000
12,000	32,000	29,500	18,500	2,025	9,500	—	—	12,000
—	32,000	29,500	18,500	2,000	9,500	—	—	12,000
—	—	37,000	18,500	1,980	9,500	—	—	12,000
—	—	57,500	18,500	1,965	9,500	—	—	12,000
—	—	57,500	18,500	1,950	9,500	—	—	12,000
—	—	—	71,500	1,930	—	—	—	12,000
—	—	—	74,000	—	—	—	—	48,000
—	—	—	8,500	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
$ 84,000	$ 240,500	$ 326,500	$ 357,500	$ 24,575	$ 94,000	$ 8,600	$ 1,100	$ 192,000

Continued

SCHEDULE OF GENERAL OBLIGATION BONDS PAYABLE (continued)

June 30, 2004

(Dollars in Thousands)

	Payable from General Fund Revenues						
	Public Improvement Series 2001A 3-1-01 4.5-5.0%	Public Improvement Series 2002A 3-1-02 4.0-5.5%	Public Improvement Series 2002B 3-1-02 3.5-4.0%	Public Improvement Series 2002C 4-1-02 3.0-4.0%	Public Improvement Series 2002D 5-1-02 Variable to 18%	Public Improvement Series 2002E 5-1-02 Variable to 18%	Public Improvement Series 2002F 5-1-02 Variable to 18%
Bonds Authorized and Issued:							
Ch. 1048, 1987 session law	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Ch. 935, 1989 session law..	—	—	—	—	—	—	—
Ch. 542, 1993 session law..	—	—	—	—	—	—	—
Ch. 631, 1995 session law..	100,000	—	—	—	55,000	—	—
General Statute Ch. 142.....	—	—	—	—	—	—	—
Ch. 590, 1995 session law..	—	—	—	—	—	—	—
Ch. 132, 1998 session law..	30,000	204,400	35,000	10,600	—	—	—
Ch. 3, 2000 session law......	250,000	—	—	—	33,750	88,750	88,750
Total bonds authorized and issued......................	380,000	204,400	35,000	10,600	88,750	88,750	88,750
Accretion...........................	—	—	—	—	—	—	—
Bonds retired......................	48,000	10,700	35,000	4,300	—	—	—
Partial defeasances............	112,000	—	—	—	—	—	—
Bonds outstanding— June 30, 2004............	$ 220,000	$ 193,700	$ —	$ 6,300	$ 88,750	$ 88,750	$ 88,750
Bond Maturity As Follows:							
2004-05.........................	16,000	22,850	—	2,150	—	—	—
2005-06.........................	16,000	22,850	—	2,150	—	—	—
2006-07.........................	16,000	23,000	—	2,000	—	—	—
2007-08.........................	16,000	25,000	—	—	—	—	—
2008-09.........................	16,000	25,000	—	—	—	—	—
2009-10.........................	16,000	25,000	—	—	—	—	—
2010-11.........................	16,000	25,000	—	—	—	—	—
2011-12.........................	16,000	25,000	—	—	—	—	—
2012-13.........................	16,000	—	—	—	6,250	6,250	6,250
2013-14.........................	16,000	—	—	—	6,250	6,250	6,250
2014-15.........................	16,000	—	—	—	6,250	6,250	6,250
2015-16.........................	16,000	—	—	—	6,250	6,250	6,250
2016-17.........................	28,000	—	—	—	6,250	6,250	6,250
2017-18.........................	—	—	—	—	10,750	10,750	10,750
2018-19.........................	—	—	—	—	23,250	23,250	23,250
2019-20.........................	—	—	—	—	18,750	18,750	18,750
2020-21.........................	—	—	—	—	4,750	4,750	4,750
2021-22.........................	—	—	—	—	—	—	—
2022-23.........................	—	—	—	—	—	—	—
2023-24.........................	—	—	—	—	—	—	—
2024-25.........................	—	—	—	—	—	—	—
2025-26.........................	—	—	—	—	—	—	—
2026-27.........................	—	—	—	—	—	—	—
2027-28.........................	—	—	—	—	—	—	—
Total Bonds Outstanding....	$ 220,000	$ 193,700	$ —	$ 6,300	$ 88,750	$ 88,750	$ 88,750

Table 5

Payable from General Fund Revenues

Public Improvement Series 2002G 5-1-02 Variable to 18%	Natural Gas Series 2002A 12-1-02 2.6 - 3.9%	Clean Water Series 2002A 12-1-02 2.25 - 5.0%	Refunding Series 2002A 12-1-02 2% - 5.25%	Refunding Series 2002B 12-12-02 Variable to 20%	Refunding Series 2002C 12-12-02 Variable to 20%	Refunding Series 2002D 12-12-02 Variable to 20%	Refunding Series 2002E 12-12-02 Variable to 20%	Refunding Series 2002F 12-12-02 Variable to 20%
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	56,480	100,000	100,000	100,000	100,000	99,870
—	—	—	—	—	—	—	—	—
—	50,000	18,800	—	—	—	—	—	—
88,750	—	—	—	—	—	—	—	—
88,750	50,000	18,800	56,480	100,000	100,000	100,000	100,000	99,870
—	—	—	—	—	—	—	—	—
—	10,000	230	5,300	—	—	—	—	—
—	—	—	—	—	—	—	—	—
$ 88,750	$ 40,000	$ 18,570	$ 51,180	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 99,870
—	10,000	190	5,740	—	—	—	—	—
—	10,000	200	5,915	—	—	—	—	—
—	10,000	210	6,075	—	—	—	—	—
—	10,000	225	6,250	—	—	—	—	—
—	—	235	6,795	—	—	—	—	—
—	—	255	10,030	—	—	—	—	—
—	—	270	10,375	—	—	—	—	—
—	—	750	—	4,520	4,520	4,520	4,520	4,500
6,250	—	1,815	—	10,920	10,920	10,920	10,920	10,915
6,250	—	1,795	—	10,815	10,815	10,815	10,815	10,795
6,250	—	1,775	—	10,700	10,700	10,700	10,700	10,690
6,250	—	2,245	—	13,385	13,385	13,385	13,385	13,370
6,250	—	510	—	3,520	3,520	3,520	3,520	3,525
10,750	—	4,915	—	27,975	27,975	27,975	27,975	27,950
23,250	—	3,180	—	18,165	18,165	18,165	18,165	18,125
18,750	—	—	—	—	—	—	—	—
4,750	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
$ 88,750	$ 40,000	$ 18,570	$ 51,180	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 99,870

Continued

SCHEDULE OF GENERAL OBLIGATION BONDS PAYABLE (continued)

June 30, 2004

(Dollars in Thousands)

