



FINANCIAL SECTION



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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 general purpose financial statements of the State of North Carolina as of and for the year ended June 30, 2001. These general purpose financial statements are the responsibility of the State's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the 401-K Supplemental Retirement Income Plan, which represent 3 percent and 36 percent, respectively, of the assets and revenues of the pension trust funds; the financial statements of the North Carolina Housing Finance Agency, which represent 39 percent and 8 percent, respectively, of the assets and revenues of the proprietary component units; the financial statements of the State Education Assistance Authority, which represent 39 percent and 8 percent, respectively, of the assets and revenues of the proprietary component units; the financial statements of the Golden LEAF, Inc., which represent 99 percent and 62 percent, respectively, of the assets and revenues of the governmental component units; nor the financial statements of the Volunteer Safety Workers' Compensation Fund, which represent 21 percent and 4 percent, respectively, of the assets and revenues of the enterprise funds. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is 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 401-K Supplemental Retirement Income Plan were not audited in accordance with *Government Auditing 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 opinion.

In our opinion, based on our audit and the reports of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the State of North Carolina as of June 30, 2001, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.



As discussed in Note 1 V to the financial statements, the State of North Carolina implemented Governmental Accounting Standards Board Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*; and Statement 36, *Recipient Reporting for Certain Shared Nonexchange Revenues* during the year ended June 30, 2001. As discussed in Note 19 to the financial statements, the State of North Carolina changed its method of accounting for securities lending transactions during the year ended June 30, 2001.

In accordance with *Government Auditing Standards*, we will also issue our report dated December 5, 2001 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit. The report on compliance and internal control will be published at a later date in the State of North Carolina's *Single Audit Report*.

The combining and individual fund and account group financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, based on our audit and the reports of other auditors, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

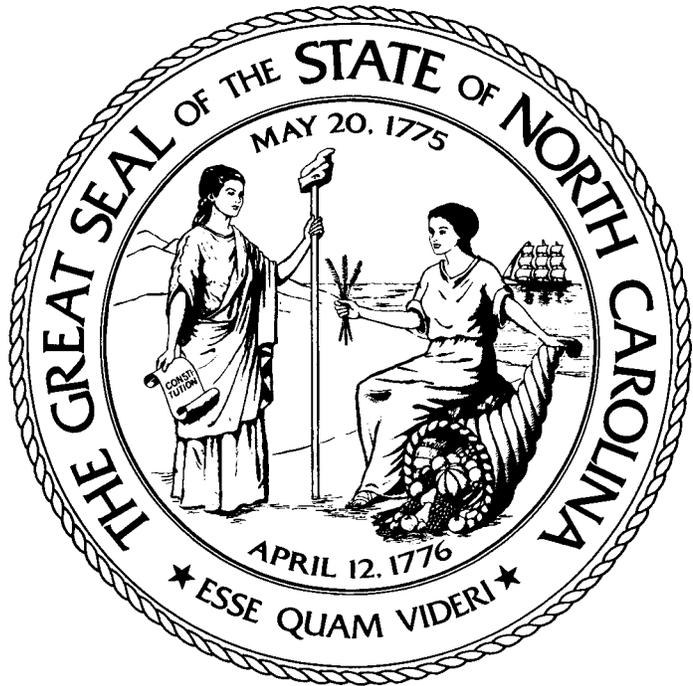
The introductory and statistical sections, identified in the table of contents, were not audited by us, and accordingly, we express no opinion thereon.



Ralph Campbell, Jr.
State Auditor

December 5, 2001

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*GENERAL
PURPOSE
FINANCIAL
STATEMENTS*

**ALL FUND TYPES, ACCOUNT GROUPS, AND DISCRETELY PRESENTED COMPONENT UNITS
COMBINED BALANCE SHEET**

June 30, 2001

(Dollars in Thousands)

	Governmental Fund Types			Proprietary Fund Types		Fiduciary Fund Types
	General	Special Revenue	Capital Projects	Enterprise	Internal Service	Trust and Agency
ASSETS AND OTHER DEBITS						
Cash and cash equivalents (Note 4).....	\$ 1,098,260	\$ 2,685,799	\$ 147,791	\$ 40,779	\$ 80,700	\$ 3,047,800
Investments (Note 4).....	51	—	—	39,111	212,072	60,777,830
Securities lending collateral (Note 4).....	1,853,568	1,198,360	—	26,330	76,936	9,710,093
Deposit with Federal government (Note 4).....	—	—	—	—	—	982,306
Receivables, net:						
Taxes receivable.....	727,489	116,796	—	—	—	239,608
Accounts receivable.....	106,044	14,105	244	1,007	23,644	22,598
Intergovernmental receivables.....	603,040	141,092	3,146	9,472	656	4,336
Interest receivable.....	11,347	12,498	18	122	65	21,164
Premiums receivable.....	—	—	—	1,063	89	—
Contributions receivable.....	11,572	—	—	477	292	88,803
Other receivables.....	—	5,856	—	—	—	—
Due from other funds (Note 8).....	18,743	111,278	1,298	—	20,173	14,407
Due from component units (Note 8).....	3,123	—	—	—	951	1,757
Due from primary government (Note 8).....	—	—	—	—	—	—
Advances to component units (Note 8).....	31,582	—	—	—	—	25,000
Notes receivable.....	3,335	125,185	—	—	—	469,618
Inventories.....	44,691	75,680	—	526	12,829	1,625
Prepaid items.....	3	60	—	3,184	10,848	—
Fixed assets (Note 5).....	—	—	—	38,886	168,454	—
Patents.....	—	—	—	—	—	—
Sureties.....	—	49,626	—	—	—	550,945
Amount to be provided for retirement of general long-term obligations.....	—	—	—	—	—	—
Total Assets and Other Debits.....	\$ 4,512,848	\$ 4,536,335	\$ 152,497	\$ 160,957	\$ 607,709	\$ 75,957,890
LIABILITIES, FUND EQUITY AND OTHER CREDITS						
Liabilities:						
Accounts payable and accrued liabilities.....	\$ 660,270	\$ 378,508	\$ 8,730	\$ 1,531	\$ 6,684	\$ 620,189
Tax refunds payable.....	951,188	—	—	—	—	—
Obligations under securities lending.....	1,853,568	1,198,360	—	26,330	76,936	9,710,093
Refunds and other payables.....	—	—	—	—	—	3,287
Due to other funds (Note 8).....	110,896	112,872	7	8	7,966	17,535
Due to component units (Note 8).....	11,777	130,670	—	—	903	18,645
Due to primary government (Note 8).....	—	—	—	—	—	—
Advance from primary government (Note 8).....	—	—	—	—	—	—
Obligations under reverse repurchase agreements.....	—	—	—	—	—	—
Notes payable (Note 7).....	—	—	—	—	—	—
Claims and benefits payable.....	591,855	60	—	26,688	1,842	95,360
Intergovernmental payable.....	—	—	—	—	—	—
Capital leases payable (Note 6).....	—	—	—	—	—	—
Bonds payable (Note 7).....	—	—	—	9,905	—	—
Interest payable.....	1,348	—	—	—	—	—
Deposits payable.....	462	126,804	6,341	78	—	821,393
Funds held for others.....	—	—	—	—	—	2,180,909
Distributions payable.....	—	—	—	—	—	1,704
Accrued vacation leave.....	—	—	—	372	3,369	—
Deferred revenue.....	363,917	5,327	—	4,712	1,404	13,567
Total Liabilities.....	4,545,281	1,952,601	15,078	69,624	99,104	13,482,682
Fund Equity and Other Credits:						
Contributed capital.....	—	—	—	65,543	49,980	—
Retained earnings.....	—	—	—	25,790	458,625	—
Investment in fixed assets.....	—	—	—	—	—	—
Fund balances:						
Reserved/restricted (Note 15).....	192,489	382,799	48,067	—	—	61,221,800
Unreserved/unrestricted (Note 15).....	(224,922)	2,200,935	89,352	—	—	1,253,408
Total Fund Equity and Other Credits.....	(32,433)	2,583,734	137,419	91,333	508,605	62,475,208
Total Liabilities, Fund Equity and Other Credits.....	\$ 4,512,848	\$ 4,536,335	\$ 152,497	\$ 160,957	\$ 607,709	\$ 75,957,890

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

Exhibit A-1

Account Groups		TOTAL PRIMARY GOVERNMENT (Memorandum only)	Component Units			TOTAL REPORTING ENTITY (Memorandum only)
General Fixed Assets	General Long-Term Obligations		Governmental	Proprietary	College and University	
\$ —	\$ —	\$ 7,101,129	\$ 4,816	\$ 452,330	\$ 1,504,949	\$ 9,063,224
—	—	61,029,064	165,438	838,558	2,357,833	64,390,893
—	—	12,865,287	—	—	—	12,865,287
—	—	982,306	—	—	—	982,306
—	—	1,083,893	—	—	—	1,083,893
—	—	167,642	200	24,749	373,962	566,553
—	—	761,742	—	10,855	195,831	968,428
—	—	45,214	983	30,490	8,324	85,011
—	—	1,152	—	44	—	1,196
—	—	101,144	—	4,528	—	105,672
—	—	5,856	—	—	—	5,856
—	—	165,899	—	—	72,350	238,249
—	—	5,831	—	—	4,117	9,948
—	—	—	—	19,144	142,851	161,995
—	—	56,582	—	—	—	56,582
—	—	598,138	—	2,065,035	86,268	2,749,441
—	—	135,351	—	993	61,600	197,944
—	—	14,095	22	9,060	26,806	49,983
3,767,745	—	3,975,085	66	202,631	7,249,136	11,426,918
—	—	—	—	1,540	—	1,540
—	—	600,571	—	—	—	600,571
—	3,265,351	3,265,351	10	—	—	3,265,361
<u>\$ 3,767,745</u>	<u>\$ 3,265,351</u>	<u>\$ 92,961,332</u>	<u>\$ 171,535</u>	<u>\$ 3,659,957</u>	<u>\$ 12,084,027</u>	<u>\$ 108,876,851</u>
\$ —	\$ —	\$ 1,675,912	\$ 1,959	\$ 73,596	\$ 328,948	\$ 2,080,415
—	—	951,188	—	—	—	951,188
—	—	12,865,287	—	—	—	12,865,287
—	—	3,287	—	—	—	3,287
—	—	249,284	—	—	72,350	321,634
—	—	161,995	547	—	3,570	166,112
—	—	—	—	14,389	942	15,331
—	—	—	—	66,082	—	66,082
—	—	—	—	—	12,220	12,220
—	7,870	7,870	—	1,219	17,990	27,079
—	7,163	722,968	—	462,410	4,295	1,189,673
—	—	—	—	21,857	—	21,857
—	—	—	10	8,848	2,586	11,444
—	3,038,693	3,048,598	—	2,132,316	1,299,568	6,480,482
—	—	1,348	—	13,552	13,038	27,938
—	—	955,078	1,144	3	17,927	974,152
—	—	2,180,909	—	—	410,589	2,591,498
—	—	1,704	—	—	—	1,704
—	211,625	215,366	—	2,627	151,348	369,341
—	—	388,927	—	21,878	46,300	457,105
—	3,265,351	23,429,721	3,660	2,818,777	2,381,671	28,633,829
—	—	115,523	—	207,184	—	322,707
—	—	484,415	—	633,996	—	1,118,411
3,767,745	—	3,767,745	66	—	6,056,382	9,824,193
—	—	61,845,155	22	—	2,017,232	63,862,409
—	—	3,318,773	167,787	—	1,628,742	5,115,302
<u>3,767,745</u>	<u>—</u>	<u>69,531,611</u>	<u>167,875</u>	<u>841,180</u>	<u>9,702,356</u>	<u>80,243,022</u>
<u>\$ 3,767,745</u>	<u>\$ 3,265,351</u>	<u>\$ 92,961,332</u>	<u>\$ 171,535</u>	<u>\$ 3,659,957</u>	<u>\$ 12,084,027</u>	<u>\$ 108,876,851</u>

**ALL GOVERNMENTAL FUND TYPES, EXPENDABLE TRUST FUNDS,
AND DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES**

For the Fiscal Year Ended June 30, 2001

Exhibit A-2

(Dollars in Thousands)

	Governmental Fund Types			Fiduciary	TOTAL	Component	TOTAL
	General	Special	Capital	Expendable	PRIMARY	Units	REPORTING
		Revenue	Projects	Trust	GOVERNMENT	Governmental	ENTITY
					(Memorandum		only)
Revenues:							
Taxes.....	\$ 13,303,776	\$1,843,401	\$ —	\$ 389,718	\$ 15,536,895	\$ —	\$ 15,536,895
Federal funds.....	6,777,503	1,130,450	16,940	14,654	7,939,547	—	7,939,547
Local funds.....	737,063	21,724	1,820	88	760,695	—	760,695
Investment earnings.....	285,311	202,203	310	109,284	597,108	6,604	603,712
Interest earnings on loans.....	—	5,789	—	—	5,789	—	5,789
Sales and services.....	69,141	28,458	87	33,122	130,808	—	130,808
Sale, rental, and lease of property.....	17,562	25,472	12	558	43,604	—	43,604
Fees, licenses, and fines.....	239,464	656,971	—	7,712	904,147	—	904,147
Tobacco settlement.....	140,272	—	—	—	140,272	—	140,272
Contributions, gifts, and grants.....	53,425	36,589	32,857	30,251	153,122	—	153,122
Funds escheated.....	—	—	—	47,432	47,432	—	47,432
Miscellaneous.....	147,206	16,172	1,971	2,018	167,367	4,078	171,445
Total revenues.....	<u>21,770,723</u>	<u>3,967,229</u>	<u>53,997</u>	<u>634,837</u>	<u>26,426,786</u>	<u>10,682</u>	<u>26,437,468</u>
Expenditures:							
Current:							
General government.....	975,487	59,953	—	12,087	1,047,527	—	1,047,527
Education.....	6,348,398	616,414	—	25,074	6,989,886	—	6,989,886
Health and human services.....	9,558,755	58,668	—	1,518	9,618,941	—	9,618,941
Economic development.....	118,168	335,763	—	—	453,931	10,101	464,032
Environment and natural resources...	220,483	238,687	—	19,768	478,938	—	478,938
Public safety, corrections, and regulation.....	1,772,872	175,551	—	30,708	1,979,131	—	1,979,131
Transportation.....	—	2,820,290	—	—	2,820,290	—	2,820,290
Agriculture.....	76,111	12,512	—	4,684	93,307	—	93,307
Claims and benefits.....	—	—	—	710,911	710,911	—	710,911
Tax judgements.....	58,679	—	—	—	58,679	—	58,679
Capital outlay.....	—	—	155,228	—	155,228	41	155,269
Debt service:							
Principal retirement.....	134,440	16,675	—	—	151,115	5	151,120
Interest.....	120,166	10,182	—	—	130,348	1	130,349
Total expenditures.....	<u>19,383,559</u>	<u>4,344,695</u>	<u>155,228</u>	<u>804,750</u>	<u>24,688,232</u>	<u>10,148</u>	<u>24,698,380</u>
Excess revenues over (under) expenditures.....	<u>2,387,164</u>	<u>(377,466)</u>	<u>(101,231)</u>	<u>(169,913)</u>	<u>1,738,554</u>	<u>534</u>	<u>1,739,088</u>
Other Financing Sources (Uses):							
Operating transfers in.....	491,037	866,877	57,403	24,573	1,439,890	—	1,439,890
Operating transfers from primary government.....	—	—	—	—	—	70,136	70,136
Operating transfers from component units.....	23,405	10,663	3,629	26	37,723	—	37,723
Operating transfers out.....	(448,972)	(956,549)	(22,086)	(78,970)	(1,506,577)	—	(1,506,577)
Operating transfers to component units.....	(2,691,664)	(127,967)	(6,000)	(18,645)	(2,844,276)	—	(2,844,276)
Proceeds from bond sale.....	—	680,000	—	—	680,000	—	680,000
Total other financing sources (uses).....	<u>(2,626,194)</u>	<u>473,024</u>	<u>32,946</u>	<u>(73,016)</u>	<u>(2,193,240)</u>	<u>70,136</u>	<u>(2,123,104)</u>
Excess revenues and other sources over (under) expenditures and other uses...	(239,030)	95,558	(68,285)	(242,929)	(454,686)	70,670	(384,016)
Fund balances — July 1 (Note 16).....	215,494	2,576,348	205,794	2,528,961	5,526,597	97,139	5,623,736
Restatements (Note 16).....	(1,621)	(68,542)	(90)	—	(70,253)	—	(70,253)
Residual equity transfers in (Note 17)....	2,593	94,702	—	—	97,295	—	97,295
Residual equity transfers out (Note 17)..	(5,072)	(96,916)	—	—	(101,988)	—	(101,988)
Increase (decrease) in reserve for related assets.....	(4,797)	(17,416)	—	(47)	(22,260)	—	(22,260)
Fund balances — June 30.....	<u>\$ (32,433)</u>	<u>\$2,583,734</u>	<u>\$ 137,419</u>	<u>\$ 2,285,985</u>	<u>\$ 4,974,705</u>	<u>\$ 167,809</u>	<u>\$ 5,142,514</u>