	Payable from General Fund Revenues						
	Clean Water Series 2003A 1-1-03 2.25% - 3.125%	Public Improvement Series 2003A 3-1-03 2.0% - 5.25%	Public Improvement Series 2003B 4-1-03 2.0-5.0%	Natural Gas Series 2003 4-1-03 1.5% - 3.5%	Clean Water Series 2003B 5-1-03 2.5% - 3.125%	Refunding Series 2003D 8-1-03 2.0%-4.75%	Refunding Series 2003E 8-1-03 4%-5%
Bonds Authorized and Issued:							
Ch. 1048, 1987 session law	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Ch. 935, 1989 session law..	—	—	—	—	—	—	—
Ch. 542, 1993 session law..	—	—	—	—	—	—	—
Ch. 631, 1995 session law..	—	—	—	—	—	—	—
General Statute Ch. 142.....	—	—	—	—	—	91,000	235,710
Ch. 590, 1995 session law..	—	—	—	—	—	—	—
Ch. 132, 1998 session law..	2,900	38,355	—	33,000	3,645	—	—
Ch. 3, 2000 session law......	—	281,645	283,255	—	—	—	—
Total bonds authorized and issued......................	2,900	320,000	283,255	33,000	3,645	91,000	235,710
Accretion...........................	—	—	—	—	—	—	—
Bonds retired......................	600	5,000	4,460	6,600	750	16,300	—
Partial defeasances............	—	—	—	—	—	—	—
Bonds outstanding— June 30, 2004............	$ 2,300	$ 315,000	$ 278,795	$ 26,400	$ 2,895	$ 74,700	$ 235,710
Bond Maturity As Follows:							
2004-05..........................	600	5,000	4,460	6,600	750	18,320	20,925
2005-06..........................	600	5,000	4,460	6,600	750	18,120	27,985
2006-07..........................	600	5,000	4,460	6,600	750	17,915	27,790
2007-08..........................	500	5,000	4,460	6,600	645	13,475	27,585
2008-09..........................	—	13,000	13,000	—	—	6,870	27,650
2009-10..........................	—	13,000	13,000	—	—	—	27,715
2010-11..........................	—	13,000	13,000	—	—	—	27,785
2011-12..........................	—	13,000	13,000	—	—	—	27,855
2012-13..........................	—	13,000	13,000	—	—	—	20,420
2013-14..........................	—	13,000	13,000	—	—	—	—
2014-15..........................	—	13,000	13,000	—	—	—	—
2015-16..........................	—	13,000	13,000	—	—	—	—
2016-17..........................	—	13,000	13,000	—	—	—	—
2017-18..........................	—	13,000	13,000	—	—	—	—
2018-19..........................	—	16,500	18,000	—	—	—	—
2019-20..........................	—	16,500	30,000	—	—	—	—
2020-21..........................	—	16,500	30,000	—	—	—	—
2021-22..........................	—	16,500	30,000	—	—	—	—
2022-23..........................	—	16,500	22,955	—	—	—	—
2023-24..........................	—	16,500	—	—	—	—	—
2024-25..........................	—	16,500	—	—	—	—	—
2025-26..........................	—	16,500	—	—	—	—	—
2026-27..........................	—	16,500	—	—	—	—	—
2027-28..........................	—	16,500	—	—	—	—	—
Total Bonds Outstanding....	$ 2,300	$ 315,000	$ 278,795	$ 26,400	$ 2,895	$ 74,700	$ 235,710

Table 5

Payable from General Fund Revenues			Payable from Highway Trust Fund		
Public Improvement Series 2004A 3-1-04 2%-5.25%	Natural Gas Series 2004A 3-1-04 2%-3.25%	Clean Water Series 2004A 3-29-04 2%-3.25%	*Total Highway Trust*	Highway Series 1997A 11-1-97 4.5-5.0%	Highway Series 2003 12-1-03 3%-5%
$ —	$ —	$ —	$ —	$ —	$ —
—	—	—	—	—	—
—	—	—	—	—	—
—	—	—	—	—	—
—	—	—	—	—	—
—	—	—	650,000	250,000	400,000
—	36,000	15,255	—	—	—
707,900	—	—	—	—	—
707,900	36,000	15,255	650,000	250,000	400,000
—	—	—	—	—	—
—	—	—	100,050	100,050	—
—	—	—	—	—	—
$ 707,900	$ 36,000	$ 15,255	$ 549,950	$ 149,950	$ 400,000
14,000	7,200	3,100	34,675	16,675	18,000
14,000	7,200	3,100	34,675	16,675	18,000
14,000	7,200	3,100	34,675	16,675	18,000
14,000	7,200	3,100	34,675	16,675	18,000
14,000	7,200	2,855	34,675	16,675	18,000
25,000	—	—	34,675	16,675	18,000
25,000	—	—	34,675	16,675	18,000
25,000	—	—	34,675	16,675	18,000
25,000	—	—	34,550	16,550	18,000
25,000	—	—	34,600	—	34,600
25,000	—	—	34,600	—	34,600
25,000	—	—	34,600	—	34,600
25,000	—	—	34,600	—	34,600
25,000	—	—	34,600	—	34,600
25,000	—	—	34,600	—	34,600
65,000	—	—	30,400	—	30,400
65,000	—	—	—	—	—
65,000	—	—	—	—	—
65,000	—	—	—	—	—
65,000	—	—	—	—	—
62,900	—	—	—	—	—
—	—	—	—	—	—
—	—	—	—	—	—
—	—	—	—	—	—
$ 707,900	$ 36,000	$ 15,255	$ 549,950	$ 149,950	$ 400,000

Source: Compiled by the Department of State Treasurer.

SCHEDULE OF SPECIAL OBLIGATION DEBT

June 30, 2004 *Table 6*

(Dollars in Thousands)

		Lease Purchase Revenue Bonds	*Certificates of Participation*			
	Total Special Obligation Debt	NC Correctional Facilities Lease Purchase Series 2003 7-15-03	*Total Certificates of Participation*	Certificates of Participation Series 2003A 4-1-03	Correctional Facilities Project Series 2004A 2-1-04	Certificates of Participation Series 2004A 5-6-04
		2.0% - 5.25%		2.0% - 5.25%		
Bonds Authorized and Issued:						
Ch. 284, 2003 session law.....	$ 502,360	$ 218,405	$ 283,955	$ —	$ 158,955	$ 125,000
	17,500	—	17,500	17,500	—	—
Total bonds authorized and issued.........................	519,860	218,405	301,455	17,500	158,955	125,000
Bonds retired.........................	290	—	290	290	—	—
Bonds outstanding— June 30, 2004...............	$ 519,570	$ 218,405	$ 301,165	$ 17,210	$ 158,955	$ 125,000
Bond Maturity As Follows:						
2004-05........................	21,380	7,000	14,380	435	7,945	6,000
2005-06........................	22,600	8,000	14,600	650	7,950	6,000
2006-07........................	22,615	8,000	14,615	665	7,950	6,000
2007-08........................	22,640	8,000	14,640	690	7,950	6,000
2008-09........................	22,670	8,000	14,670	720	7,950	6,000
2009-10........................	22,690	8,000	14,690	740	7,950	6,000
2010-11........................	22,715	8,000	14,715	765	7,950	6,000
2011-12........................	22,745	8,000	14,745	795	7,950	6,000
2012-13........................	22,775	8,000	14,775	825	7,950	6,000
2013-14........................	22,810	8,000	14,810	860	7,950	6,000
2014-15........................	22,855	8,000	14,855	905	7,950	6,000
2015-16........................	22,900	8,000	14,900	950	7,950	6,000
2016-17........................	22,945	8,000	14,945	1,000	7,945	6,000
2017-18........................	23,000	8,000	15,000	1,055	7,945	6,000
2018-19........................	23,055	8,000	15,055	1,110	7,945	6,000
2019-20........................	35,110	19,000	16,110	1,165	7,945	7,000
2020-21........................	35,175	19,000	16,175	1,230	7,945	7,000
2021-22........................	35,235	19,000	16,235	1,290	7,945	7,000
2022-23........................	35,305	19,000	16,305	1,360	7,945	7,000
2023-24........................	38,350	23,405	14,945	—	7,945	7,000
Total Bonds Outstanding..	$ 519,570	$ 218,405	$ 301,165	$ 17,210	$ 158,955	$ 125,000

Source: Compiled by the Department of State Treasurer.

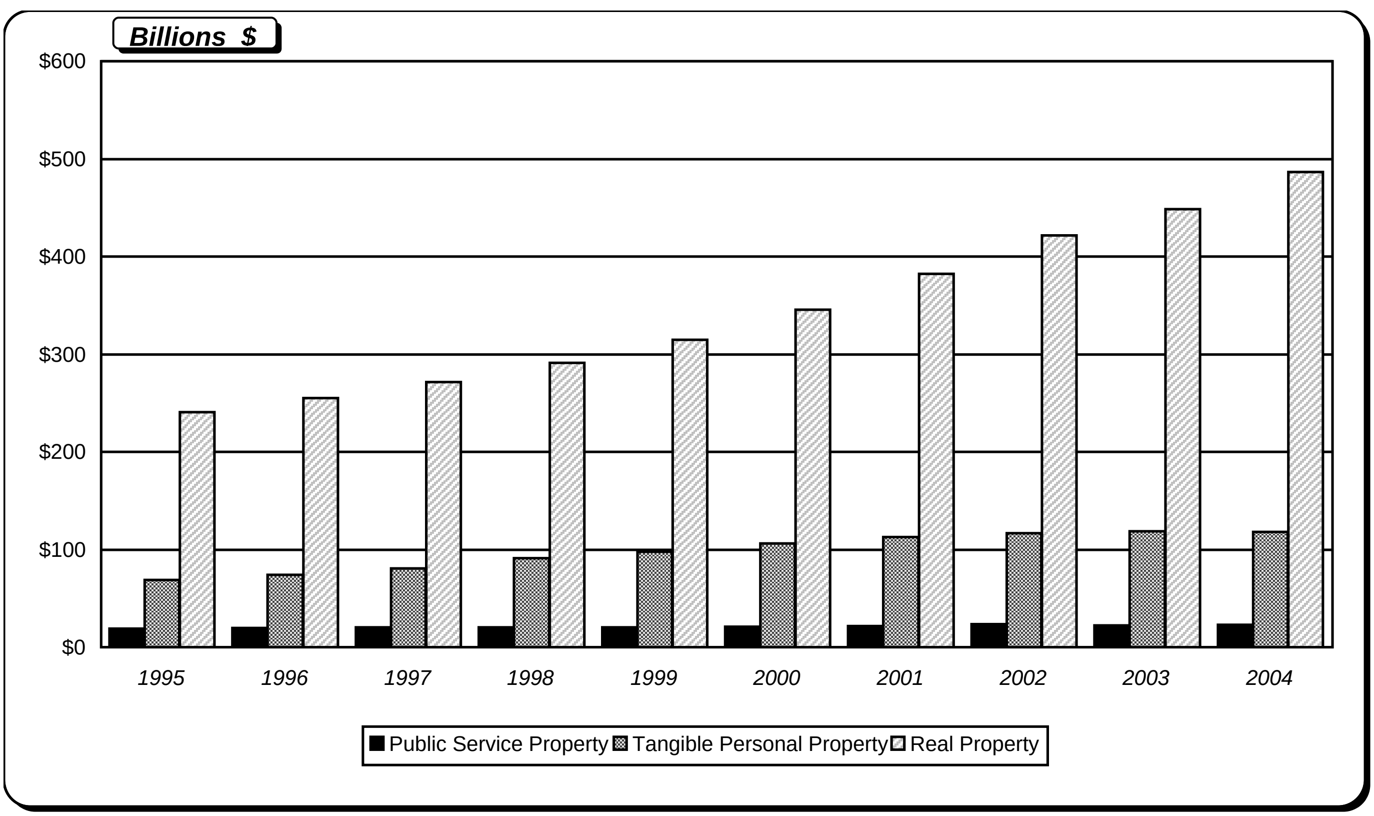
STATEWIDE ASSESSED PROPERTY VALUES REAL PROPERTY, TANGIBLE PERSONAL PROPERTY AND PUBLIC SERVICE COMPANIES

For the Fiscal Years 1995-2004

Table 7

	Assessed Value at January 1			
For the Years	**Real Property**	**Tangible Personal Property**	**Public Service Companies**	**Total**
2004	486,461,699,574	117,944,792,111	22,997,034,378	627,403,526,063
2003	448,370,864,967	118,788,285,500	22,602,081,344	589,761,231,811
2002	421,831,969,378	116,740,143,820	23,355,586,210	561,927,699,408
2001	382,422,908,009	112,992,132,642	21,952,438,541	517,367,479,192
2000	345,704,989,165	105,984,739,896	20,874,178,731	472,563,907,792
1999	314,949,315,291	97,834,758,018	20,244,024,631	433,028,097,940
1998	291,205,137,584	91,392,925,590	20,442,713,966	403,040,777,140
1997	271,764,063,900	80,698,570,134	20,194,521,863	372,657,155,897
1996	255,260,809,402	74,021,864,531	19,847,155,764	349,129,829,697
1995	240,636,714,460	68,881,737,558	19,193,111,331	328,711,563,349

Statewide Assessed Property Values
Ten-Year Comparison



Source: Compiled by the Department of Revenue from reports submitted by counties and municipalities.

SCHEDULE OF BANK AND SAVINGS AND LOAN DEPOSITS OF FINANCIAL INSTITUTIONS LOCATED IN NORTH CAROLINA

For the Years 1995-2004 *Table 8*

(Dollars in Thousands)

Commercial, Savings Banks & Thrifts

As of June 30	Chartered State	Chartered National		Total Deposits
2004	90,732,421	734,363,393	[1]	825,095,814
2003	80,487,515	653,561,925	[1]	734,049,440
2002	70,914,385	565,715,954	[1],[2]	636,630,339