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

**GENERAL FUND AND SPECIAL REVENUE FUNDS
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
UNRESERVED FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)**

For the Fiscal Year Ended June 30, 2001

Exhibit A-3

(Dollars in Thousands)

	General Fund			Special Revenue Funds		
	<i>Final Budget</i>	<i>Actual</i>	<i>Variance- Favorable (Unfavorable)</i>	<i>Final Budget</i>	<i>Actual</i>	<i>Variance- Favorable (Unfavorable)</i>
Revenues:						
Taxes:						
Individual income.....	\$ 7,650,700	\$ 7,391,343	\$ (259,357)	\$ —	\$ —	\$ —
Corporate income.....	781,500	460,315	(321,185)	—	—	—
Sales and use.....	3,613,300	3,435,559	(177,741)	—	—	—
Franchise.....	408,500	580,432	171,932	—	—	—
Insurance.....	288,700	305,791	17,091	—	—	—
Beverage.....	174,000	172,699	(1,301)	—	—	—
Intangibles.....	—	4	4	—	—	—
Other.....	297,600	226,917	(70,683)	—	—	—
Non-Tax:						
Fees, licenses and fines.....	112,800	109,261	(3,539)	—	—	—
Investment income.....	214,000	170,900	(43,100)	—	—	—
Disproportionate share receipts.....	106,000	109,143	3,143	—	—	—
Other.....	149,900	305,898	155,998	—	—	—
Transfers in.....	183,800	183,600	(200)	—	—	—
Departmental						
Federal funds.....	7,120,500	6,453,614	(666,886)	256,726	221,475	(35,251)
Local funds.....	789,340	741,260	(48,080)	9,809	7,813	(1,996)
Inter-agency grants and allocations.....	147,808	140,526	(7,282)	6,545	5,343	(1,202)
Intra-governmental transactions.....	2,851,054	2,705,736	(145,318)	323,627	302,672	(20,955)
Sales and services.....	68,001	70,175	2,174	8,377	9,037	660
Sale, rental and lease of property.....	15,909	15,856	(53)	2,954	3,308	354
Fees, licenses and fines.....	144,500	144,278	(222)	101,815	96,036	(5,779)
Contributions, gifts and grants.....	36,973	28,918	(8,055)	551	538	(13)
Miscellaneous.....	344,020	344,342	322	3,982	4,953	971
Universities.....	566,243	551,874	(14,369)	—	—	—
Total Revenues.....	<u>26,065,148</u>	<u>24,648,441</u>	<u>(1,416,707)</u>	<u>714,386</u>	<u>651,175</u>	<u>(63,211)</u>
Expenditures:						
Current:						
General government.....	1,494,513	913,904	580,609	137,543	95,571	41,972
Education.....	7,693,831	7,309,105	384,726	—	—	—
Health and human services.....	11,420,500	11,066,148	354,352	37	23	14
Environment and natural resources.....	332,475	293,803	38,672	110,839	101,699	9,140
Economic development.....	142,969	135,196	7,773	289,349	250,369	38,980
Public safety, corrections, and regulation..	2,247,632	1,874,981	372,651	199,709	187,222	12,487
Transportation.....	15,455	15,434	21	—	—	—
Agriculture.....	85,957	79,110	6,847	—	—	—
Capital outlay.....	75,474	75,474	—	—	—	—
Debt service.....	268,834	254,606	14,228	—	—	—
Universities.....	2,356,825	2,308,502	48,323	—	—	—
Total Expenditures.....	<u>26,134,465</u>	<u>24,326,263</u>	<u>1,808,202</u>	<u>737,477</u>	<u>634,884</u>	<u>102,593</u>
Excess revenues over (under) expenditures.....	(69,317)	322,178	391,495	<u>(\$23,091)</u>	16,291	<u>\$ 39,382</u>
Transfers from reserves (Note 2D).....	69,475	246,430	176,955	—	—	—
Transfers to reserves (Note 2D).....	—	(568,608)	(568,608)	—	—	—
Unreserved fund balances (budgetary basis) at July 1, 2000.....	—	—	—	—	105,014	—
Restatements (Note 2B).....	—	—	—	—	1	—
Unreserved fund balances (budgetary basis) at June 30, 2001 (Note 2B).....	<u>\$ 158</u>	<u>\$ —</u>	<u>\$ (158)</u>	—	<u>\$ 121,306</u>	—

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

**ALL PROPRIETARY FUND TYPES, SIMILAR TRUST FUNDS, AND
DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY**

For the Fiscal Year Ended June 30, 2001

(Dollars in Thousands)

	Proprietary Fund Types		Fiduciary Fund Types	TOTAL PRIMARY GOVERNMENT
	Enterprise	Internal Service	Nonexpendable Trust	(Memorandum only)
Operating Revenues:				
Sales and services.....	\$ 5,025	\$ 313,307	\$ 999	\$ 319,331
Federal funds.....	—	—	39,845	39,845
Investment earnings.....	6,620	30,061	18,568	55,249
Interest earnings on loans.....	—	—	9,401	9,401
Rental and lease earnings.....	3,911	2,028	—	5,939
Fees, licenses and fines.....	9,249	1,008	1,698	11,955
Contributions, gifts and grants.....	—	11,088	—	11,088
Insurance premiums.....	8,059	16,369	—	24,428
Miscellaneous.....	37	1,191	1,261	2,489
Total operating revenues.....	<u>32,901</u>	<u>375,052</u>	<u>71,772</u>	<u>479,725</u>
Operating Expenses:				
Personal services.....	7,355	64,284	2,568	74,207
Supplies and materials.....	856	15,376	14	16,246
Services.....	15,099	124,557	680	140,336
Interest.....	1,832	4,717	5,840	12,389
Cost of goods sold.....	457	35,063	—	35,520
Depreciation/amortization.....	1,975	34,445	—	36,420
Grants to local governments.....	—	—	73,027	73,027
Claims and benefits.....	97,514	31,382	—	128,896
Insurance and bonding.....	3,053	11,264	—	14,317
Other.....	1,409	40,847	346	42,602
Total operating expenses.....	<u>129,550</u>	<u>361,935</u>	<u>82,475</u>	<u>573,960</u>
Operating income (loss).....	(96,649)	13,117	(10,703)	(94,235)
Net Nonoperating Revenues (Expenses).....	<u>75,663</u>	<u>3,015</u>	<u>—</u>	<u>78,678</u>
Income (loss) before operating transfers.....	<u>(20,986)</u>	<u>16,132</u>	<u>(10,703)</u>	<u>(15,557)</u>
Operating Transfers:				
Transfers in.....	24,358	7,114	75,305	106,777
Transfers from component units.....	—	78	—	78
Transfers from primary government.....	—	—	—	—
Transfers out.....	(953)	(36,247)	(2,890)	(40,090)
Transfers to component units.....	—	—	—	—
Transfers to primary government.....	—	—	—	—
Total operating transfers in (out).....	<u>23,405</u>	<u>(29,055)</u>	<u>72,415</u>	<u>66,765</u>
Net income (loss).....	2,419	(12,923)	61,712	51,208
Excess of revenues over (under) expenditures from governmental operations.....	—	—	—	—
Fund equity — July 1 (Note 16).....	82,499	520,618	499,943	1,103,060
Restatements (Note 16).....	142	192	(9)	325
Residual equity transfers out.....	—	—	(410)	(410)
Increase (decrease) in contributed capital.....	6,273	718	—	6,991
Fund equity — June 30.....	<u>\$ 91,333</u>	<u>\$ 508,605</u>	<u>\$ 561,236</u>	<u>\$ 1,161,174</u>

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

Exhibit A-4

Component Units	TOTAL REPORTING ENTITY
Proprietary Fund Types	(Memorandum only)
\$ 61,737	\$ 381,068
—	39,845
76,755	132,004
150,349	159,750
15,799	21,738
3,600	15,555
54,258	65,346
930,483	954,911
10,641	13,130
<u>1,303,622</u>	<u>1,783,347</u>
44,593	118,800
6,762	23,008
80,270	220,606
119,136	131,525
—	35,520
15,232	51,652
—	73,027
1,226,882	1,355,778
1,369	15,686
<u>34,874</u>	<u>77,476</u>
<u>1,529,118</u>	<u>2,103,078</u>
(225,496)	(319,731)
<u>(210,615)</u>	<u>(131,937)</u>
<u>(436,111)</u>	<u>(451,668)</u>
—	106,777
18,063	18,141
243,383	243,383
—	(40,090)
(345)	(345)
<u>(13,126)</u>	<u>(13,126)</u>
<u>247,975</u>	<u>314,740</u>
(188,136)	(136,928)
(1,781)	(1,781)
1,061,730	2,164,790
(30,010)	(29,685)
—	(410)
<u>(623)</u>	<u>6,368</u>
<u>\$ 841,180</u>	<u>\$ 2,002,354</u>

**ALL PROPRIETARY FUND TYPES, NONEXPENDABLE TRUST FUNDS, AND
DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF CASH FLOWS**

For the Fiscal Year Ended June 30, 2001

(Dollars in Thousands)

	<u>Proprietary Fund Types</u>		<u>Fiduciary</u>	<u>TOTAL</u>
	<u>Enterprise</u>	<u>Internal Service</u>	<u>Fund Types</u>	<u>PRIMARY</u>
			<u>Nonexpendable</u>	<u>GOVERNMENT</u>
			<u>Trust Funds</u>	<u>(Memorandum</u>
				<u>only)</u>
Cash Provided From (Used For) Operations:				
Operating income (loss).....	\$ (96,649)	\$ 13,117	\$ (10,703)	\$ (94,235)
Adjustments to reconcile operating income to net cash flows from operating activities:				
Depreciation/amortization.....	1,975	34,445	—	36,420
Investment earnings.....	(6,620)	(30,061)	(18,568)	(55,249)
Securities lending fees.....	1,832	4,717	5,840	12,389
Mortgage/loan/note principal repayments.....	—	—	20,842	20,842
Loan sales.....	—	—	—	—
Mortgages/loans/notes issued.....	—	—	(75,988)	(75,988)
Mortgage/loan/note cancellation and write-offs.....	—	—	—	—
Allowances and uncollectible accounts.....	—	—	—	—
Nonoperating mortgage/loan/note interest income.....	—	—	—	—
Restatements and adjustments to cash.....	142	1,736	(9)	1,869
Nonoperating miscellaneous income/expense.....	155	4,912	—	5,067
Capitalized interest.....	—	—	—	—
Interest expense.....	—	—	—	—
(Increases) decreases in assets:				
Receivables.....	(2,468)	(19)	(679)	(3,166)
Due from other funds.....	—	16,233	—	16,233
Due from component units.....	—	725	—	725
Due from primary government.....	—	—	—	—
Inventories.....	19	(252)	—	(233)
Prepaid items.....	(1,684)	(10,848)	—	(12,532)
Increases (decreases) in liabilities:				
Accounts payable and accrued liabilities.....	281	(5,486)	260	(4,945)
Due to other funds.....	(7)	(6,309)	6	(6,310)
Due to component units.....	—	(387)	—	(387)
Due to primary government.....	—	—	—	—
Claims and benefits payable.....	(2,095)	(334)	—	(2,429)
Deposits payable.....	4	—	—	4
Accrued vacation leave.....	(16)	378	—	362
Deferred revenue.....	1,222	(690)	—	532
Total cash provided from (used for) operations.....	<u>(103,909)</u>	<u>21,877</u>	<u>(78,999)</u>	<u>(161,031)</u>
Cash Provided From (Used For)				
Noncapital Financing Activities:				
Proceeds from sale of bonds/notes.....	—	—	—	—
Repayment of bond/note principal.....	—	—	—	—
Interest payments on bonds and notes.....	—	—	—	—
Bond issuance cost.....	—	—	—	—
Grants.....	74,725	—	—	74,725
Grants, aid and subsidies.....	—	—	—	—
Operating transfers in.....	24,358	7,114	75,305	106,777
Operating transfers from component units.....	—	78	—	78
Operating transfers from primary government.....	—	—	—	—
Operating transfers out.....	(953)	(36,247)	(2,890)	(40,090)
Operating transfers to component units.....	—	—	—	—
Operating transfers to primary government.....	—	—	—	—
Nonoperating cash donations.....	268	—	—	268
Nonoperating miscellaneous income/expense.....	—	—	—	—
Increase in contributed capital.....	4,500	608	—	5,108
Decrease in contributed capital.....	—	(6)	—	(6)
Residual equity transfers out.....	—	—	(410)	(410)
Total cash provided from (used for) noncapital financing activities.....	<u>102,898</u>	<u>(28,453)</u>	<u>72,005</u>	<u>146,450</u>

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

Exhibit A-5

Component Units	TOTAL REPORTING ENTITY
Proprietary Fund Types	(Memorandum only)
\$ (225,496)	\$ (319,731)
15,232	51,652
(76,755)	(132,004)
—	12,389
427,305	448,147
3,254	3,254
(717,172)	(793,160)
7,737	7,737
2,524	2,524
19	19
229	2,098
(9)	5,058
(6,327)	(6,327)
74,164	74,164
9,597	6,431
—	16,233
—	725
(4,040)	(4,040)
(203)	(436)
(1,424)	(13,956)
10,110	5,165
—	(6,310)
—	(387)
(19,493)	(19,493)
110,700	108,271
3	7
235	597
<u>15,618</u>	<u>16,150</u>
<u>(374,192)</u>	<u>(535,223)</u>
377,175	377,175
(130,275)	(130,275)
(78,774)	(78,774)
(4,163)	(4,163)
4,293	79,018
(185,730)	(185,730)
—	106,777
18,063	18,141
208,934	208,934
—	(40,090)
(345)	(345)
(23,544)	(23,544)
4,917	5,185
(103)	(103)
—	5,108
(623)	(629)
—	(410)
<u>189,825</u>	<u>336,275</u>

Continued

**ALL PROPRIETARY FUND TYPES, NONEXPENDABLE TRUST FUNDS, AND
DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF CASH FLOWS (continued)**

For the Fiscal Year Ended June 30, 2001

(Dollars in Thousands)