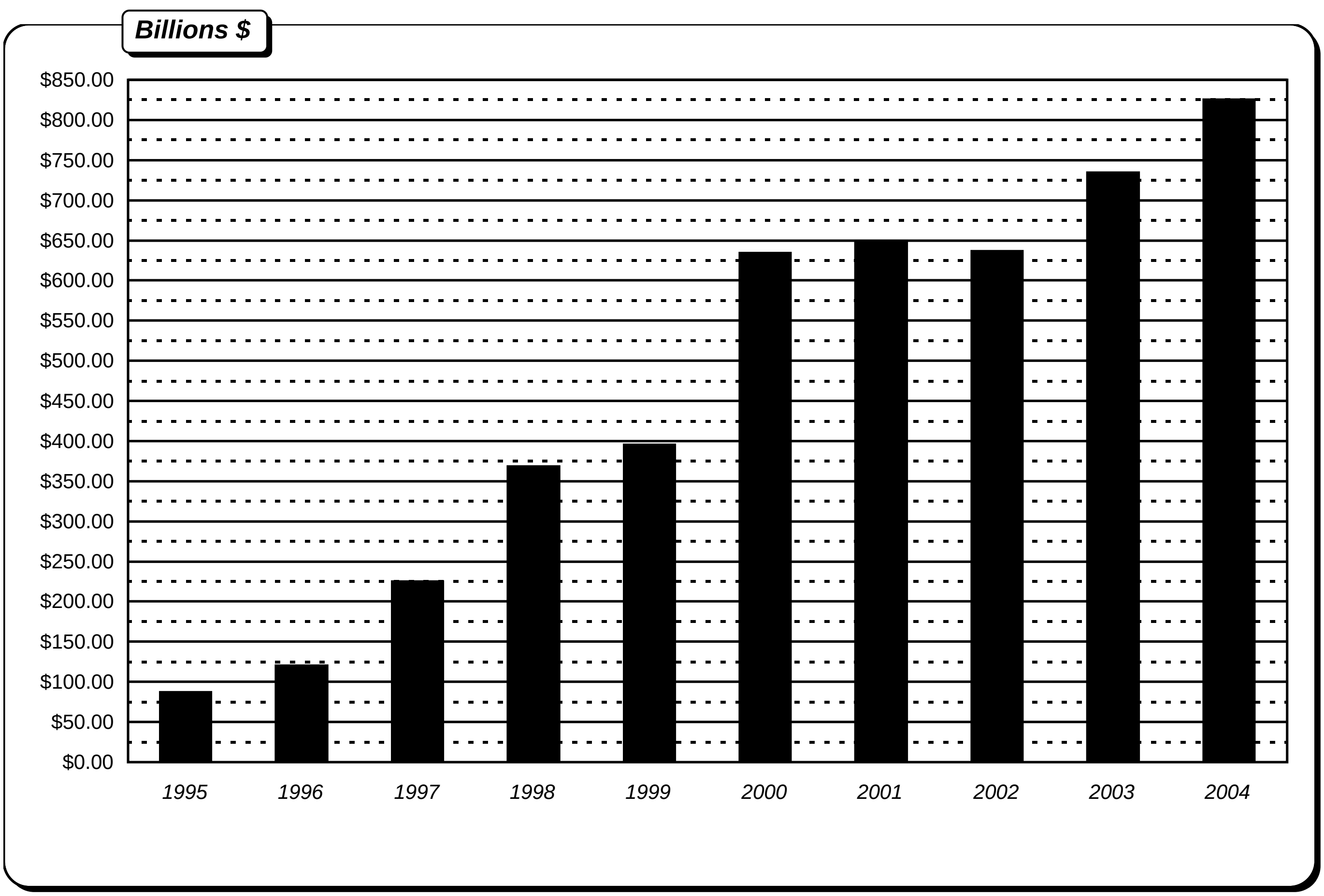
Banks

As of June 30	Chartered State	Chartered National		Total Deposits
2001	68,181,993	575,167,149	[1]	643,349,142
2000	54,700,398	574,253,124	[1]	628,953,522
1999	47,171,364	342,200,834	[1]	389,372,198
1998	42,834,645	319,721,396	[1]	362,556,041
1997	40,258,721	178,556,322	[1]	218,815,043
1996	37,637,624	75,499,983		113,137,607
1995	34,336,993	52,883,449		87,220,442

Savings and Loan Associations

As of Dec. 31	Chartered State	Chartered Federal	Total Deposits
2000	2,563,408	2,113,000	4,676,408
1999	2,951,811	2,294,505	5,246,316
1998	3,283,086	2,408,829	5,691,915
1997	3,440,310	2,663,747	6,104,057
1996	3,459,159	2,636,338	6,095,497
1995	3,949,870	2,898,852	6,848,722

Deposits in North Carolina Financial Institutions Last Ten Years



[1] The large increases in deposits in national banks are due to the consolidation of separate out-of-state charters of North Carolina banks into one charter in North Carolina due to a change in Federal law, and the acquisition and consolidation of banks and individual branches in other states by North Carolina banks.

[2] Savings & Loans were merged with banks as of July 1, 2001.

Source: North Carolina Department of Commerce - State Chartered

CASH RECEIPTS FROM FARMING BY COMMODITIES

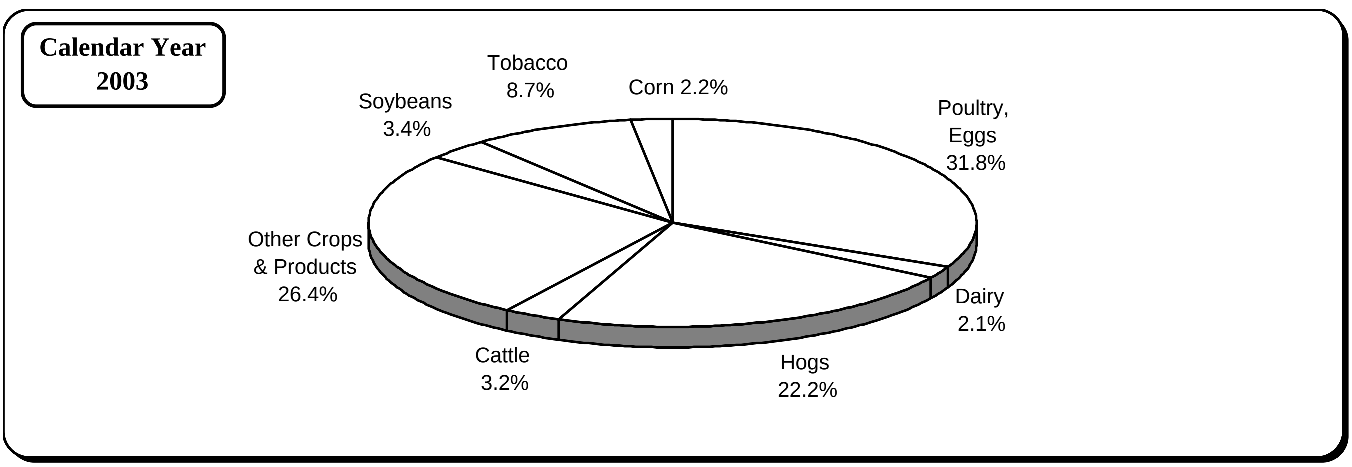
For the Calendar Years 1994-2003 *Table 9*

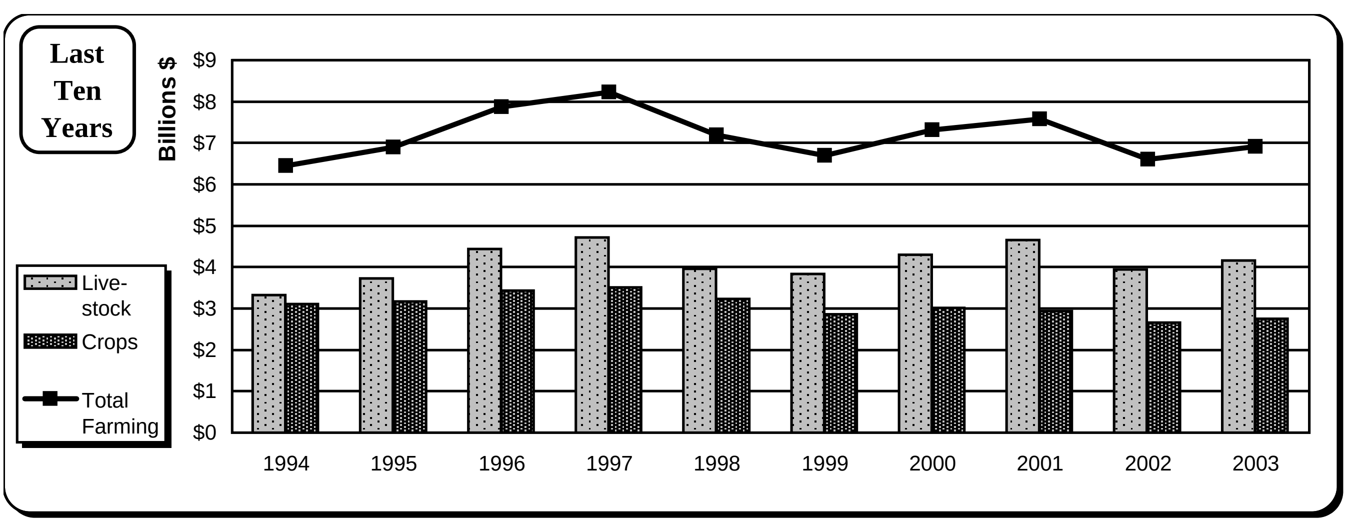
(Dollars in Millions)

	Livestock and Related Products						*Crops*					*Total*
Year	Poultry and Eggs	Dairy Products	Hogs	Cattle	Other Livestock and Products	Total Livestock and Products	Tobacco	Soybeans	Corn	Other Crops	Total Crops	All Livestock and Crops
2003	2,198.7	143.3	1,533.3	220.0	62.5	4,157.8	598.3	238.0	150.8	1,761.4	2,748.5	6,906.3
2002	2,093.3	154.7	1,407.1	223.8	60.8	3,939.7	694.4	162.0	131.5	1,672.0	2,659.9	6,599.6 [1]
2001	2,458.2	194.4	1,721.5	227.7	52.6	4,654.4	685.8	183.2	151.6	1,909.9	2,930.5	7,584.9
2000	2,171.3	174.5	1,671.6	231.7	50.8	4,299.9	854.1	169.4	116.8	1,869.4	3,009.7	7,309.6
1999	2,212.3	207.1	1,160.3	208.7	50.8	3,839.2	784.3	174.7	101.5	1,795.4	2,855.9	6,695.1
1998	2,225.0	208.0	1,323.1	154.0	46.2	3,956.3	976.7	173.8	111.7	1,966.5	3,228.7	7,185.0
1997	2,210.3	193.6	2,058.8	213.1	47.5	4,723.3	1,193.2	270.9	196.6	1,843.0	3,503.7	8,227.0
1996	2,250.6	214.3	1,766.5	153.2	56.9	4,441.5	1,021.5	229.3	298.0	1,879.0	3,427.8	7,869.3
1995	2,053.9	189.9	1,279.3	146.9	61.0	3,731.0	1,048.5	157.4	165.7	1,795.4	3,167.0	6,898.0
1994	1,911.5	210.5	982.8	166.7	57.5	3,329.0	942.9	217.3	149.0	1,804.6	3,113.8	6,442.8

[1] Numbers restated by Agricultural Departmen

CASH RECEIPTS FROM FARMING





Source: North Carolina Crop and Livestock Reporting Service (Data for 2004 is not available.)

MAJOR PRIVATE EMPLOYERS IN NORTH CAROLINA

Table 10

The State's largest major private employers, ranked in order according to first quarter 2004 preliminary employment averages, are listed:

2004 Rank	Employer	Type of Business
1	Wal-Mart Stores, Inc.	Discount store chain
2	Food Lion, Inc.	Supermarket chain
3	Duke University	Private university, medical center
4	Wachovia Bank, NA	Banking and financial services
5	IBM Corporation	Computers, telecommunications
6	Lowes Home Centers, Inc.	Hardware chain
7	Harris Teeter, Inc	Supermarket chain
8	Sara Lee Corporation	Hosiery, baked goods, apparel
9	Branch Banking & Trust Co	Banking and financial services
10	Bank of America, NA	Banking and financial services
11	United Parcel Service, Inc	Delivery services
12	U S Air, Inc	Airlines
13	GlaxoSmithKline	Pharmaceuticals
14	Lowes Food Stores, Inc	Supermarket chain
15	Moses H Cone Memorial Hospital	Medical services
16	Duke Energy Corporation	Utility - electrical
17	Smithfield Packing Co.	Meat packing
18	Belk, Inc	Department store chain
19	R J Reynolds Tobacco Corporation	Tobacco
20	Adecco USA, Inc	Professional and business services
21	Target Stores	Department store chain
22	Broyhill Furniture Industries, Inc.	Furniture manufacturing
23	Coca Cola Bottling Company	Distributor
24	Sears Roebuck and Co, Inc	Department store chain
25	Forsyth Memorial Hospital, Inc	Medical services

Source: North Carolina Employment Security Commission

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SCHEDULE OF DEMOGRAPHIC DATA

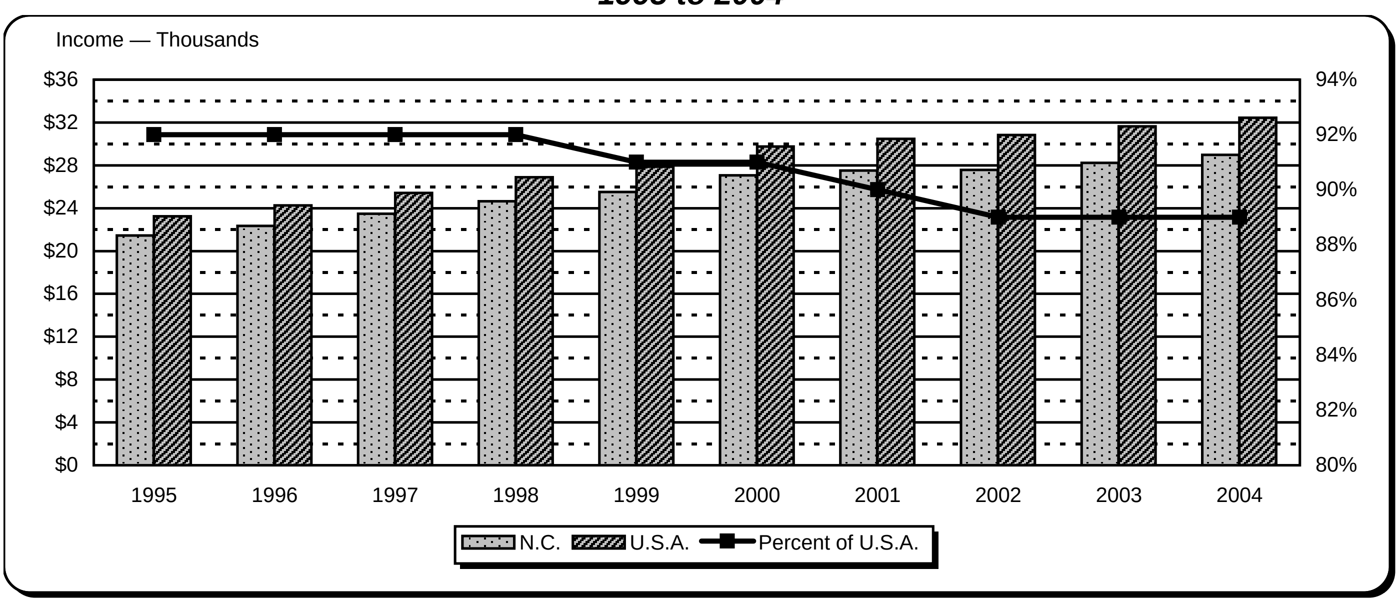
For the Years 1950, 1960, 1970, 1980, 1990, 1995-2004

	Population [1]						Per Capita Income [2]				
Year	United States Population		U.S. Increase from Prior Period	North Carolina Population		N.C. Increase from Prior Period	United States		North Carolina		N.C. as a Percentage of U.S.
2004	293,281,660	[F]	0.85%	8,495,524	[F]	1.05%	$ 32,454	[G]	$ 28,968	[G]	89.26%
2003	290,809,777	[D]	0.85%	8,407,248	[D]	1.05%	31,632	[E]	28,235	[E]	89.26%
2002	288,368,698	[D]	1.25%	8,320,146	[D]	1.64%	30,832	[E]	27,566	[E]	89.41%
2001	284,797,000	[D]	0.95%	8,186,268	[D]	1.70%	30,472	[E]	27,514	[E]	90.29%
2000	282,125,000	[D]	3.46%	8,049,313	[D]	5.25%	29,770	[E]	27,055	[E]	90.88%
1999	272,691,000	[B]	0.90%	7,647,934	[C]	1.35%	27,880	[E]	25,504	[E]	91.48%
1998	270,248,000	[B]	0.92%	7,545,735	[C]	1.58%	26,893	[E]	24,661	[E]	91.70%
1997	267,784,000	[B]	0.96%	7,428,579	[C]	1.66%	25,412	[E]	23,468	[E]	92.35%
1996	265,229,000	[B]	0.92%	7,307,565	[C]	1.70%	24,270	[E]	22,350	[E]	92.09%
1995	262,803,000	[B]	0.95%	7,185,327	[C]	1.76%	23,255	[E]	21,462	[E]	92.29%
1990	248,791,000	[A]	9.82%	6,632,448	[A]	12.79%	19,588		17,295		88.29%
1980	226,546,000	[A]	11.13%	5,880,095	[A]	15.65%	10,062		8,090		80.40%
1970	203,849,000	[A]	13.26%	5,084,411	[A]	11.59%	4,072		3,255		79.94%
1960	179,979,000	[A]	18.51%	4,556,155	[A]	12.17%	2,254		1,615		71.65%
1950	151,868,000	[A]		4,061,929	[A]		1,496		1,037		69.32%