	<u>Proprietary Fund Types</u>		<u>Fiduciary</u>	<u>TOTAL</u>
	<u>Enterprise</u>	<u>Internal Service</u>	<u>Fund Types</u> <u>Nonexpendable</u> <u>Trust Funds</u>	<u>PRIMARY</u> <u>GOVERNMENT</u> <u>(Memorandum</u> <u>only)</u>
Cash Provided From (Used For)				
Capital Financing Activities:				
Acquisition of fixed assets.....	(1,140)	(25,755)	—	(26,895)
Proceeds from the sale of fixed assets.....	—	2,745	—	2,745
Proceeds from sale of bonds/notes.....	9,905	—	—	9,905
Repayment of bond/note principal.....	—	—	—	—
Interest payments on bonds, notes and capital leases.....	(84)	—	—	(84)
Bond issuance cost.....	(134)	—	—	(134)
Capital grants.....	132	—	—	132
Principal payment on capital leases.....	—	—	—	—
Transfer from primary government.....	—	—	—	—
Insurance recoveries.....	—	8	—	8
Total cash provided from (used for).....	<u>8,679</u>	<u>(23,002)</u>	<u>—</u>	<u>(14,323)</u>
Cash Provided From (Used For)				
Investment Activities:				
Proceeds from the sale/maturities of non-State				
Treasurer investments.....	5,301	—	74	5,375
Redemptions from the State Treasurer				
Long-Term Investment Portfolio.....	—	23,000	2,337	25,337
Purchase of non-State Treasurer investments.....	(15,061)	—	(72)	(15,133)
Purchase into State Treasurer				
Long-Term Investment Portfolio.....	—	—	(1,930)	(1,930)
Investment earnings.....	<u>2,333</u>	<u>1,121</u>	<u>7,800</u>	<u>11,254</u>
Total cash provided from (used for)				
investment activities.....	<u>(7,427)</u>	<u>24,121</u>	<u>8,209</u>	<u>24,903</u>
Net increase (decrease) in cash				
and cash equivalents.....	241	(5,457)	1,215	(4,001)
Deficit from governmental operations.....	—	—	—	—
Cash and cash equivalents at July 1, as restated.....	40,538	86,157	146,750	273,445
Cash and cash equivalents at June 30.....	<u>\$ 40,779</u>	<u>\$ 80,700</u>	<u>\$ 147,965</u>	<u>\$ 269,444</u>
Noncash Investing, Capital,				
and Financing Activities:				
Noncash distributions from the State Treasurer				
Long-Term Investment Portfolio.....	\$ 1,749	\$ 15,858	\$ 3,280	\$ 20,887
Change in fair value of investments.....	993	7,242	1,589	9,824
Donated assets (fair market value).....	15	—	—	15
Increase in contributed capital.....	1,773	116	—	1,889
Assets acquired through the assumption of a				
liability.....	26,330	77,004	108,662	211,996
Change in construction in progress as a result				
of accrued accounts payable.....	—	—	—	—
Transfer of fixed assets.....	—	(116)	—	(116)
Fair market value of leased capital asset.....	—	—	—	—
Cash and cash equivalents in the Fiduciary Fund Types on the Combined Balance Sheet include:				
Expendable Trust Funds.....	\$ 268,345			
Nonexpendable Trust Funds.....	147,965			
Pension Trust Funds.....	375,579			
Investment Trust Fund.....	30,313			
Agency Funds.....	<u>2,225,598</u>			
Total.....	<u>\$ 3,047,800</u>			

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

Exhibit A-5

Component Units	TOTAL REPORTING ENTITY
Proprietary Fund Types	(Memorandum only)
(31,565)	(58,460)
542	3,287
666	10,571
(1,656)	(1,656)
(896)	(980)
—	(134)
3,122	3,254
(3,032)	(3,032)
7,859	7,859
—	8
(24,960)	(39,283)
834,475	839,850
80,000	105,337
(801,590)	(816,723)
(5,200)	(7,130)
48,943	60,197
156,628	181,531
(52,699)	(56,700)
1,781	1,781
503,248	776,693
\$ 452,330	\$ 721,774

\$ 20,241	\$ 41,128
(30,467)	(20,643)
—	15
26,590	28,479
—	211,996
1,152	1,152
—	(116)
5,256	5,256

**PENSION TRUST FUNDS
COMBINING STATEMENT OF PLAN NET ASSETS
ALL PENSION PLANS**

June 30, 2001

Exhibit A-6

(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	Totals
ASSETS								
Cash and cash equivalents....	\$ 136,074	\$ 2,415	\$ 196	\$ 491	\$ 323	\$ 17,880	\$ 218,200	\$ 375,579
Investments (Note 9, 10):								
Bank investment contracts.....	—	—	—	—	—	—	313,844	313,844
Mutual funds.....	—	—	—	—	—	—	1,670,900	1,670,900
State Treasurer investment pool.....	44,511,519	332,162	26,132	254,802	47,688	11,434,672	—	56,606,975
Securities lending collateral....	6,128,657	47,428	3,888	36,230	7,141	1,608,954	—	7,832,298
Receivables:								
Accounts receivable.....	650	—	—	—	—	560	960	2,170
Interest receivable.....	638	12	1	3	2	126	2,825	3,607
Contributions receivable....	47,181	249	21	—	—	34,369	5,256	87,076
Notes receivable.....	—	—	—	—	—	—	106,308	106,308
Total Assets.....	<u>50,824,719</u>	<u>382,266</u>	<u>30,238</u>	<u>291,526</u>	<u>55,154</u>	<u>13,096,561</u>	<u>2,318,293</u>	<u>66,998,757</u>
LIABILITIES								
Obligations under securities lending.....	6,128,657	47,428	3,888	36,230	7,141	1,608,954	—	7,832,298
Refunds and other payables	—	—	—	—	—	—	3,287	3,287
Due to other funds (Note 8)....	—	—	—	1	—	—	—	1
Benefits payable.....	32,221	—	—	—	—	112	—	32,333
Total Liabilities.....	<u>6,160,878</u>	<u>47,428</u>	<u>3,888</u>	<u>36,231</u>	<u>7,141</u>	<u>1,609,066</u>	<u>3,287</u>	<u>7,867,919</u>
FUND BALANCE								
Reserved for employees' pension benefits (Note 15).	<u>\$ 44,663,841</u>	<u>\$ 334,838</u>	<u>\$ 26,350</u>	<u>\$ 255,295</u>	<u>\$ 48,013</u>	<u>\$ 11,487,495</u>	<u>\$ 2,315,006</u>	<u>\$ 59,130,838</u>

A schedule of funding progress for each defined benefit plan is presented on page 116

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

PENSION TRUST FUNDS
COMBINING STATEMENT OF CHANGES IN PLAN NET ASSETS
ALL PENSION PLANS

For the Fiscal Year Ended June 30, 2001

Exhibit A-7

(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	Totals
Additions:								
Contributions:								
Employer.....	\$ 308,788	\$ 5,848	\$ 469	\$ —	\$ —	\$ 182,464	\$ 80,890	\$ 578,459
Plan members.....	598,741	3,528	284	4,827	—	221,467	156,245	985,092
Other contributions.....	—	—	—	11,079	2,075	—	—	13,154
Total contributions.....	<u>907,529</u>	<u>9,376</u>	<u>753</u>	<u>15,906</u>	<u>2,075</u>	<u>403,931</u>	<u>237,135</u>	<u>1,576,705</u>
Investment Income:								
Investment earnings (loss).....	(680,207)	(4,490)	(227)	(3,334)	(355)	(149,291)	(54,273)	(892,177)
Less investment expenses.....	<u>(397,637)</u>	<u>(3,026)</u>	<u>(249)</u>	<u>(2,269)</u>	<u>(449)</u>	<u>(102,558)</u>	<u>—</u>	<u>(506,188)</u>
Net investment income (loss).	<u>(1,077,844)</u>	<u>(7,516)</u>	<u>(476)</u>	<u>(5,603)</u>	<u>(804)</u>	<u>(251,849)</u>	<u>(54,273)</u>	<u>(1,398,365)</u>
Fees, licenses and fines.....	—	—	—	—	—	4,579	1,761	6,340
Interest earnings on loans.....	—	—	—	—	—	—	8,120	8,120
Miscellaneous additions.....	<u>2,725</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>27</u>	<u>—</u>	<u>2,752</u>
Total additions.....	<u>(167,590)</u>	<u>1,860</u>	<u>277</u>	<u>10,303</u>	<u>1,271</u>	<u>156,688</u>	<u>192,743</u>	<u>195,552</u>
Deductions:								
Administrative expense.....	8,658	42	9	756	36	3,164	6,199	18,864
Benefits.....	1,690,869	14,796	1,091	14,423	1,955	360,471	177,146	2,260,751
Refund of contributions.....	79,135	37	2	417	—	55,486	—	135,077
Other deductions.....	<u>46</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>—</u>	<u>47</u>
Total deductions.....	<u>1,778,708</u>	<u>14,875</u>	<u>1,102</u>	<u>15,596</u>	<u>1,991</u>	<u>419,122</u>	<u>183,345</u>	<u>2,414,739</u>
Net increase (decrease)	(1,946,298)	(13,015)	(825)	(5,293)	(720)	(262,434)	9,398	(2,219,187)
Fund balance reserved for employees' pension benefits								
Beginning of the year (Note 16)	<u>46,610,139</u>	<u>347,853</u>	<u>27,175</u>	<u>260,588</u>	<u>48,733</u>	<u>11,749,929</u>	<u>2,305,608</u>	<u>61,350,025</u>
End of year.....	<u>\$ 44,663,841</u>	<u>\$ 334,838</u>	<u>\$ 26,350</u>	<u>\$ 255,295</u>	<u>\$ 48,013</u>	<u>\$ 11,487,495</u>	<u>\$ 2,315,006</u>	<u>\$59,130,838</u>

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

**INVESTMENT TRUST FUND
STATEMENT OF NET ASSETS**

June 30, 2001

Exhibit A-8

(Dollars in Thousands)

	<i>Investment Trust Fund</i>
ASSETS	
Cash and cash equivalents.....	\$ 30,313
Investments.....	461,265
Securities lending collateral.....	316,181
Receivables:	
Interest receivable.....	7,275
Total Assets.....	<u>815,034</u>
LIABILITIES	
Obligations under securities lending.....	316,181
Distributions payable.....	1,704
Total Liabilities.....	<u>317,885</u>
NET ASSETS	
Held in trust for pool participants.....	<u><u>\$ 497,149</u></u>

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

**INVESTMENT TRUST FUND
STATEMENT OF CHANGES IN NET ASSETS**

For the Fiscal Year Ended June 30, 2001

Exhibit A-9

(Dollars in Thousands)

	<i>Investment Trust Fund</i>
Additions:	
Investment Income:	
Investment earnings.....	\$ 91,174
Less investment expenses.....	<u>(35,994)</u>
Net investment income.....	<u>55,180</u>
Pool's share transactions:	
Reinvestment of dividends.....	58,949
Net share purchases/(redemptions).....	<u>(747,507)</u>
	(688,558)
Total additions.....	<u>(633,378)</u>
Deductions:	
Distributions paid and payable.....	<u>(55,180)</u>
Total deductions.....	<u>(55,180)</u>
Net increase (decrease)	(688,558)
Net Assets Held in Trust	
Beginning of the year (Note 16).....	1,185,707
End of year.....	<u>\$ 497,149</u>

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

**COMPONENT UNITS — COLLEGE AND UNIVERSITY FUNDS
 COMBINED STATEMENT OF CHANGES IN FUND EQUITY**

For the Fiscal Year Ended June 30, 2001

Exhibit A-10

*(Dollars in Thousands)***Revenues and Other Additions:**

Tuition and fees.....	\$ 625,707
Federal appropriations.....	21,792
County appropriations.....	112,913
Federal contracts and grants.....	793,085
State contracts and grants.....	137,290
Local and other governmental contracts and grants.....	45,127
Nongovernmental grants and contracts.....	164,580
Gifts.....	231,181
Endowment income.....	21,917
Sales and services.....	992,046
Investment earnings.....	1,845
Expended for plant facilities.....	386,778
Retirement of indebtedness.....	39,619
Proceeds of refunding debt.....	27,004
Income from hospital operations.....	824,382
Other revenues and additions.....	63,999
Total Revenues and Other Additions.....	<u>4,489,265</u>

Expenditures and Other Deductions:

Educational and general.....	4,249,362
Auxiliary enterprises.....	556,573
Internal service.....	40,123
Independent operations.....	14,097
Professional clinical services.....	257,401
Indirect cost recovered.....	112,114
Refunded to grantors.....	1,880
Administrative and collection costs, loan cancellation and bad debts.....	3,915
Expended for plant facilities.....	319,127
Retirement of indebtedness.....	41,096
Payment to escrow agent.....	25,594
Interest on indebtedness.....	41,515
Disposal of plant facilities.....	58,237
Loss on refunding of debt.....	330
Hospital operations.....	786,367
Other expenditures and deductions.....	12,260
Total Expenditures and Other Deductions.....	<u>6,519,991</u>

Transfers-Additions (Deductions):

Operating transfers from primary government.....	2,547,847
Operating transfers to primary government.....	(24,675)
Operating transfers from component units.....	345
Operating transfers to component units.....	(18,063)
Net transfers.....	<u>2,505,454</u>
Net increase in fund equity.....	474,728
Fund equity — July 1 (Note 16).....	9,139,162
Restatements (Note 16).....	88,466
Fund equity — June 30.....	<u>\$ 9,702,356</u>

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

COMPONENT UNITS — COLLEGE AND UNIVERSITY FUNDS
COMBINED STATEMENT OF CURRENT FUNDS
REVENUES, EXPENDITURES AND TRANSFERS

For the Fiscal Year Ended June 30, 2001

Exhibit A-11

*(Dollars in Thousands)***Revenues:**

Tuition and fees.....	\$ 624,396
Federal appropriations.....	21,792
County appropriations.....	91,072
Federal contracts and grants.....	687,451
State contracts and grants.....	110,370
Local and other governmental contracts and grants.....	34,780
Nongovernmental grants and contracts.....	152,151
Gifts.....	169,361
Endowment income.....	21,729
Sales and services.....	992,035
Investment earnings.....	61,591
Other revenues.....	54,855
Total Current Revenues.....	<u>3,021,583</u>

Expenditures:

Educational and general:	
Instruction.....	1,834,763
Organized research.....	457,053
Public service.....	290,893
Academic support.....	353,641
Student services.....	149,732
Institutional support.....	418,374
Physical plant operations.....	337,057
Student financial aid.....	407,849
Total educational and general.....	<u>4,249,362</u>
Auxiliary enterprises.....	556,573
Internal service.....	40,123
Independent operations.....	14,097
Professional clinical services.....	257,401
Total Expenditures.....	<u>5,117,556</u>

Transfers and Additions (Deductions):

Refund to grantors.....	(1,881)
Mandatory transfers.....	(74,721)
Non-mandatory transfers.....	(3,015)
Interinstitutional transfers.....	(2,672)
Operating transfers from primary government.....	2,309,973
Operating transfers to primary government.....	(2,504)
Operating transfers from component units.....	345
Operating transfers to component units.....	<u>(18,063)</u>
Net increase in fund equity.....	<u>\$ 111,489</u>

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

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The accompanying financial statements of the State of North Carolina financial reporting entity have been prepared in conformity with generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB), which consist of GASB Statements and Interpretations, as well as American Institute of Certified Public Accountants (AICPA) and Financial Accounting Standards Board (FASB) pronouncements specifically made applicable to state and local governmental entities by GASB Statements and Interpretations. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the State does not apply FASB pronouncements issued after November 30, 1989 for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date. The financial statements of the college and university funds have been prepared in conformity with generally accepted accounting principles for colleges and universities as prescribed by GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*. The financial statements of the North Carolina Railroad Company (Railroad), a for-profit corporation (*discretely presented proprietary component unit*), have been prepared based on FASB pronouncements. The Railroad's financial statements have been incorporated into the State's reporting entity based on the definition and display provisions of GASB Statement No. 14, *The Financial Reporting Entity*.

The financial statements are presented as of and for the fiscal year ended June 30, 2001, except for the USS North Carolina Battleship Commission whose statements are as of and for the fiscal year ended September 30, 2000, 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, 2000. Occupational licensing boards have financial statements with various fiscal year ending dates.

B. Financial Reporting Entity

The financial reporting entity includes (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) organizations for which the nature and significance of their relationships with the primary government are such that exclusion would cause the primary government's financial statements to be misleading or incomplete.

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, 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.