[A] - U.S. Census count - April 1 (1950 - 1990)
[B] - U.S. Census estimates - July 1 (1991 - 2000)
[C] - N.C. Office of State Planning estimate - July 1, 1991 - 1999, based on April, 1990 census population of 6,628,637 and April census population of 8,049,313
[D] - U.S. Census estimates based on 2000 census
[E] - Bureau of Economic Analysis estimate

[F] - Since the 2004 population estimates are not available, the Office of State Controller used the growth rate of the previous year to project the 2004 amounts.
[G] - Since the 2004 per capita income estimates are not available, the Office of State Controller used the growth rate of the previous year to project the 2004 amount for US and the 2004 percentage of US for North Carolina.

Per Capita Income
North Carolina Compared to United States
1995 to 2004



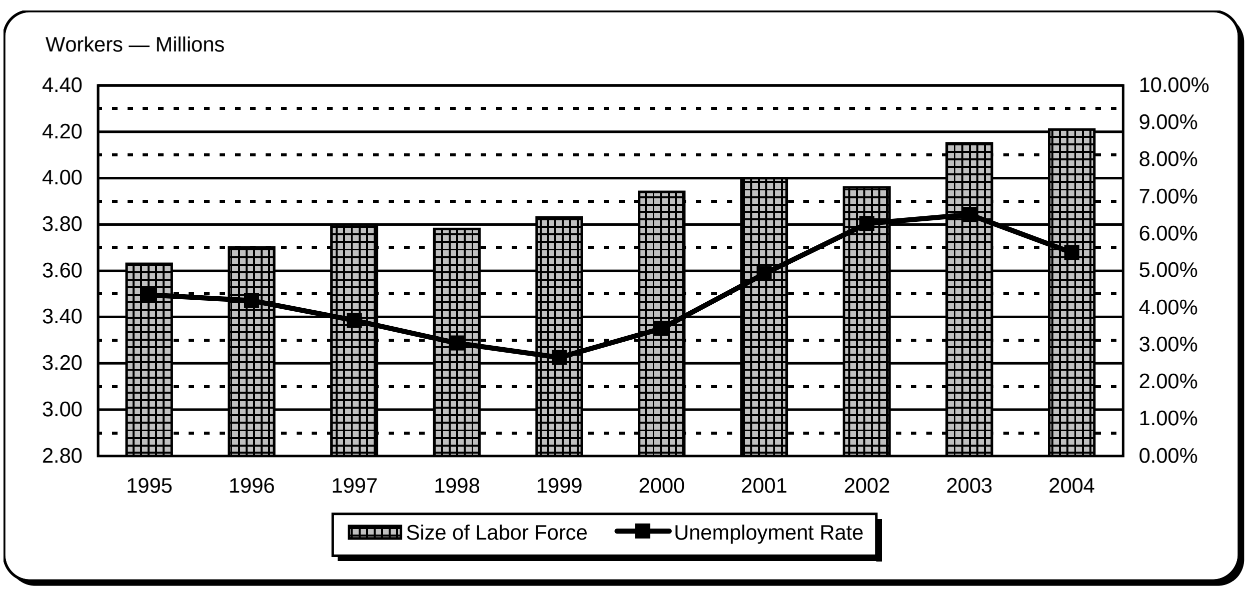
Sources:	*[1] Population*	*U.S. Department of Commerce, Bureau of the Census* *N.C. Office of State Planning*
	[2] Per Capita Income	*U.S. Department of Commerce, Bureau of Economic Analysis* *N.C. Office of State Budget and Management*
	[3] Labor Force Data - As of June 30	*N.C. Employment Security Commission*

Table 11

	North Carolina Civilian Labor Force Data			*[3]*	*North Carolina - Other Data*		
					[4]	*[5]*	*[6]*
Year	**Total**	**Employed**	**Unemployed**	**Unemployed Percentage Rate**	**Public School Enrollment**	**Motor Vehicles Registered**	**Residential Construction Authorized**
2004	4,208,568	3,977,421	231,147	5.49%	1,325,344	7,701,410	46,735
2003	4,152,243	3,882,026	270,217	6.51%	1,303,777	7,624,272	38,137
2002	3,964,000	3,715,400	248,600	6.27%	1,285,729	7,498,181	40,763
2001	3,999,300	3,802,500	196,800	4.92%	1,267,070	7,344,437	23,555
2000	3,941,000	3,805,300	135,700	3.44%	1,249,922	7,112,610	77,351
1999	3,826,000	3,724,100	101,900	2.66%	1,229,929	6,911,814	105,117
1998	3,776,300	3,661,000	115,300	3.05%	1,208,368	6,428,104	103,432
1997	3,796,900	3,657,800	139,100	3.66%	1,183,335	6,392,269	93,609
1996	3,703,000	3,548,000	155,000	4.19%	1,156,885	6,303,969	89,485
1995	3,634,000	3,476,000	158,000	4.35%	1,131,090	6,167,660	85,215
1990	3,471,000	3,339,000	132,000	3.80%	1,065,399	5,600,050	30,471
1980	2,759,197	2,607,925	151,272	5.48%	1,191,342	5,094,814	6,730
1970	2,054,838	1,984,402	70,436	3.43%	1,217,024	3,218,292	N/A
1960	1,680,442	1,605,478	74,964	4.46%	1,105,412	1,907,988	N/A
1950	1,512,924	1,463,352	49,572	3.28%	893,745	1,171,228	N/A

N/A = Data not available.

Civilian Labor Force Trends
With Unemployment Percentages
1995 to 2004



Sources:

[4] Public School Enrollment - Final Average Daily Membership for the School Year September 1 to June 30 — *N.C. Department of Public Instruction*

[5] Motor Vehicle Registrations - For the Fiscal Year Ended June 30 — *N.C. Division of Motor Vehicles*