As required by generally accepted accounting principles, these financial statements present the State (the primary government) and its component units. The component units are included in the financial reporting entity because of the significance of their operational or financial relationships with the State, as described below.

Discretely Presented Component Units

The component units columns in the combined financial statements include the financial data of the following organizations. They are reported as either college and university funds, governmental funds, or proprietary funds.

College and University Funds**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 there is 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.

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

- Appalachian State University
- East Carolina University
- Elizabeth City State University
- Fayetteville State University
- North Carolina Agricultural and Technical State University
- North Carolina Central University

NOTES TO THE FINANCIAL STATEMENTS

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. 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 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

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

The Golden LEAF, Inc. (the "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.

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 \$5.15 billion trust fund for tobacco growers and quota holders in 14 grower states, including North Carolina. The Trust Fund's purpose is to compensate quota owners and growers for potential reductions in their tobacco production and sales following the settlement of litigation by various states. The \$1.9 billion allocated for distribution in North Carolina, the largest portion of the settlement among the states, is intended to be paid out in the form of direct payments to qualified growers and quota holders over a twelve year period. 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.

Proprietary Funds**Comprehensive Major Medical Plan (State Health Plan)**

The State Health Plan (Plan) is a component unit that provides medical benefits to employees and retirees of the State, most of its component units, and local boards of education that are not part of the reporting entity. The Plan has corporate powers and is governed by a board whose members are appointed by either the Governor or the General Assembly. Provisions and contribution rates are approved by the General Assembly, with the State making significant contributions as an employer and through its funding of local boards of education.

Disability Income Plan of North Carolina

The Disability Income Plan of North Carolina (Plan) is a component unit that provides disability benefits to employees of the State, most of its component units, and local boards of education that are not part of the reporting entity. The Plan has

NOTES TO THE FINANCIAL STATEMENTS

corporate powers and is governed by a fourteen-member board. Ten members are appointed by the Governor, two are appointed by the General Assembly, and two are elected State officials. Provisions and contribution rates are approved by the General Assembly, with the State making significant contributions as an employer and through its funding of local boards of education.

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 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.

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. 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.

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 for years to come; therefore, a financial benefit/ burden relationship exists between the State and the Authority.

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. The State has the ability to impose its will since appointed members may be removed at will by the Governor and elected members may be removed at will by the MCNC board.

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.

North Carolina Ports Railway Commission

The North Carolina Ports Railway Commission is a legally separate organization established to operate, maintain and control all railway equipment and railway operations transferred to it by the North Carolina State Ports Authority in January 1981. The Commission is governed by a five-member board, all of whom are appointed by the Governor. A financial benefit/burden relationship exists between the State and the Commission.

North Carolina Rural Rehabilitation Corporation

The North Carolina Rural Rehabilitation Corporation is a legally separate nonprofit corporation created to assist individuals and families in rural areas of the state. The Corporation is governed by a nine-member board, all of whom are appointed by the Governor or serve by virtue of their positions as state officials. The State has the ability to influence the budget, programs, and activities of the Corporation.

NOTES TO THE FINANCIAL STATEMENTS

North Carolina 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.

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 universities in the UNC System
Community colleges
North Carolina State Ports Authority
North Carolina Global TransPark Authority
North Carolina Partnership for Children, Inc.
North Carolina Ports Railway Commission

Complete financial statements of the remaining component units, examined by independent auditors, 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

MCNC
P.O. Box 12889
Research Triangle Park, NC 27709-2889

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

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

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

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

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

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

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

The North Carolina Agricultural Finance Authority, the North Carolina Rural Rehabilitation Corporation, the State Health Plan, the UNC Health Care System, and the Disability Income Plan of North Carolina do not issue separate financial statements.

C. Fund Accounting

The financial activities of the State and its component units are organized on a basis of individual funds and account groups, each of which is a separate accounting entity segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with specific regulations, restrictions, or limitations. The financial activities of the State and its component units accounted for in the accompanying financial statements have been classified into the following fund categories and account groups:

1. Primary Government (the State)

Governmental Funds

Governmental funds are those through which most governmental functions of the State are financed. The acquisition, use, and balances of the primary government's expendable financial resources and the related liabilities (except those accounted for in proprietary funds) are accounted for through governmental funds. The measurement focus is upon determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than upon net income determination. The following are the State's governmental funds.

General Fund

All financial resources received and used for services traditionally provided by a state government and not required to be accounted for in other funds are accounted for in the General Fund. These services include general government; education (other than universities and community colleges); health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; and agriculture.

NOTES TO THE FINANCIAL STATEMENTS
Special Revenue Funds

Transactions related to resources obtained from specific revenue sources (other than for expendable trusts or major capital projects) that are legally restricted to expenditures for specific purposes are accounted for in special revenue funds.

Capital Projects Funds

Transactions related to resources obtained and used for the acquisition, construction, or improvement of major governmental general fixed assets are accounted for in the capital projects funds. Such resources are derived principally from operating transfers from the General Fund and from bond funds. Highway infrastructure construction projects are accounted for in the State Highway Fund and the Highway Trust Fund. These projects are not included in the capital projects funds.

Proprietary Funds

Proprietary funds are used to account for the State's ongoing activities which are similar to those often found in the private sector. The measurement focus is upon determination of net income, financial position, and changes in cash flows. The generally accepted accounting principles used are those applicable to similar businesses in the private sector; thus, these funds are reported on the accrual basis of accounting. The following are the State's proprietary funds.

Enterprise Funds

Enterprise funds account for operations of the State that are financed and operated in a manner similar to private business enterprises or where periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for management accountability or other purposes. The acquisition, maintenance, and improvement of physical plant facilities required to provide these goods and services are financed from existing cash resources, the issuance of bonds, federal grants, and other State funds.

Internal Service Funds

Internal service funds account for the operations of State agencies that provide services to other State agencies, departments, or other governmental units on a cost reimbursement basis.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. The following are the primary government's fiduciary funds.

Trust Funds

- **Expendable Trust** — Expendable trust funds account for assets held by the State in a trustee capacity where the principal and income may be expended in the course of the funds' designated operations.
- **Nonexpendable Trust** — Nonexpendable trust funds account for assets held by the State in a trustee capacity where only income derived from the principal may be

expended in the course of the funds' designated operations. The principal must be preserved intact.

- **Pension Trust** — Pension trust funds account for transactions, assets, liabilities, and net assets available for plan benefits of the various State and local governmental public employee retirement systems which the State administers.
- **Investment Trust** — The investment trust fund accounts for the external portion of the Investment Pool sponsored by the State Treasurer.

Agency Funds

Agency funds account for the various taxes, deposits, deductions, and property collected by the State, acting in the capacity of an agent, for distribution to other governmental units or designated beneficiaries.

Account Groups

Account groups are used to establish accounting control and accountability for the State's general fixed assets and general long-term obligations and do not involve measurement of operations.

General Fixed Assets Account Group

This account group is established to account for fixed assets acquired for general government purposes, except those accounted for in proprietary funds or college and university funds. General fixed assets do not represent financial resources available for appropriation and expenditure.

General Long-Term Obligations Account Group

This account group is established to account for the unmatured principal of the State's general long-term debt and other long-term obligations of governmental funds. The unmatured principal of general long-term debt and other long-term obligations does not require current appropriation and expenditure of governmental fund financial resources.

2. Component Units*Governmental Funds*

Governmental funds are used to account for the ongoing activities of component units that provide traditional governmental services, which are similar to those found within the primary government described above.

Proprietary Funds

Proprietary funds are used to account for the various component units' ongoing activities which are similar to those often found in the private sector, as well as those within the primary government described above.

College and University Funds

College and university funds account for the operations of the UNC system and community colleges in accordance with existing authoritative accounting and reporting principles applicable to colleges and universities. Presentation of the underlying fund groups of the individual universities and

NOTES TO THE FINANCIAL STATEMENTS

community colleges is available from each respective institution's separately issued financial statements.

D. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements.

All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current 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.

All proprietary, nonexpendable trust, pension trust, and investment trust funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the balance sheet. The operating statements of proprietary and similar trust funds report events and transactions that improve the economic position as revenues and those that diminish the economic condition as expenses.

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. 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 expenditures as soon as recipients have met all eligibility requirements. Amounts paid before all eligibility requirements have been met are reported as prepaid items.

1. Governmental, Expendable Trust, and Agency Funds

The accounts of the general, special revenue, capital projects, expendable trust, and agency funds are reported using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and

available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year-end. The State considers amounts to be available if due within 31 days of the close of the fiscal year. Expenditures and other uses of financial resources are recognized when the related liability is incurred, except for items that are not planned to be liquidated with expendable available resources, such as the long-term portion of the liability for compensated absences and capital lease obligations.

Other modifications to the accrual basis of accounting include the following:

- inventories generally are considered expenditures at acquisition;
- prepayments usually are not capitalized; and
- principal and interest on long-term debt are recorded when due.

2. Proprietary, Nonexpendable Trust, Pension Trust, and Investment Trust Funds

The accounts of the enterprise, internal service, nonexpendable trust, pension trust, investment trust funds, and proprietary component units are reported using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

3. College and University Funds

The accounts of the college and university funds are reported using the accrual basis of accounting with the following exceptions:

- Depreciation expense related to plant fund assets is not recorded; and
- Revenues and expenditures of an academic term encompassing more than one fiscal year are reported solely in the fiscal year in which the program is predominantly conducted.

E. Cash and Cash Equivalents

This classification appears on the accompanying combined balance sheet, combining statement of pension plan net assets, investment trust fund statement of net assets, and combined statement of cash flows. It includes deposits held by the State Treasurer in the short-term investment portfolio more fully discussed in Note 4, investment of bond proceeds, deposits with private financial institutions, and cash on hand. 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. Bond proceeds are invested in highly liquid securities with an original maturity of 3 months or less.

F. Investments/Securities Lending

Investments

This classification includes deposits held by the State Treasurer in certain long-term investment portfolios more fully

NOTES TO THE FINANCIAL STATEMENTS

discussed in Note 4 as well as investments held separately by the State and its component units. Investments are generally valued at fair value. Additional investment valuation information is provided in Note 4.

The classification does not include any of the reporting entity's accounts that would be defined as cash equivalents based on GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Securities Lending

In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, assets and liabilities resulting from securities lending transactions are reported on the combined balance sheet (see Note 19, Other Accounting Changes).

G. Deposit with Federal Government

This classification consists of unemployment compensation trust funds (expendable trust fund) held on deposit in the Federal Reserve Bank of the United States Treasury.

H. Receivables and Due from Other Funds

Receivables in governmental and fiduciary funds consist primarily of tax, interest, and federal revenues. Receivables in proprietary and college and university funds occur in the normal course of business. The "Due from other funds" classification represents interfund receivables consisting of transactions between fund types within the State (primary government). Operating transfers, quasi-external transactions, and reimbursements are classified in this account. All receivables are shown net of allowances for doubtful accounts.

I. Advances to Other Funds

Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset by a fund balance reserve account which indicates that they do not constitute expendable available financial resources, and therefore, are not available for appropriation.

J. Inventories

The inventories of the State and proprietary component units are valued on the first-in, first-out, last invoice cost, or average cost basis. 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 basis. Inventories of all proprietary funds are valued by the first-in, first-out method or average cost basis.

Except for the State Highway Fund's maintenance and construction inventories, the cost of inventory items in the State's governmental funds is recorded as an expenditure when purchased. Reported inventories are equally offset by a fund balance reserve that indicates they do not constitute "available spendable resources" even though they are a part of net current assets. All other inventories of the State and its component units are recognized as expenses or expenditures when consumed.

K. Fixed Assets

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions and construction are reflected as expenditures in governmental funds, and the related assets are reported in the general fixed assets account group. For financial reporting purposes, depreciation is not recorded on general fixed assets. Fixed assets of all proprietary funds are capitalized in the fund in which they are utilized and are depreciated either on the straight-line basis or on the units of output basis over their useful lives. Fixed assets of the UNC system and community colleges are capitalized in college and university funds. Depreciation is not reported on these assets.

Fixed assets are stated at historical cost, or in some instances, estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. The State (except for the USS N.C. Battleship Commission), some proprietary component units, and the college and university component units capitalize all fixed assets that have a value or cost greater than or equal to \$5,000 at the date of acquisition and have an expected useful life of two or more years. Certain proprietary component units (N.C. Housing Finance Agency, N.C. State Ports Authority, N.C. Railroad Company, Northeastern N.C. Regional Economic Development Commission, Southeastern N.C. Regional Economic Development Commission, Western N.C. Regional Economic Development Commission), and the USS N.C. Battleship Commission (an enterprise fund) maintain a minimum threshold of \$500. The Golden LEAF, Inc. and the N.C. Phase II Tobacco Certification Entity, Inc. maintain minimum thresholds of \$500 and \$150, respectively. Occupational licensing boards use various thresholds to capitalize fixed assets.

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.

Public domain ("infrastructure") general fixed assets consisting of highways, bridges, highway lands, and rights-of-way are not capitalized.

NOTES TO THE FINANCIAL STATEMENTS

The depreciation methods and estimated lives used by proprietary funds are:

	<u>Method</u>	<u>Estimated Useful Life</u>
Buildings	Straight-line	7-50 years
Other structures and improvements.....	Straight-line	10-50 years
Machinery and.....	Straight-line	3-15 years
equipment	Units of output for motor vehicles	90,000 miles/ vehicle

L. 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".

M. Lease Obligations

Assets acquired under capital leases are generally valued at the present value of the lease payments. Capital leases of governmental funds are reported in the general long-term obligations account group and the related assets are reported in the general fixed assets account group. Capital leases for proprietary funds and college and university funds are reported in those funds, along with the related assets.

GASB Codification Section L20 and the Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, issued by the Financial Accounting Standards Board (FASB), establish requirements for lease obligations. Leases meeting the standards of FASB 13 have been capitalized and are reported as capital leases payable. Other leases are accounted for as operating leases and are not recorded on the balance sheet. Operating lease payments are recorded as expenditures or expenses of the related funds when paid or incurred. Refer to Note 6 for specific disclosures on lease obligations.

All leases of the State contain appropriation clauses indicating that continuation of the lease is subject to continued funding by the Legislature. For reporting purposes, leases are fully disclosed since cancellation due to lack of appropriation is deemed unlikely.

N. Compensated Absences

The State and its component units have adopted the accounting and reporting principles outlined in GASB Codification Section C60 regarding employee vacation leave. Since unpaid vacation leave will not be liquidated with expendable available financial resources, the State's liability for long-term accumulated unpaid vacation leave is reported in the

accompanying general long-term obligations account group for all governmental funds. There is no liability in the accompanying financial statements for unpaid accumulated sick leave because the State has no obligation to pay sick leave upon employee termination or retirement.

In the proprietary funds and college and university funds, the liability for accumulated unpaid vacation leave is reported as a current liability. For the same reasons as cited for governmental funds, no liability for unpaid accumulated sick leave is recorded.

In governmental funds, the expenditure for compensated absences (vacation and sick leave) is recorded when the leave is taken. In proprietary funds the expense for vacation leave is recorded when the leave is earned. In college and university funds a year-end adjustment is recorded to reflect the current year's vacation leave expense. The expense for sick leave is recorded when the leave is taken in both proprietary and college and university funds.

The State's policy on compensated absences is generally adhered to by its agencies, departments, and most of its component units. Full-time permanent, probationary, trainee, and time-limited employees earn vacation leave ranging from 0.98 to 2.15 days per month, depending upon years of service. Part-time employees working at least half-time earn the same range of leave on a pro-rata amount based on the number of hours a week they work. There is no requirement that vacation leave be taken, but the maximum permissible accumulation is 30 days. Any vacation accumulated beyond 30 days is converted to sick leave at year end. At termination, employees are paid for any accumulated vacation leave up to 240 hours. Full-time permanent, probationary and trainee employees earn sick leave at the rate of one day per month with an unlimited accumulation. Part-time employees earn a percentage of the total of 8 hours per month based on the number of hours a week they work. Employees are not paid for accumulated sick leave upon termination; however, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

O. Long-Term Liabilities

Long-term liabilities expected to be financed from governmental funds are accounted for in the general long-term obligations account group. Expenditures for principal and interest payments are recognized in the respective fund type when due. Long-term liabilities expected to be financed from the proprietary funds and the college and university funds, as well as the related interest payments, are accounted for in those funds.

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.

NOTES TO THE FINANCIAL STATEMENTS

This deep-discount debt is reported in the general long-term obligations account group at its net or accreted value rather than at face value.

P. Sureties

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

Q. Fund Equity

Contributed capital is recorded in all proprietary funds that have received capital grants or contributions from other sources. Fund balance reserved (in governmental and trust funds) and fund balance restricted (in college and university funds) represent that portion of fund balances (1) not available for appropriation or expenditure and/or (2) that is legally segregated by third parties for a specific future use. Designations of unreserved fund balance represent tentative management plans that are subject to change. Refer to Note 15 for disclosure on reserves and designations.

R. Revenues**Tobacco Settlement**

Tobacco settlement payments are recognized as revenues when received (See Note 18, Commitments and Contingencies).

S. 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.

T. Interfund Transactions

During the course of normal operations there are numerous transactions between and within fund types of the State and its component units, including expenditures and transfers of resources to provide services, construct assets, and service debt. The accompanying financial statements generally reflect such transactions as operating transfers, except for retirement contributions made by the State and its component units, which are accounted for as revenues in the pension trust funds and expenditures/expenses in the contributing funds. In addition, proprietary funds (primarily internal service funds) record

charges for services to all other funds as operating revenue. All funds record their payments to proprietary funds as expenditures/operating expenses. The balances at year-end resulting from these transactions are interfund receivables or payables and are classified as "Due to," "Due from," "Advance to," or "Advance from" on the Combined Balance Sheet. The composition of the State and its component units' interfund receivables and payables is presented in Note 8.

U. Totals - Memorandum Only

The "Totals - Memorandum Only" columns on the general purpose financial statements are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations, or cash flows in conformity with GAAP. Neither is the data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

V. New GASB Pronouncements

Effective July 1, 2000, the State implemented the new accounting and reporting standards required in GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. This new statement provides guidance on the timing of recognition of nonexchange transactions involving financial or capital resources, such as taxes; fines and forfeitures; grants, entitlements, and similar items; and donations. This statement defines "transactions" as external events in which something of value passes between two or more parties. GASB Statement No. 33 also requires governments to recognize capital contributions to proprietary funds and to other governmental entities that use proprietary accounting as revenues in the current year, not contributed capital. In addition, the State implemented GASB Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*. Statement No. 36, which amended Statement No. 33, provides symmetrical accounting treatment for certain shared revenues by requiring recipient governments to account for the sharing of revenues in the same manner as provider governments.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2: BUDGETARY ACCOUNTING AND REPORTING

A. 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 State Highway Fund, the Highway Trust Fund, certain special revenue funds, and capital projects funds. Annual budgets are adopted for the "Employment and Training Administration", "Employment Security Commission", "Highway Patrol", "Wildlife Resources Commission", and numerous "Other Funds" Special Revenue Funds. Budgets adopted by the General Assembly based on annual State tax and non-tax revenues for the State Highway Fund and the Highway Trust Fund are combined with federal and local participation revenues and are primarily budgeted and accounted for on a multi-year project basis. Capital projects funds are budgeted on a project basis. Since these funds have multi-year project budgets, they are not included in the budgetary comparison statement.

The accompanying budgetary comparison statement discloses the annual "appropriated budget" for the General Fund and budgeted special revenue funds. Actual amounts in the statement 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 Note 2 C.

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.

For the year ended June 30, 2001, there were 234 annually budgeted (*budgetary basis*) special revenue funds located in 47 departmental budget codes. A list of these funds and detailed 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. Fund Balance Restatement

The July 1, 2000 fund balance for budgeted special revenue funds has been restated. A fund that was budgeted in the prior year has been reclassified as unbudgeted during the fiscal year. The following table summarizes this restatement (expressed in thousands).

Fund balance as previously reported	
at June 30, 2000	\$ 105,015
Funds removed:	
Unbudgeted funds	<u>(1)</u>
Fund balance as restated	
at July 1, 2000	<u>\$ 105,014</u>

C. Reconciliation of Budget/GAAP Reporting Differences

The *General Fund and Special Revenue Funds, Combined Statement of Revenues, Expenditures and Changes in Unreserved Fund Balances - Budget and Actual (Budgetary Basis - Non-GAAP)* - Exhibit A-3, 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. The State Highway Fund and the Highway Trust Fund, as discussed in section A, have multi-year budgets and therefore are not included in the budgetary statements. They are presented in the special revenue funds for

NOTES TO THE FINANCIAL STATEMENTS

GAAP purposes. Certain funds not included in the annual budgetary statements but which have the characteristics of governmental funds are presented in either the General Fund or the special revenue funds 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, 2001 to the fund balances on a modified accrual basis (GAAP). Amounts are expressed in thousands.

	General Fund	Special Revenue Funds
Unreserved fund balance (Exh. A-3, budgetary basis), June 30, 2001.....	\$ —	\$ 121,306
Reserved fund balance (budgetary basis),		
Savings.....	157,522	—
Exec. Order #3.....	178,472	—
Retirees' health premium.....	53,895	—
Disaster relief.....	448,608	—
N.C. Railroad acquisition.....	31,582	—
Disproportionate share.....	1,170	—
Fund balance (budgetary basis).....	\$ 871,249	\$ 121,306
Reconciling Adjustments:		
Entity Differences:		
Primary government:		
State Highway Fund.....	—	394,338
Highway Trust Fund.....	—	700,553
Other.....	81,894	1,355,409
Component unit.....	—	(8,339)
Basis Differences:		
Accrued revenues.....	100,449	10,102
Accrued expenditures.....	(1,337,794)	(11,293)
Other Adjustments:		
Notes receivable.....	3,335	15,512
Inventories.....	44,691	6,095
Investments.....	51	—
Prepaid items.....	3	51
Timing Differences:		
Authorized carryforward for specific encumbrances.....	28,045	—
Authorized carryforward for designated programs.....	175,644	—
Fund balance (Exh. A-2, GAAP basis) June 30, 2001.....	<u>(\$32,433)</u>	<u>\$2,583,734</u>

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. The 2001 Session of the General Assembly under Session Law 2001-424 Section 2.2.(g), suspended the transfer of funds from the unreserved credit balance to the Savings Reserve Account (G.S. 143-15.2 and G.S. 143-15.3) for the 2000-2001 fiscal year only.

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.

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. Funds were not transferred to the Repairs and Renovations Account for fiscal year 2000-2001, in accordance with Session Law 2001-424, Section 33.2.(b).

Intangibles Tax Refunds. On February 21, 1996, the U.S. Supreme Court declared North Carolina's intangibles tax unconstitutional. *Smith, et al. v. State* aimed at recovering intangibles tax refunds for taxpayers who failed to comply with the refund statute's 30-day demand requirement. On December 4, 1998, the Supreme Court ruled that North Carolina would have to pay refunds to non-protesters who paid intangibles taxes. This case was consolidated with *Shaver, et al. v. State*, another action for refund of intangibles tax paid on shares of stock. The consolidated case was settled and the agreement required the State to pay \$440 million into a settlement fund in two installments, \$200 million by October 1, 1999, and \$240 million by July 10, 2000. The 2000 General Assembly directed \$240 million to be transferred from the State Aid to Local School Administrative Units to a reserve in the Department of the State Treasurer. The final payment of

NOTES TO THE FINANCIAL STATEMENTS

\$240 million was made on July 10, 2000.

Clean Water Management Trust Fund (G.S. 143-15.2 through 143-15.3B). This reserve account provides for the Clean Water Management Trust Fund to finance projects to clean up or prevent surface water pollution as approved by the Clean Water Management Commission. The amount reserved in the General Fund each year is defined as 6.5% of any unreserved credit balance remaining in the General Fund at the end of the fiscal year, or \$30.0 million dollars, whichever is greater. However, the 2000 Session of the General Assembly under Session Law 2000-67 Section 7.7.(a) directed the State Controller to not reserve to the Clean Water Management Trust Fund any portion of the unreserved credit balance remaining in the General Fund at the end of the 2000-2001 fiscal year.

North Carolina Railroad Acquisition Reserve and North Carolina Railroad Dividends Reserve (1997 General Assembly, Senate Bill 352, Section 32.30). For fiscal year 1996-97, the General Assembly established the Railroad Reserve Account. In order to help promote trade, industry, and transportation within the State of North Carolina and to advance the economic interests of the State and its citizens, the General Assembly found it advantageous for the State to acquire the outstanding shares of the North Carolina Railroad Company not held by the State. On April 1, 1998 the General Fund loaned the North Carolina Railroad Company \$61 million for the retirement of non-State owned common stock shares of the Railroad. The 1999 General Assembly's House Bill 168, (*signed June 30, 1999*) required \$19 million of Railroad dividends paid to the State during fiscal year 1999-2000, be used for specific purposes related to the Railroad and that they directly reduce the Railroad's obligation to the State. The 1999 General Assembly's House Bill 1840, (*signed June 30, 2000*) amended G.S. 124-5.1, *State use of North Carolina Railroad dividends*, and stated that any dividends paid to the State shall be used for the improvement of the property of the Railroad and therefore reduce the Railroad's loan obligation to the State. During fiscal year 1999-2000 the State received \$19.9 million in dividends from the North Carolina Railroad Company, and in fiscal year 2000-01 the State received \$9.5 million of dividends. The \$29.4 million of dividends received were applied to reduce the outstanding obligation to \$31.6 million. The \$0.9 million deposited in the Railroad Dividends Reserve during the fiscal year 1999-2000 was transferred to General Fund availability at the end of fiscal year 2000-2001.

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.

Easley Executive Order No. 3 Reserve. On February 8, 2001, Governor Easley signed Executive Order Number 3 authorizing a Declaration of Emergency and directing the Office of State Budget and Management (OSBM) to take

necessary measures to insure a balanced budget for 2000-01 fiscal year. Measures taken by OSBM included spending restrictions, suspension of employer retirement contributions to the retirement fund, suspension of local government reimbursements, and cash balance transfers from agency Special Revenue Funds, Trust Funds and Internal Service Funds. Suspension of the retirement contributions to the retirement fund and suspension of the local government reimbursements were accounted for in the newly created Easley Executive Order No. 3 Reserve. Per instructions from OSBM, \$129.9 million was transferred to the Reserve for Disaster Relief, resulting in an ending balance in the Easley Executive Order No. 3 Reserve of \$178.5 million at 2000-01 fiscal year-end.

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. At the end of fiscal year 2000-01, \$312.3 million was transferred to the Disaster Relief Reserve from the Hurricane Floyd Disaster Relief Fund, \$6.4 million was transferred from General Fund availability, and \$129.9 million was transferred from the Easley Executive Order No. 3 Reserve. The fiscal year 2000-01 ending balance in the Disaster Relief Reserve was \$448.6 million.

NOTES TO THE FINANCIAL STATEMENTS

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, 2000	Increases		(Decreases)		Balance June 30, 2001
		Transfers from General Fund Unreserved Fund Balance	Unbudgeted Revenues	Transfers to General Fund Unreserved Fund Balance	Unbudgeted Expenditures	
Savings.....	\$ 37,522	\$ 120,000	\$ —	\$ —	\$ —	\$ 157,522
Retirees' health premium...	117,746	—	—	—	(63,851)	53,895
Repairs and renovations....	7,052	—	—	(4,458)	(2,594)	—
Intangibles tax refunds.....	240,000	—	—	(240,000)	—	—
N.C. Railroad acquisition...	42,000	—	—	—	(10,418)	31,582
N.C. Railroad dividends.....	918	—	—	(918)	—	—
Clean water management..	1,054	—	—	(1,054)	—	—
Disproportionate share.....	1,170	—	—	—	—	1,170
Disaster relief.....	—	448,608	—	—	—	448,608
Exec. Order #3.....	—	—	178,472	—	—	178,472
Total.....	\$ 447,462	\$ 568,608	\$ 178,472	\$ (246,430)	\$ (76,863)	\$ 871,249

NOTE 3: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY**Retained Earnings / Fund Balance Deficit****Primary Government**

At June 30, 2001, the General Fund has a fund balance deficit of \$32.433 million, compared to a positive balance of \$265.675 million the previous year. The slowdown in the economy has led to a decline in the rate of growth in taxes and an increase in spending for governmental services.

At June 30, 2001, the Educational Materials and School Buses Fund (special revenue fund) within the Department of Public Instruction reported a fund balance deficit of \$23.925 million. The deficit resulted from the large textbook adoption year for fiscal year 2001.

At June 30, 2001, the following enterprise funds reported retained earnings deficits: Agricultural Farmers Market, \$4.753 million and Workers' Compensation, \$9.575 million.

At June 30, 2001, the following internal service funds reported retained earnings deficits: Courier Service, \$580 thousand; N.C. Information Highway, \$112 thousand; Cherry Hospital Auxiliary Services, \$1.923 million; and John Umstead Hospital Auxiliary Services, \$591 thousand.

Component Units

At June 30, 2001, the following component unit proprietary funds reported retained earnings deficits: State Health Plan, \$159.672 million; Disability Income Plan of North Carolina, \$35.765 million; and North Carolina Railroad Company, \$49.755 million.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4: 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; shares, deposits, savings certificates, and certificates of deposit of specified 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; certain venture capital limited partnerships; and the obligations or securities of the North Carolina Enterprise Corporation or the North Carolina Economic Opportunities Fund. The deposits of the pension trust funds may be invested in all of the above plus certain insurance contracts; individual and group trusts; certain real estate investment funds; 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 equity-based trusts. 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.

Venture Capital Investment – This portfolio holds investments in venture capital limited partnerships, the long-term investment portfolio 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.

A complete set of the audited financial statements for the Investment Pool of the North Carolina Department of State Treasurer can be obtained from the Office of the State Auditor, 2 Salisbury Street, Raleigh, NC 27699-0601.

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, 2001**

Assets:	
Cash and cash equivalents.....	\$ 247,639
Other assets.....	433,101
Investments.....	<u>77,424,142</u>
Total assets.....	<u>78,104,882</u>
Liabilities:	
Distributions payable.....	32,320
Obligations under securities lending.....	<u>12,865,287</u>
Total liabilities.....	<u>12,897,607</u>
Net Assets:	
Internal:	
Primary government.....	62,535,584
Component units.....	2,174,542
External.....	<u>497,149</u>
Total net assets.....	<u>\$ 65,207,275</u>

**Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2001**

Increase in net assets from operations:	
Revenues:	
Investment income.....	\$ 51,283
Expenses:	
Securities lending expenses.....	769,994
Investment management.....	<u>49,981</u>
Total expenses.....	<u>819,975</u>
Net increase (decrease) in net assets resulting from operations.....	(768,692)
Distributions to participants:	
Distributions paid and payable.....	(6,720,593)
Share transactions:	
Reinvestment of distributions.....	6,731,814
Net share purchases.....	<u>(2,604,939)</u>
Total increase(decrease) in net assets.....	(3,362,410)
Net assets:	
Beginning of year.....	68,569,685
End of year.....	<u>\$ 65,207,275</u>

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 Venture Capital 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 (see Note 19, Other Accounting Changes).

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, monthly for the Equity Investment portfolios and quarterly for the Real Estate Investment and Venture Capital 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 funds, venture capital limited partnerships, and equity investment funds are valued using market prices provided by the investment managers. 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, 2001, \$71,084,066 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 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

NOTES TO THE FINANCIAL STATEMENTS

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, 2001, the deposits maintained by the State Treasurer consisted of (dollars in thousands):

	<u>Carrying Value</u>	<u>Bank Balance</u>
Demand.....	\$ 107,693	\$ 110,800
Time.....	139,946	139,946
Total Deposits.....	<u>\$ 247,639</u>	<u>\$ 250,746</u>

At year end, 97 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 the escrow agent.