[6] Residential Housing Permits — *N.C. Department of Labor*

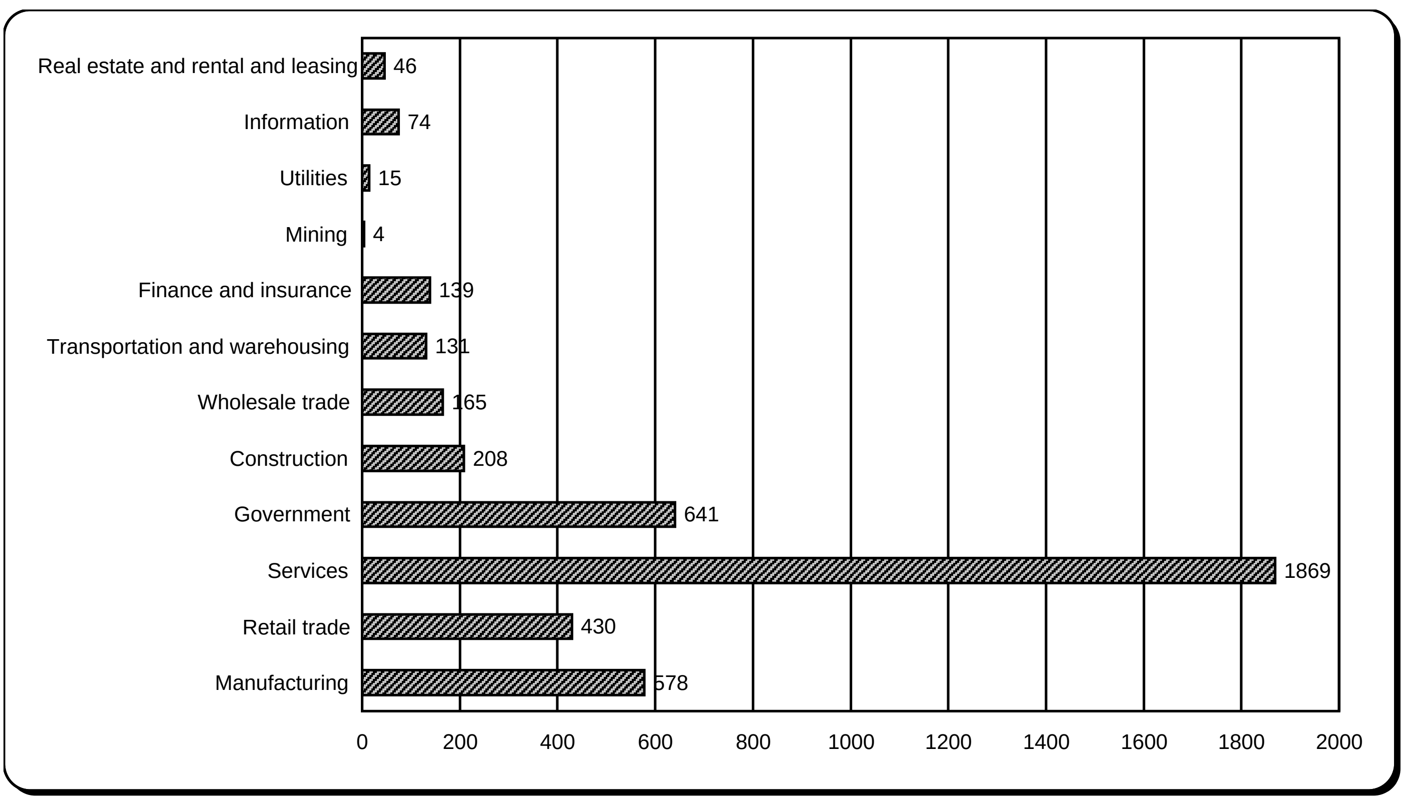
TEN LARGEST NON-AGRICULTURAL INDUSTRIES BY NUMBER OF EMPLOYEES

For the Calendar Years 1994-2003 *Table 12*

(Expressed in Thousands of Workers)

	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994
Manufacturing	577.6	633.9	674.8	750.4	769.2	788.7	800.7	810.5	819.5	827.1
Retail trade	429.5	452.4	459.1	467.3	462.1	447.9	446.9	432.3	423.7	403.4
Services	1,868.5	1,859.5	1,836.6	1,811.9	1,781.4	1,718.4	1,625.6	1,568.6	1,505.6	1,457.9
Government	641.1	638.0	633.9	614.6	605.7	596.4	574.3	559.2	547.7	538.5
Construction	208.1	215.6	226.9	232.0	228.7	221.4	207.7	197.0	180.7	173.1
Wholesale trade	165.2	162.8	160.0	166.0	165.0	159.7	154.7	148.9	150.9	146.2
Transportation and warehousing	131.1	133.8	139.4	148.3	144.8	142.2	139.5	137.1	137.3	124.9
Finance and insurance	139.0	137.7	126.6	126.6	126.7	126.0	125.1	119.4	110.3	108.3
Mining	3.5	4.2	4.2	4.2	4.3	4.5	4.3	4.1	3.9	3.9
Utilities	14.8	15.5	15.3	15.2	17.6	17.7	23.4	24.2	25.3	26.2
Information	74.4	79.4	82.3	85.6	79.1	76.2	72.0	69.4	65.9	64.0
Real estate and rental and leasing	45.8	47.2	48.2	48.1	47.4	45.4	44.0	42.3	39.0	36.5
Total Non-Agricultural Employment	4,298.6	4,380.0	4,407.3	4,470.2	4,432.0	4,344.5	4,218.2	4,113.0	4,009.8	3,910.0

Number of Employees by Industry - 2003 (Non-Agricultural)



Source: North Carolina Employment Security Commission (Data for 2004 is not available)

TOTAL NUMBER OF STATE GOVERNMENT PERMANENT POSITIONS FUNDED IN THE STATE BUDGET BY AGENCY

For the Fiscal Years 1995-2004 *Table 13*

	Fiscal Years Ended June 30									
State Agency	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**	**1995**
Education:										
Public education [1]	147,339	142,876	139,503	138,623	133,531	130,525	127,578	123,027	116,695	113,123
Higher education.............	31,289	30,036	33,749	33,756	33,326	31,556	31,173	30,607	30,386	30,094
Community colleges.........	15,103	14,406	13,770	13,045	13,045	11,192	10,534	10,309	10,729	10,814
Total Education............	193,731	187,318	187,022	185,424	179,902	173,273	169,285	163,943	157,810	154,031
% Annual growth............	**3.42%**	**0.16%**	**0.86%**	**3.07%**	**3.83%**	**2.36%**	**3.26%**	**3.89%**	**2.45%**	
% Cumulative growth.....	**22.76%**	**21.61%**	**21.42%**	**20.38%**	**16.80%**	**12.49%**	**9.90%**	**6.44%**	**2.45%**	
All Other:										
Health and human services [2]...............	18,432	17,984	18,103	18,754	18,640	18,606	19,724	18,373	18,373	18,191
% Annual growth............	**2.49%**	**(0.66)%**	**(3.47)%**	**0.61%**	**0.18%**	**(5.67)%**	**7.35%**	**0.00%**	**1.00%**	
% Cumulative growth.....	**1.32%**	**(1.14)%**	**(0.48)%**	**3.09%**	**2.47%**	**2.28%**	**8.43%**	**1.00%**	**1.00%**	
Correction	19,874	18,845	19,062	19,001	19,217	18,796	19,774	19,099	18,879	17,890
% Annual growth............	**5.46%**	**(1.14)%**	**0.32%**	**(1.12)%**	**2.24%**	**(4.95)%**	**3.53%**	**1.17%**	**5.53%**	
% Cumulative growth.....	**11.09%**	**5.34%**	**6.55%**	**6.21%**	**7.42%**	**5.06%**	**10.53%**	**6.76%**	**5.53%**	
Transportation.................	14,218	16,550	16,505	16,524	16,281	16,081	17,010	16,536	16,411	16,593
% Annual growth............	**(14.09)%**	**0.27%**	**(0.11)%**	**1.49%**	**1.24%**	**(5.46)%**	**2.87%**	**0.76%**	**(1.10)%**	
% Cumulative growth.....	**(14.31)%**	**(0.26)%**	**(0.53)%**	**(0.42)%**	**(1.88)%**	**(3.09)%**	**2.51%**	**(0.34)%**	**(1.10)%**	
Judicial	5,577	5,460	5,463	5,458	5,438	5,337	5,486	5,124	4,978	5,002
% Annual growth............	**2.14%**	**(0.05)%**	**0.09%**	**0.37%**	**1.89%**	**(2.72)%**	**7.06%**	**2.93%**	**(0.48)%**	
% Cumulative growth.....	**11.50%**	**9.16%**	**9.22%**	**9.12%**	**8.72%**	**6.70%**	**9.68%**	**2.44%**	**(0.48)%**	
Other..............................	19,421	18,456	18,568	18,673	18,345	17,465	16,457	16,964	16,730	16,921
% Annual growth............	**5.23%**	**(0.60)%**	**(0.56)%**	**1.79%**	**5.04%**	**6.13%**	**(2.99)%**	**1.40%**	**(1.13)%**	
% Cumulative growth.....	**14.77%**	**9.07%**	**9.73%**	**10.35%**	**8.42%**	**3.21%**	**(2.74)%**	**0.25%**	**(1.13)%**	
Total Positions.................	271,253	264,613	264,723	263,834	257,823	249,558	247,736	240,039	233,181	228,628
N.C. population (1000's)	**8,496 [3]**	**8,407**	**8,320**	**8,186**	**8,049**	**7,648**	**7,546**	**7,429**	**7,308**	**7,185**
Annual growth	**1.06%**	**1.05%**	**1.64%**	**1.70%**	**5.25%**	**1.35%**	**1.58%**	**1.66%**	**1.71%**	
Cumulative growth	**18.25%**	**17.01%**	**15.80%**	**13.93%**	**12.03%**	**6.44%**	**5.02%**	**3.40%**	**1.71%**	