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):

	<u>Category</u>		<u>Carrying</u>
	<u>1</u>	<u>3</u>	<u>Amount</u>
Investment Pool			
Investments Categorized:			
U.S. government and agency securities:			
Not on loan.....	\$ 8,532,509	\$ 1,562,583	\$ 10,095,092
On loan for securities collateral.....	942,461	—	942,461
Corporate bonds and notes:			
Not on loan.....	9,012,478	7,248,202	16,260,680
On loan for securities collateral.....	1,193	—	1,193
Repurchase agreements.....	230,000	4,054,502	4,284,502
International bonds.....	453,910	—	453,910
Domestic equities.....	31,457	—	31,457
Total Investments Categorized.....	<u>\$ 19,204,008</u>	<u>\$ 12,865,287</u>	32,069,295
Investments Not Categorized:			
Equity-based trusts.....			31,716,223
Venture capital investments.....			39,584
Real estate trust funds.....			1,016,714
Investments held by broker/dealers under securities loans with cash collateral:			
U.S. government and agency securities.....			12,394,850
Corporate bonds and notes..			187,476
Total Investment Pool.....			<u>\$ 77,424,142</u>

During the year other investment types, such as commercial paper, may have been owned by the Investment Pool, but all material investment categories are disclosed above. At year end, the major investment classifications of the Investment Pool had the following attributes (dollars in thousands):

<u>Investment Classification</u>	<u>Carrying Amount</u>	<u>Principal Amount</u>	<u>Range of Interest Rates</u>	<u>Range of Maturities</u>
U.S. government and agency securities:				
U.S. Treasury notes and bonds.....	\$ 13,210,683	\$ 12,194,126	4.25 to 9.125%	31 days to 29 years
GNMA securities.....	4,751,301	4,742,111	6.0 to 9.0%	15 to 29 years
U.S. agency notes and bonds.....	5,470,419	5,552,835	zero to 7.625%	3 days to 28 years
Corporate bonds and notes.....	16,449,349	16,631,944	3.68% to 14.5%	1 day to 34 years
Repurchase agreements.....	4,284,502	4,338,419	3.7 to 6.79%	2 to 24 days
Equity-based trusts.....	31,716,223	Not applicable	Not applicable	Not applicable

NOTES TO THE FINANCIAL STATEMENTS

The equity-based trusts are investments in trust funds managed by third party money managers. The trust funds invest in common stocks and other equity-type securities. For these investments, the State Treasurer does not own individual securities but rather has a percentage ownership in the trust.

Included in the "U.S. government and agency securities" investment category are mortgage-backed securities issued by an agency of the United States government, the Government National Mortgage Association (GNMA). The State Treasurer invests in these securities to maximize yield while maintaining a high degree of safety. The securities are based on cash flows from payments on underlying mortgages. Although these investments are not derivatives, the investment values are sensitive to mortgage prepayments that tend to occur during periods of declining interest rates.

Derivatives are not widely used by the State Treasurer's Investment Pool. However, certain portfolios within the Investment Pool utilize third-party professional managers that may invest in collateralized mortgage obligations, financial futures, forwards, options, swaps and mutual funds that may also invest in such derivatives. The State Treasurer does not have any direct involvement over these transactions nor are they material.

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

Bond Proceeds	<u>Category</u>	<u>Carrying</u>
Investments Categorized:	<u>1</u>	<u>Amount</u>
U.S. government and agency securities....	\$ 122,350	\$ 122,350
Repurchase agreements.....	519,850	519,850
Total Investments.....	<u>\$ 642,200</u>	<u>\$ 642,200</u>

The Bond Proceeds Investment Accounts also invested in commercial paper during the year, but such assets were not owned at year-end.

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 securities, corporate bonds and notes for collateral. The custodian is permitted to receive cash, U.S. government 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 two years, the custodian agent is not permitted to make investments where the weighted average maturity of all investments exceeds 90 days. At June 30, 2001, the weighted average maturity of unmatched investments was approximately 18 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 by certain component units. As a general rule, these deposits are not covered by the rules in Chapter 20 NCAC 7 requiring collateralization of uninsured deposits.

At June 30, 2001, the deposits maintained outside the State Treasurer by the primary government consisted of (dollars in thousands):

	<u>Carrying Value</u>	<u>Bank Balance</u>
Demand.....	\$ 14,350	\$ 19,260
Time.....	828,004	842,586
Total Deposits.....	<u>\$ 842,354</u>	<u>\$ 861,846</u>

Of these bank balances, \$401.210 million was covered by federal depository insurance, \$418.643 million by collateral held by the escrow agent in the depositor's name, and \$41.993 million was uninsured and uncollateralized. In addition, the North Carolina Employment Security Commission had \$982 million on deposit with the U.S. Treasurer at June 30, 2001.

NOTES TO THE FINANCIAL STATEMENTS

At June 30, 2001, the deposits maintained by the component units consisted of (dollars in thousands):

	<u>Carrying Value</u>	<u>Bank Balance</u>
Demand.....	\$ 57,086	\$ 24,410
Time.....	114,582	115,599
Total Deposits.....	<u>\$ 171,668</u>	<u>\$ 140,009</u>

Of these bank balances, \$15.636 million was covered by federal depository insurance, \$18.178 million by collateral held by the escrow agent in the depositor's name, \$40.561 million was covered under the State Treasurer's collateral pool, \$6.593 million was covered by collateral held in the pledging bank's trust department in the depositor's name and \$59.041 million was uninsured and uncollateralized.

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, 2001. 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-426.25(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. Any assets of such investment vehicles or trusts shall remain solely the property and rights of the State subject only to the claims of the State's general creditors.

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):

	<u>Category</u>			<u>Carrying</u>
	<u>1</u>	<u>2</u>	<u>3</u>	<u>Amount</u>
<i>Investments Categorized:</i>				
U.S. Government securities.....	\$ 1,647	\$ 572	\$ 858	\$ 3,077
State and municipal securities.....	2,184	—	—	2,184
Corporate bonds.....	17,580	—	810	18,390
Corporate common stock.....	51	—	1,525	1,576
<i>Total Investments Categorized.....</i>	<u>\$ 21,462</u>	<u>\$ 572</u>	<u>\$ 3,193</u>	25,227
<i>Investments Not Categorized:</i>				
Money market funds.....				10,120
Mutual funds.....				2,056,097
Annuity contracts.....				237,079
Total Investments.....				<u>\$ 2,328,523</u>

NOTES TO THE FINANCIAL STATEMENTS**Component Units**

The component units of the State (except for the North Carolina Railroad) are required to follow certain investment guidelines as outlined by the General Statutes. The component units include the University of North Carolina system; the community colleges; the Golden LEAF, a governmental component unit; and proprietary component units, such as the North Carolina State Ports Authority, MCNC, and the North Carolina Housing Finance Agency. The investments by these units comprise 96% of the total investments maintained by the component units at June 30, 2001. The investments by the component units adhere to the following General Statutes guidelines.

General Statute 115D-58.6 authorizes the community colleges to invest in obligations of or fully guaranteed by the United States; obligations of the State of North Carolina; bonds and notes of any North Carolina local government or public authority; obligations of certain non-guaranteed federal agencies; prime quality commercial paper; the North Carolina Capital Management Trust, an SEC registered mutual fund; commingled investment pool established and administered by the State Treasurer; repurchase agreements; and 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.

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.

The General Statutes place no specific investment restrictions on the University of North Carolina system, the Golden LEAF, the North Carolina State Ports Authority, or MCNC. 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.

NOTES TO THE FINANCIAL STATEMENTS

At year end, investment balances maintained outside the State Treasurer for the component units were as follows (dollars in thousands):

	<i>Category</i>			<i>Carrying Amount</i>
	1	2	3	
<i>Investments Categorized:</i>				
U.S. Government securities.....	\$ 229,994	\$ 27,454	\$ 53,430	\$ 310,878
Collateralized mortgage obligations.....	59,602	12,604	—	72,206
State and municipal securities.....	5,881	660	—	6,541
Corporate bonds.....	123,219	11,704	18,317	153,240
Corporate common stock.....	245,723	97,708	30,767	374,198
Repurchase agreements.....	239,788	1,341	6,286	247,415
International corporate bonds.....	2,286	299	—	2,585
International government bonds.....	1,182	—	—	1,182
International equity securities.....	4,828	1,592	—	6,420
<i>Total Investments Categorized.....</i>	<u>\$ 912,503</u>	<u>\$ 153,362</u>	<u>\$ 108,800</u>	1,174,665
<i>Investments Not Categorized:</i>				
Money market funds.....				430,046
Mutual funds.....				624,224
Annuity contracts.....				263
Real estate.....				33,991
Real estate investment trust.....				34,990
Limited partnerships.....				307,231
Investments held by broker-dealers under reverse repurchase agreements:				
U.S. Government securities.....				11,447
N.C. Capital Management Trust				993
Other investments.....				58,120
Total Investments.....				<u>\$ 2,675,970</u>

Included in the "U.S. government securities" investment category are mortgage-backed securities issued by agencies of the United States government, the Government National Mortgage Association (GNMA) and the Federal National Mortgage Association (FNMA). The University of North Carolina at Chapel Hill and the North Carolina Housing Finance Agency invest in these securities to maximize yield while maintaining a high degree of safety. The securities are based on cash flows from payments on underlying mortgages. Although these investments are not derivatives, the investment values are sensitive to mortgage prepayments that tend to occur during periods of declining interest rates.

Derivatives are not widely used by the various component units investing outside the State Treasurer. Of the above balances, only the Collateralized Mortgage Obligations (CMOs) and certain investments held by limited partnerships were considered material derivative positions during the year.

NOTES TO THE FINANCIAL STATEMENTS

Collateralized Mortgage Obligations - The University of North Carolina at Chapel Hill, North Carolina State University, and UNC Hospitals invest in collateralized mortgage obligations (CMOs) issued by FNMA, FHLMC and by certain trusts and private corporations. In a CMO, cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple classes with different priority claims and payment streams (commonly referred to as tranches.) A holder of the security thus chooses the class of security that best meets risk and return objectives. CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates, and various liquidity factors related to their specific markets. The universities and UNC Hospitals invest in these securities to increase the yield and return on their investment portfolios given the available alternative investment opportunities.

Limited Partnerships – The limited partnership positions are 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 market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the

NOTES TO THE FINANCIAL STATEMENTS

NOTE 5: FIXED ASSETS

Primary Government:

A summary of changes in general fixed assets for the year ended June 30, 2001 is presented below (dollars in thousands).

	Balance July 1, 2000	Prior Year Adjustments	Transfers		Additions	Deletions	Balance June 30, 2001
			Between Assets	Between Funds			
Land.....	\$ 321,733	\$ 78	\$ —	\$ (786)	\$ 36,098	\$ 113	\$ 357,010
Buildings.....	1,758,354	(1,237)	17,441	4,594	4,997	2,674	1,781,475
Other structures and improvements.....	150,694	229	9,011	2,553	1,055	351	163,191
Machinery and equipment.....	1,148,017	2,633	784	(2,363)	94,075	62,640	1,180,506
Art, literature and artifacts.....	47,367	402	—	—	939	87	48,621
Construction in progress.....	224,315	(9,137)	(27,236)	(17,505)	70,693	4,188	236,942
Total — General Fixed Assets...	\$ 3,650,480	\$ (7,032)	\$ —	\$ (13,507)	\$ 207,857	\$ 70,053	\$ 3,767,745

A summary of proprietary funds' fixed assets by classification for the primary government, at June 30, 2001, is presented below (dollars in thousands).

	Internal	
	Enterprise	Service
Land.....	\$ 2,855	\$ 4,161
Buildings.....	30,685	46,625
Other structures and improvements...	18,326	3,697
Machinery and equipment.....	3,265	275,039
Construction in progress.....	10,546	5,608
	65,677	335,130
Less: Accumulated depreciation.....	(26,791)	(166,676)
Total Fixed Assets.....	\$ 38,886	\$ 168,454

Component Units:

A summary of fixed assets by classification for the component units, at June 30, 2001, is presented below (dollars in thousands).

	Proprietary Funds					
	N.C.		MCNC	North Carolina Railroad	Other Component Units	Total
	State Ports Authority	N.C. Global TransPark Authority				
Land.....	\$ 19,795	\$ 7,339	\$ —	\$ 1,932	\$ 592	\$ 29,658
Buildings.....	111,603	11,439	20,791	2,152	464	146,449
Other structures and improvements...	39,893	17,875	—	7,849	212	65,829
Machinery and equipment.....	54,381	2,431	37,520	131	5,518	99,981
Construction in progress.....	8,827	13,264	1,673	63	—	23,827
	234,499	52,348	59,984	12,127	6,786	365,744
Less:						
Accumulated depreciation.....	(109,055)	(7,545)	(42,583)	(358)	(3,572)	(163,113)
Total Fixed Assets.....	\$ 125,444	\$ 44,803	\$ 17,401	\$ 11,769	\$ 3,214	\$ 202,631

	College and University Funds		
	University	Community	
		Colleges	Total
Land.....	\$ 123,359	\$ 70,760	\$ 194,119
Buildings.....	3,183,808	963,275	4,147,083
Other structures and improvements...	538,369	42,308	580,677
Machinery and equipment.....	832,424	145,354	977,778
Art, literature and artifacts.....	730,712	71,530	802,242
Construction in progress.....	445,074	102,163	547,237
Total Fixed Assets.....	\$ 5,853,746	\$ 1,395,390	\$ 7,249,136

NOTES TO THE FINANCIAL STATEMENTS**NOTE 6: 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, 2001, total operating lease expenditures were \$60,069,845 for Primary Government, \$23,900,453 for Universities, \$5,229,719 for Community Colleges, and \$1,084,596 for other component units. Future minimum lease commitments for noncancelable operating leases and capital leases as of June 30, 2001 are (dollars in thousands):

Fiscal Year	Operating Leases		Capital Leases			
	Primary Government	Component Units	University Funds	Community College Funds	Total College and University Funds	Governmental and Proprietary
2002	\$ 41,231	\$ 19,072	\$ 1,274	\$ 82	\$ 1,356	\$ 3,528
2003	32,769	13,773	592	42	634	2,333
2004	25,450	9,833	473	39	512	2,273
2005	19,270	6,995	342	3	345	2,019
2006	16,403	2,915	90	—	90	—
2007 - 2011	27,337	5,272	—	—	—	—
2012 - 2016	11,857	117	—	—	—	—
2017 - 2021	11,857	40	—	—	—	—
2022 - 2026	11,857	23	—	—	—	—
Total Future Minimum Lease Payments.....	\$ 198,031	\$ 58,040	2,771	166	2,937	10,153
Less: Amounts Representing Interest			<u>318</u>	<u>33</u>	<u>351</u>	<u>1,295</u>
Present Value of Future Minimum Lease Payments			\$ 2,453	\$ 133	\$ 2,586	\$ 8,858

Falls Lake Operating Lease. The State has leased from the federal government approximately 40,000 acres of land and water areas at Falls Lake, located in Wake and Durham counties. The agreement allows the State to operate the areas for recreational purposes, and in return the State agreed to pay for one half of the development costs. Payments, which have not yet begun, are to take place over 50 years with an option to prepay. Current cost estimates indicate that the State has a total obligation of \$57.8 million, including \$31.4 million in interest and \$26.4 million in principal. Annual payments are estimated to be \$1.156 million beginning in fiscal year 2001-2002. Since the costs and payment period are yet to be finalized, this commitment has not been included in the above table.

At June 30, 2001, fixed assets acquired under capital leases are as follows (dollars in thousands):

	Component Units			
	University Funds	Community College Funds	Total College and University Funds	Governmental and Proprietary
Machinery and Equipment	\$ 3,833	\$ 314	\$ 4,147	\$ 15,398
Other	611	—	611	—
Less: Accumulated Depreciation	(1,400)	—	(1,400)	(6,586)
Total Fixed Assets	\$ 3,044	\$ 314	\$ 3,358	\$ 8,812

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7: LONG-TERM OBLIGATIONS

A. Changes in Long-Term Liabilities

During the year ended June 30, 2001, the following changes occurred in liabilities reported in the general long-term obligations account group (dollars in thousands):

	<i>Rates</i>	<i>Balance June 30, 2000</i>	<i>Accretion</i>	<i>Increases</i>	<i>Decreases</i>	<i>Balance June 30, 2001</i>
General Obligation Bonds :						
Capital Improvement, Series 1989, 5-1-89.....	6.5-6.9	\$ 12,456	\$ 867	\$ —	\$ 1,910	\$ 11,413
Capital Improvement, Series A, 3-1-91.....	5.75-6.0	16,500	—	—	8,300	8,200
Capital Improvement, Series 1991, 10-1-91.....	5.3-5.6	12,500	—	—	6,200	6,300
Prison and Youth Services Facilities, Series A, 3-1-92....	5.9-6.2	17,600	—	—	8,800	8,800
Prison and Youth Services Facilities, Series B, 10-1-93..	2.5-4.5	66,100	—	—	8,800	57,300
Clean Water Refunding, Series 1993, 10-1-93.....	3.0-5.0	2,450	—	—	2,450	—
Prison & Youth Services Facilities Refunding, Series C, 10-15-93.....	4.2-4.8	63,480	—	—	640	62,840
Capital Improvement, Series 1994A, 2-1-94.....	4.6-4.75	356,500	—	—	28,000	328,500
Clean Water, Series 1994A, 10-1-94.....	5.7-5.8	8,000	—	—	2,000	6,000
Clean Water, Series 1995A, 6-1-95.....	5.0-5.25	51,000	—	—	3,000	48,000
Capital Improvement, Series 1997, 1-1-97.....	4.8-5.1	186,000	—	—	12,000	174,000
Public School Building, Series 1997A, 3-1-97.....	5.1-5.2	426,000	—	—	9,500	416,500
Public School Building, Series 1998A, 4-1-98.....	4.75-5.0	418,000	—	—	16,000	402,000
Highway, Series 1997A, 11-1-97.....	4.5-5.0	216,650	—	—	16,675	199,975
Public School Building, Series 1999, 4-1-99.....	4.5-5.0	431,500	—	—	18,500	413,000
Clean Water Refunding, Series 1999, 4-1-99.....	2.9-5.0	25,250	—	—	160	25,090
Public Improvement, Series 1999A, 9-1-99.....	5.0-5.4	177,400	—	—	6,000	171,400
Public Improvement, Series 1999B, 9-1-99.....	6.7-6.75	20,000	—	—	2,850	17,150
Public Improvement, Series 1999C, 10-1-99.....	4.5-4.7	2,600	—	—	375	2,225
Public Improvement, Series 2000A, 9-1-00.....	5.0-5.1	—	—	300,000	—	300,000
Public Improvement, Series 2001A, 3-1-01.....	4.5-5.0	—	—	380,000	—	380,000
Total Bonds Payable.....		<u>2,509,986</u>	<u>867</u>	<u>680,000</u>	<u>152,160</u>	<u>3,038,693</u>
Other Long-Term Obligations :						
Tax judgements payable.....		58,744	—	—	58,744	—
Notes payable.....	5.05-5.06	8,797	—	—	927	7,870
Deferred death benefit payable.....		85	—	70	60	95
Obligations for workers' compensation.....		7,123	—	555	610	7,068
Capital leases payable.....		853	—	—	853	—
Accrued vacation leave.....		198,234	—	14,619	1,228	211,625
Total General Long-Term Obligations.....		<u>\$ 2,783,822</u>	<u>\$ 867</u>	<u>\$ 695,244</u>	<u>\$ 214,582</u>	<u>\$ 3,265,351</u>

NOTES TO THE FINANCIAL STATEMENTS

B. Bonds and Notes Payable

Bonds and notes payable at June 30, 2001 were (dollars in thousands):

	Interest Rates	Final Maturity	Total
Primary Government:			
General long-term obligations:			
Bonds payable.....	2.5 - 6.9	3/1/19	\$ 3,038,693
General long-term obligations:			
Notes payable.....	5.05 - 5.06	9/1/21	7,870
Component Units:			
University Funds:			
Bonds payable.....	1.05 - 9.25	2/15/31	1,299,568
Other Component Units:			
Housing Finance:			
Bonds payable.....	3.45 - 8.25	1/1/33	1,232,055
Other:			
Bonds payable.....	2.85-6.35	7/1/28	900,261
College and University Funds:			
Notes payable.....	0.0 - 7.00	5/1/22	17,990
Other Component Units:			
Notes payable.....	4.75-5.98	6/21/41	1,219

The full faith, credit, and taxing power of the State has been pledged only for the payment of the principal of and the interest on the general obligation serial bonds and capital appreciation bonds. 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

On September 1, 2000, \$300 million in Public Improvement Bonds, Series 2000A were issued, representing a consolidation of Public School Building Bonds in the amount of \$295 million and Natural Gas Bonds in the amount of \$5 million, with a settlement date of September 1, 2018. In November 2000, North Carolina voters approved \$3.1 billion of University and Community College (higher education) general obligation bonds. On March 1, 2001, \$380 million in Public Improvement Bonds, Series 2001A were issued, representing a consolidation of Public School Building Bonds in the amount of \$100 million, Clean Water Bonds in the amount of \$30 million, and Higher Education Bonds in the amount of \$250 million, with a settlement date of March 1, 2019. The amount of authorized but unissued bonds was \$4.37 billion as of June 30, 2001.

The limitations on the increase of State debt are contained in the State Constitution, Article 5, Section 3. This section 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:

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;
6. For any other lawful purposes, 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.

D. Capital Appreciation Bonds

General Obligation Bonds

Capital Improvement Bonds, Series 1989, 5-1-89, 5-24-89, include capital appreciation bonds recorded in the amount of \$11.413 million, which represents the accreted value of these bonds. The accumulated accretion for the capital appreciation bonds is \$12.724 million since May 24, 1989.

University Bonds

The *University of North Carolina at Chapel Hill, Series 1997 Utility System* and the *Series 1991 U. S. Environmental Protection Agency Project* bond issues include capital appreciation bonds with an ultimate maturity value of \$84.135 million and \$25.275 million, respectively. These bonds are recorded in the amounts of \$36.959 million and \$9.355 million, respectively, which is the accreted value at June 30, 2001. These bonds mature in the years from 2010 to 2021.

E. Demand Bonds

University Revenue Bonds

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

On February 7, 2001 the University of North Carolina at Chapel Hill 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; Housing System, Series 2000; 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 agent, Lehman Brothers Inc. (2001B) and Paine Webber Incorporated (2001C).

Under an irrevocable letter of credit issued by Toronto-Dominion Bank and Chase Manhattan Bank, the trustee is entitled to draw amounts sufficient to pay 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 letters of credit of .08% per annum of the amount of bonds then currently outstanding.

NOTES TO THE FINANCIAL STATEMENTS

Under the letter of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the letter 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, 2001, no purchase drawings had been made under the letter of credit.

Revenue Bonds, Series 1999A – North Carolina State University

On September 22, 1999, North Carolina State 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 proceeds of this issuance were used to (i) discharge a portion of a loan from First Union National Bank, the proceeds from which were used for the construction and equipping of a building known as the Partners II Building located on the University's Centennial Campus, (ii) paying the cost of relocating utility easements on the Centennial Campus, 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 days' notice and delivery to the University's bond paying agent, The Bank of New York. Upon notice from the bond 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 between the Board of Governors of the University of North Carolina and First Union National Bank, 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 0.11% 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, 2001 there were no liquidity provider bonds held by the liquidity facility. The original liquidity facility is scheduled to expire on September 15, 2002 unless otherwise extended based on the terms of the agreement.

Upon expiration or termination of the agreement, the University is required to redeem the liquidity provider bonds held by the liquidity facility in twenty 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.

Effective October 1, 1999, the University entered into an interest rate swap contractual agreement with Lehman Brothers, Inc. on \$9,000,000 of these demand bonds. Under this agreement the University will pay interest at a fixed rate of 4.574%. On a monthly basis the difference between 67% of the weighted average of the weekly LIBOR rate and the fixed rate will be calculated. If the fixed rate is greater than the LIBOR calculated rate, the University will pay the difference to Lehman Brothers, Inc. If the LIBOR rate is greater, Lehman Brothers will refund the difference to the University. During fiscal year 2000-2001, the University paid Lehman Brothers \$50,000 under this agreement.

The University of North Carolina System Variable Rate Demand Pool Revenue Bonds, Series 1998A – East Carolina University

On November 3, 1998, East Carolina University issued variable rate demand bonds in the amount of \$3,645,000 that have a final maturity date of October 1, 2008. The bonds are subject to mandatory sinking fund redemption that began on October 1, 1999. The proceeds of this issuance were used to refinance notes payable which were issued to pay the costs of repairs to Dowdy-Ficklen Stadium, construction of the Blount Intramural Field, and construction of the Reade Street Parking Lot. 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 bond-paying agent, The Bank of New York. Upon notice from the bond-paying agent, the remarketing agent, Salomon Smith Barney, 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 between the Board of Governors of the University of North Carolina and Bank of America N.A., a liquidity facility has been established for the trustee 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 standby fee equal to .13% of the available commitment, payable semiannually in advance, beginning on November 3, 1998, and on each May 1 and November 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 (LIBOR plus one percent). 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

NOTES TO THE FINANCIAL STATEMENTS

provider bonds is due the first business day of each month in which liquidity provider bonds are outstanding.

Upon expiration or termination of the agreement, the University is required to redeem (purchase) the liquidity provider bonds held by the liquidity facility in sixty equal monthly 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. The expiration date of the agreement is November 3, 2001 and may be extended for an additional period of up to three years at the discretion of the liquidity provider and acceptance by the Board of Governors of the University of North Carolina.

Amounts due under this standby bond purchase agreement are allocated by the trustee directly to and paid by the constituent universities participating in the system wide bond issuance.

Athletic Department, Series 1996 – East Carolina University

On December 1, 1996, East Carolina University issued tax-exempt adjustable mode demand bonds in the amount of \$7,000,000 that have a final maturity date of May 1, 2017. The bonds are subject to mandatory sinking fund redemption that began on May 1, 1998. The proceeds of this issuance were used to pay the cost of renovating and expanding Dowdy-Ficklen Stadium on the campus of East Carolina University and to pay the costs incurred in connection with the issuance of the 1996 bonds. The bonds are subject to purchase on demand with seven days' notice and delivery to the University's remarketing agent, Alex. Brown & Sons, Inc.

Under an irrevocable direct-pay letter of credit issued by Wachovia Bank, N.A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase. The University is required to pay an annual commitment fee of .30% of the amount of the bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia Bank in which it has agreed upon termination of the letter of credit to repay all amounts that are drawn under the letter of credit. Interest is charged at the rate of prime. At June 30, 2001, no drawings had been made under the letter of credit.

The letter of credit automatically extends every month so that termination will not occur until 13 months after notice is received from Wachovia Bank that the letter of credit will not be extended. As of June 30, 2001, the earliest such termination date is July 31, 2002.

The University of North Carolina System Variable Rate Demand Pool Revenue Bonds, Series 1998A – The University of North Carolina at Asheville

On November 3, 1998, the University of North Carolina at Asheville issued variable rate demand bonds in the amount of \$2,580,000 that have a final maturity date of October 1, 2008. The bonds are subject to mandatory sinking fund redemption that began on October 1, 1999. The proceeds of this issuance were used to construct a 200-car parking structure. 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 bond paying agent, The Bank of New York. Upon notice from the bond-paying agent, the remarketing agent, Salomon Smith Barney, 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 between the Board of Governors of the University of North Carolina and Bank of America, a liquidity facility has been established for the trustee 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 standby fee equal to .13% of the available commitment, payable semiannually in advance, beginning on November 3, 1998, and on each May 1 and November 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 (LIBOR plus one percent). 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, 2001, there were no liquidity provider bonds held by the liquidity facility.

Upon expiration or termination of the agreement, the University is required to redeem (purchase) the liquidity provider bonds held by the liquidity facility in sixty equal monthly 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. The expiration date of the agreement is November 3, 2001 and may be extended for an additional period of up to three years at the discretion of the liquidity provider and acceptance by the Board of Governors of the University of North Carolina.

Amounts due under this standby bond purchase agreement are allocated by the trustee directly to and paid by the constituent universities participating in the system wide bond issuance.

NOTES TO THE FINANCIAL STATEMENTS**The University of North Carolina Hospitals' Variable Rate Demand Pool Revenue Bonds, Series 2001A and 2001B**

On January 31, 2001, the Board of Governors of the University of North Carolina issued Series 2001A and Series 2001B Revenue Bonds on behalf of the Hospitals. These tax-exempt variable rate demand bonds with an initial interest rate mode of daily were issued in the amount of \$110,000,000 and have a final maturity date of February 15, 2031. The bonds are subject to mandatory sinking fund redemption that begins on February 15, 2002. The proceeds of this issuance are for certain amounts paid by the Hospitals that allowed the UNC Health Care System to acquire controlling interest in Rex Healthcare Inc. (\$75,000,000) and for the renovation of space vacated when the construction of the North Carolina Children's Hospital, North Carolina Women's Hospital, and support services is completed (\$35,000,000). 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.

The bonds are subject to purchase on demand with seven days' notice and delivery to the bond tender agent, First Union National Bank. The Hospitals' remarketing agents, Merrill Lynch, Pierce, Fenner & Smith Incorporated (Series 2001A) or 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.

Under separate standby bond purchase agreements for the Series 2001A and Series 2001B between the Hospitals and Landesbank Hessen-Thüringen 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 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, 2001, there were no bank bonds held by the liquidity facility.

The original expiration date of the agreements is January 29, 2002, and the Hospitals has requested and received an extension through July 31, 2002. The Hospitals may request additional extensions of up to 364 days through the third anniversary date of the agreements on January 31, 2004. Extensions are at the discretion of the liquidity provider.

The Hospitals is required to redeem (purchase) the bank bonds held by the liquidity facility 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.

NOTES TO THE FINANCIAL STATEMENTS

F. Debt Service Requirements

Bonds Payable and Notes Payable

The following schedule shows the annual debt service requirements to pay principal and interest on general obligation bonds and revenue bonds, as well as on notes payable, outstanding at June 30, 2001 (dollars in thousands). Current and long-term principal requirements are disclosed for the proprietary component unit funds.