[1] This figure includes local educational agencies receiving funding by State appropriation for element and secondary school teachers

[2] Due to departmental reorganizations, the positions for health services are included in the "Other" category in fiscal years prior to 1998. In the fiscal years prior to 1999 the positions for youth services are included in the "Health and human services" category. These positions are now included in the "Other" category.

[3] Since 2004 population estimates are not available, the Office of State Controller used the growth rate of the previous year to project the 2004 amount.

REQUIRED SUPPLEMENTARY INFORMATION
TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
PUBLIC SCHOOL INSURANCE FUND
For the Fiscal Years Ended June 30, 1995-2004

The following table illustrates how earned revenues (net of reinsurance) and investment income of the Public School Insurance Fund (the Fund) compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Fund for the last ten fiscal years ended June 30. The rows of the table are defined as follows:

(1) Total of each fiscal year's earned contribution revenues, investment revenues, contribution revenues ceded to excess insurers or reinsurers, and amount of reported revenues net of excess insurance or reinsurance.

(2) Each fiscal year's other operating costs of the Fund, including overhead and claims expense not allocable to individual claims.

(3) The Fund's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (before the effect of loss assumed by excess insurers or reinsurers), the loss assumed by excess insurers or reinsurers, and total net amount of incurred claims and allocated claim adjustment expenses.

(4) Cumulative amounts paid as of the end of successive years for each policy year.

(5) The reestimated amount for loss assumed by excess insurers or reinsurers as of the end of the current year.

(6) The reestimated net incurred claims and expenses based on the information available as of the end of the year. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known.

(7) Comparison of the latest reestimated net incurred claims amount to the amount originally established (line 3) and indication of whether this latest estimate of claims cost is greater or less than originally thought.

REQUIRED SUPPLEMENTARY INFORMATION
TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
PUBLIC SCHOOL INSURANCE FUND

For the Fiscal Years Ended June 30, 1995-2004 *Table 14*

As data for individual policy years mature, the correlation between original estimated and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns in the table present data for successive policy years. Amounts are expressed in thousands.

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1) Required contribution and investment revenue:										
Earned	6,749	7,180	7,099	8,354	6,343	6,687	8,136	9,599	12,255	10,826
Ceded	2,134	2,264	2,298	2,041	1,683	1,727	2,453	2,839	3,396	3,121
Net earned	4,615	4,916	4,801	6,313	4,660	4,960	5,683	6,760	8,859	7,705
2) Unallocated expenses	2,843	2,909	2,941	2,706	2,398	2,541	3,214	3,597	3,953	3,689
3) Estimated claims and expenses, end of policy year:										
Incurred	5,078	3,246	14,351	8,496	8,615	21,141	6,449	4,846	2,690	12,586
Ceded	359	—	6,862	700	357	—	—	—	—	—
Net incurred	4,719	3,246	7,489	7,796	8,258	21,141	6,449	4,846	2,690	12,586
4) Paid (cumulative) as of:										
End of policy year	3,790	2,061	9,595	2,044	4,077	13,158	422	392	1,921	10,381
One year later	5,107	3,723	13,129	4,193	5,931	15,818	2,475	640	2,765	
Two years later	5,242	3,742	13,803	4,297	6,108	17,368	2,475	640		
Three years later	5,246	3,744	13,810	4,324	6,388	17,368	2,475			
Four years later	5,246	3,760	13,822	4,324	6,388	17,368				
Five years later	5,246	3,760	13,822	4,324	6,388					
Six years later	5,246	3,760	13,822	4,324						
Seven years later	5,246	3,760	13,822							
Eight years later	5,246	3,760								
Nine years later	5,246									
5) Reestimated ceded claims and expenses	359	—	6,862	700	357	—	—	—	—	—
6) Reestimated net incurred claims and expenses:										
End of policy year	4,719	3,246	7,489	7,796	8,258	21,141	6,449	4,846	2,690	12,586
One year later	4,943	3,814	6,771	3,724	6,740	17,240	2,475	4,846	3,543	
Two years later	4,927	3,789	7,023	3,735	6,161	17,368	2,475	4,846		
Three years later	4,887	3,765	6,976	3,640	6,031	17,368	2,475			
Four years later	4,887	3,760	6,960	3,624	6,031	17,368				
Five years later	4,887	3,760	6,960	3,624	6,031					
Six years later	4,887	3,760	6,960	3,624						
Seven years later	4,887	3,760	6,960							
Eight years later	4,887	3,760								
Nine years later	4,887									
7) Increase (decrease) in estimated net incurred claims and expenses from end of policy year	168	514	(529)	(4,172)	(2,227)	(3,773)	(3,974)	—	853	—

SCHEDULE OF MISCELLANEOUS STATISTICS

As of June 30, 2004 *Table 15*

Adoption of State Constitution	1776, 1868, 1971
Form of government	Executive, Legislative, Judicial
Land area:	
Square miles	50,000
Acres	31,999,760
Miles of highway	78,615
State police protection:	
Number of stations	61
Number of state police	1,660 [1]
Higher Education:	
Community colleges	
Number of campuses	58
Number of students [average annual full time equivalent (FTE)]	188,610
State universities	
Number of campuses	16
Number of regular term students (FTE)	152,224
Number of regular term teaching positions (FTE)	11,372
Recreation:	
Number of State parks and other recreational areas	58
Area of State parks (acres)	174,862
Area of State forests (acres)	409,812

Sources: *Land area* — *Department of Environment and Natural Resources*

Miles of highways — *Department of Transportation*

State police protection — *Department of Crime Control and Public Safety*

Higher education — community colleges — *N.C. Community College System Office*

Higher education — State universities — *University of North Carolina - General Administration*

Recreation — *Department of Environment and Natural Resources*; *Department of Agriculture and Consumer Services*; *Department of Correction*

[1] - Effective January 3, 2003, Motor Vehicle Enforcement moved to the State Highway Patrol.

Additional copies of this document may be obtained from:

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North Carolina Office of the State Controller
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Raleigh, North Carolina 27699-1410

Phone requests can be made at **(919) 981-5454** or **(919) 981-5560** (FAX)

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