Fiscal Year	Bonds Payable							
	Primary Government		Component Units					
	General Long-Term Obligations		Proprietary					
	Account Group		N.C. Housing Finance		Other Proprietary Funds		University Funds	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2002	\$ 180,245	\$ 147,290	\$ 15,762	\$ 77,487	\$ 2,190	\$ 36,781	\$ 48,088	\$ 60,845
2003	180,280	138,493	23,404	72,201	2,140	36,685	51,987	58,620
2004	180,180	129,920	25,502	70,105	1,740	36,589	54,045	55,899
2005	180,585	121,342	26,902	67,993	1,730	36,508	54,679	53,210
2006	180,445	112,776	28,302	66,567	32,016	35,701	56,272	50,560
2007-2011	899,885	434,735	165,285	302,439	208,175	157,955	294,503	215,531
2012-2016	845,550	218,420	220,755	249,496	357,270	84,978	287,021	155,222
2017-2021	395,400	32,973	223,330	180,431	25,000	52,095	248,367	82,603
2022-2026	—	—	280,005	115,913	—	52,095	173,916	36,262
2027-2031	—	—	234,430	21,123	270,000	19,983	84,325	9,361
2032-2036	—	—	9,890	1,984	—	—	—	—
	3,042,570	1,335,949	1,253,567	1,225,739	900,261	549,370	1,353,203	778,113
Less:								
Unamortized discount	(3,877)	—	—	—	—	—	(49,491)	—
Deferred charges	—	—	(21,512)	—	—	—	(3,954)	—
Underwriters fees	—	—	—	—	—	—	(190)	—
Total requirements	<u>\$ 3,038,693</u>	<u>\$ 1,335,949</u>	<u>\$ 1,232,055</u>	<u>\$ 1,225,739</u>	<u>\$ 900,261</u>	<u>\$ 549,370</u>	<u>\$ 1,299,568</u>	<u>\$ 778,113</u>
Current portion			\$ 15,762		\$ 2,190			
Long-term portion			\$ 1,216,293		\$ 898,071			

Notes Payable

Fiscal Year	Primary Government		Component Units			
	General Long-Term Obligations		Proprietary Funds		College and University Funds	
	Principal	Interest	Principal	Interest	Principal	Interest
2002	\$ 935	\$ 376	\$ 74	\$ 63	\$ 2,241	\$ 882
2003	984	327	77	58	4,055	751
2004	1,035	276	83	54	1,611	594
2005	1,088	223	88	49	1,532	514
2006	1,145	167	93	43	1,430	434
2007-2011	1,204	107	210	157	5,876	1,087
2012-2016	1,266	45	51	136	712	233
2017-2021	213	2	65	123	432	96
2022-2026	—	—	82	106	101	4
2027-2031	—	—	103	85	—	—
2032-2036	—	—	130	58	—	—
2037-2041	—	—	163	24	—	—
Total requirements	<u>\$ 7,870</u>	<u>\$ 1,523</u>	<u>\$ 1,219</u>	<u>\$ 956</u>	<u>\$ 17,990</u>	<u>\$ 4,595</u>
Current portion			\$ 74			
Long-term portion			\$ 1,145			

NOTES TO THE FINANCIAL STATEMENTS
G. Arbitrage Rebate Payable

The State and universities have incurred an arbitrage rebate liability in connection with general obligation and university revenue bonds sold in previous years. Arbitrage rebates payable at June 30, 2001 have been recorded (dollars in thousands) in the following funds:

Capital projects funds.....	\$	132
Special revenue funds.....		9,415
University funds.....		<u>948</u>
Total.....	\$	<u>10,495</u>

H. Bond Defeasances
University of North Carolina at Chapel Hill

On February 7, 2001, the University issued \$89,930,000 in the University of North Carolina at Chapel Hill *General Revenue Bonds, Series 2001A*, with an average interest rate of 4.60%. The refunding component of this bond issue was used to advance refund (defease) \$13,205,000 of outstanding University of North Carolina at Chapel Hill *Dining System Revenue Bonds, Series 1997* with a combined average interest rate of 5.28%. Of the net proceeds amount, \$13,453,364 was combined with Bond Trustee funds of \$351,289 and 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's debt service requirements to early redemption of the 1997 Bonds were not affected by the refunding, and there was no economic gain on the transaction. At June 30, 2001, the outstanding balance was \$12,690,000 for the defeased outstanding *Dining System Revenue Bonds, Series 1997*.

East Carolina University

On May 16, 2001, the University issued \$11,985,000 in *Housing & Dining Facilities System Revenue Refunding Bonds, Series 2001B*, with an average interest rate of 4.92%. The refunding component of this bond issue was used to advance refund (defease) \$11,655,000 of outstanding *Housing & Dining Facilities System Revenue Bonds, Series 1992, 1994, and 1995*, with a combined average interest rate of 5.62%. Of the net proceeds amount, \$12,140,925 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 \$321,113 over the next 15 years and obtained an economic gain of \$238,455. At June 30, 2001, the outstanding balance was \$11,655,000 for the defeased *Housing and Dining Facilities System Revenue Bonds, Series 1992, Series 1994, and Series 1995*.

North Carolina Agricultural and Technical State University

On October 1, 2000, the University issued \$1,555,000 in the North Carolina Agricultural and Technical State University *Student Fee Revenue Promissory Bond* with an average interest rate of 5.14%. The refunding component of this bond was used to refund (defease) \$1,495,000 of outstanding *Stadium System Student Fee Revenue Refunding Bonds*, with a combined average interest rate of 7.2%. Net proceeds of \$1,545,474 resulted from the issuance of the bond. The University reduced its debt service requirements by \$231,269 over the next 12 years and obtained an economic gain of \$131,541. At June 30, 2001 there were no outstanding bonds for the defeased *Stadium System Student Fee Revenue Refunding Bonds*.

Western Carolina University

On October 31, 2000, the University issued \$1,370,000 in Western Carolina University *Dormitory Pool Revenue Bond, Series 2000* with an average interest rate of 5.12%. The refunding component of this bond issue was used to advance refund (defease) \$1,285,000 of outstanding Western Carolina University *Dormitory System Revenue and Revenue Refunding Bonds of 1991, Series G*, with a combined average interest rate of 6.69%. Net proceeds of \$1,393,988 resulted from the bond sale. The University reduced its debt service requirements by \$121,932 over the next 10 years and obtained an economic gain of \$75,341. At June 30, 2001 the outstanding balance was \$1,370,000 for the defeased Western Carolina University *Dormitory Pool Revenue Bond, Series 2000*.

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, 2001, the outstanding balance of current and prior year defeased bonds was \$83.6 million for the primary government and \$156.9 million for the component units.

I. Bond Redemptions

Provisions of 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 or from unexpended bond proceeds of the issues along with the related decreases in the respective debt service reserve requirements. In addition, various bond issues are redeemable at the option of the Agency at premiums ranging up to 2% during periods from 10 to 16 years after the date of issuance.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 8: INTERFUND RECEIVABLES AND PAYABLES

Interfund receivables and payables as of June 30, 2001 are as follows (dollars in thousands):

	<u><i>Interfund Receivables</i></u>	<u><i>Interfund Payables</i></u>
Primary Government		
General:		
General Fund.....	\$ 53,448	\$ 122,673
Special Revenue:		
State Highway Fund.....	102,051	7,855
Highway Trust Fund.....	—	100,247
Tobacco Trust.....	—	1
Higher Education Bond.....	—	109,585
Clean Water Management Trust Fund.....	—	110
Educational Materials, School Buses Fund.....	167	—
Employment Security Commission Funds.....	583	—
Employment and Training Administration Fund.....	—	6
Highway Patrol Fund.....	284	75
Leaking Petroleum Underground Storage Tank Cleanup Fund.....	—	401
Wildlife Resources Commission Fund.....	215	193
Other Funds.....	7,978	25,069
Total Special Revenue Funds.....	<u>111,278</u>	<u>243,542</u>
Capital Projects:		
Capital Projects Fund.....	1,298	7
Total Capital Projects Funds.....	<u>1,298</u>	<u>7</u>
Enterprise:		
Public School Insurance.....	—	4
N.C. State Fair.....	—	4
Total Enterprise Funds.....	<u>—</u>	<u>8</u>
Internal Service:		
Workers' Compensation Program.....	1,102	—
State Property Fire Insurance.....	—	1,919
Prison Enterprises.....	4,589	111
Motor Fleet Management.....	3,400	344
Courier Service.....	4	824
Temporary Solutions.....	308	1
N.C. Information Highway.....	90	267
Centralized Computing Services.....	3,708	3,072
State Telecommunications Services.....	5,968	44
Applications Development Services.....	773	179
Decentralized Computing Services.....	409	—
State Treasurer IT Center.....	—	9
Surplus Property.....	773	2,099
Total Internal Service.....	<u>21,124</u>	<u>8,869</u>

NOTES TO THE FINANCIAL STATEMENTS

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
Primary Government		
<i>(continued)</i>		
Expendable Trust:		
Unemployment Compensation		
Funds.....	—	31
Escheat Fund.....	26,757	18,645
Recreation and Natural Heritage		
Trust Fund.....	226	—
Other Funds.....	406	97
Total Expendable Trust.....	<u>27,389</u>	<u>18,773</u>
Nonexpendable Trust:		
Wildlife Endowment Program.....	—	8
Clean Water Revolving Loan and Grant Fund.....	—	1
Total Nonexpendable Trust.....	<u>—</u>	<u>9</u>
Pension Trust Funds:		
Firemen's and Rescue Squad Workers'		
Pension Fund.....	—	1
Agency:		
Local Sales Tax Collections.....	9,685	—
Clerks of Court.....	314	6,066
Departmental Agency Funds.....	3,776	11,331
Total Agency.....	<u>13,775</u>	<u>17,397</u>
Component Units		
Governmental:		
Golden LEAF.....	—	547
Total Governmental Component Units.....	<u>—</u>	<u>547</u>
Proprietary:		
State Education		
Assistance Authority.....	18,645	—
State Health Plan.....	—	2
N.C. State Ports Authority.....	499	—
North Carolina Railroad Company.....	—	50,582
N.C. Global TransPark Authority.....	—	26,763
N.C. Agricultural Finance Authority.....	—	1
N.C. Partnership for Children		
.....	—	3,123
Total Proprietary Funds.....	<u>19,144</u>	<u>80,471</u>
College and University:		
University Funds.....	195,179	76,429
Community Colleges Funds.....	24,139	433
Total University and		
Community College.....	<u>219,318</u>	<u>76,862</u>
Subtotal.....	<u>\$ 466,774</u>	<u>\$ 569,159</u>
Timing difference —		
Delayed retirement contributions.....	83,385	—
North Carolina Railroad Company.....	19,000	—
Total.....	<u>\$ 569,159</u>	<u>\$ 569,159</u>

Included in the category of interfund receivables are "Due from other funds," "Due from component units," "Due from primary government," and "Advance to component units." Included in the category of interfund payables are "Due to other funds," "Due to component units," "Due to primary government," and "Advance from primary government." Interfund payables exceeded interfund receivables in the amount of \$19 million due to timing differences in the recognition of a loan repayment (\$9.5 million), and dividend earnings (\$9.5 million). Interfund payables also exceeded interfund receivables in the amount of \$83.385 million due to the retirement contributions held by the General Fund and not recorded in the Pension Trust Fund.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9: RETIREMENT PLANS

The State reports seven retirement plans as pension trust funds. This note describes the six defined benefit public employee retirement plans administered by the State. The remaining plan, described in Note 10, is the Supplemental Retirement Income Plan, a defined contribution plan provided under the Internal Revenue Code Section 401(k). Although the assets of the six defined benefit 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. Separate reports are not issued for the plans described in this note. 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, 2001, the number of participating local boards of education and component unit employers was 197 as shown below:

Local boards of education	117
Community colleges	58
University of North Carolina system	17
Proprietary component units	5

Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by employer contributions. For the period July 1, 2000 through June 30, 2001, the actuarially based annual required contribution was 5.33% 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 February of 2001, the Governor, by executive order, diverted all employer contributions to the plan for the remainder of the fiscal year to an escrow account for the purpose of balancing the state budget. The percentage of actual contributions made in relation to the required contributions for the State and its component units is shown in *Section D* of this note. All contributions are shown 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, 2000 through June 30, 2001, the actuarially based annual required contribution was 18.58% 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 February of 2001, the Governor, by executive order, diverted all employer contributions to the plan for the remainder of the fiscal year to an escrow account for the purpose of balancing the state budget. 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.

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 employer contributions. For the period July 1, 2000 through June 30, 2001, the actuarially based annual required contribution was 24% of covered payroll. 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.

For this plan, legislation established a contribution rate of 22.7% of covered payroll. In February of 2001, the Governor,

NOTES TO THE FINANCIAL STATEMENTS

by executive order, diverted all employer contributions to the plan for the remainder of the fiscal year to an escrow account for the purpose of balancing the state budget. 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.

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, 2001, there were 1,477 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, the State did not make the full actuarially required contribution. 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.

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

6. 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, 2001, the number of participating local governments was 879, as shown below:

Cities.....	402
Counties.....	100
Special districts.....	377

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. Employers contribute 5.27% of covered payroll for law enforcement officers and 4.80% for general employees and firemen for normal costs and an unfunded liability rate, which is established when the government initially enters the system. The State's responsibility is administrative only. 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.

NOTES TO THE FINANCIAL STATEMENTS

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

	Teachers' and State Employees'	Judicial	Legislative	Firemen's, Rescue	National Guard	Local Govern- mental
Employee Groups						
Retirees and beneficiaries currently receiving benefits	107,743	368	189	7,807	1,997	30,061
Terminated employees entitled to benefits but not yet receiving them	45,918	60	84	153	5,806	14,126
Active plan members	<u>292,311</u>	<u>470</u>	<u>172</u>	<u>29,148</u>	<u>7,631</u>	<u>116,240</u>
Total	<u>445,972</u>	<u>898</u>	<u>445</u>	<u>37,108</u>	<u>15,434</u>	<u>160,427</u>
Date of Valuation	12-31-00	12-31-00	12-31-00	6-30-00	12-31-00	12-31-00

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 an investment pool in which the systems participate. The investment balance of each system represents its share of the fair value of the net assets of various portfolios within the pool. Additionally, the securities lending balance represents assets occurring from securities lending transactions resulting from the systems' participation in

the pool. The investments of the State Treasurer and securities lending are fully discussed in Note 4.

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, 2000 (June 30, 2000, 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.

<i>Retirement System</i>	<i>Valuation Date</i>	<i>Actuarial Cost Method</i>	<i>Amortization Method</i>	<i>Remaining Amortization Period</i>	<i>Period Open/Closed</i>	<i>Asset Valuation Method</i>	<i>Actuarial Assumptions</i>	
							<i>Investment Rate of Return</i>	<i>Projected Salary Increase</i>
Teachers' and State Employees'	12/31/00	Entry age	Level percentage	11 years	Open	5 year smoothed	7.25%	5.45-12.08%
Consolidated Judicial	12/31/00	Projected unit credit	Level percentage	9 years	Open	5 year smoothed	7.25%	5.63-12.58%
Legislative	12/31/00	Projected unit credit	Level dollar	None	Open	5 year smoothed	7.25%	7.50%
Firemen's, Rescue Squad Workers'	6/30/00	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
National Guard	12/31/00	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
Local Governmental Employees'	12/31/00	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 valuation for the Local Governmental Employees' system includes an effective 3.7% cost of living increase for retirees and an increase in the benefit accrual rate from 1.78% to 1.81%. The valuations for the Teachers' and State Employees', Legislative Retirement, and Consolidated Judicial, systems reflect a 2% cost of living increase for retirees in these systems. All of the benefit enhancements listed in this paragraph reflect legislation enacted by the North Carolina General Assembly and are effective July 1, 2001.

Since its last valuation, legislation for the Teachers' and State Employees' system, removed a market value cap in the computation of actuarial assets. The *Schedule of Funding Progress* presented in the *Required Supplementary Information* section of this report has been adjusted for the impact of these changes.

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 for the fiscal year ended June 30, 2001, were developed from various prior year valuations. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial, and National Guard systems' valuations were as of December 31, 1998, the Legislative system was valued at December 31, 1999, and the Firemen's and Rescue Squad Worker's Fund was valued at June 30, 1999. These valuations used amortization periods of 14 years for Consolidated Judicial, 6 years for National Guard and 3 years for the Firemen's and Rescue Squad Worker's Fund. The Teachers' and State Employees' system used the level dollar amortization method that produced a remaining amortization period of 2 years. The Local Governmental Employees' system is an aggregate of numerous employers, and

consequently, had 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.

As a result of interim legislation, the December 31, 1998, actuarial value of assets for the Teachers' and State Employees' system was restated by the actuary from his original presentation. The system's actuarially required contributions for this fiscal year and its actuarial funding parameters were affected by these changes. The *Schedule of Funding Progress* presented in the *Required Supplementary Information* section of this report reflects adjustments for the impact of these changes on that valuation.

The actuarial required contribution originally developed in the December 31, 1999 valuation for the Legislative Retirement System was adjusted to align the contribution period with the state fiscal year. The effect is considered actuarially insignificant, but will affect future contribution rates.

During the current fiscal year, the Local Governmental Employees' system provided a 3.8% cost of living increase for retirees and an increase in the benefit accrual rate from 1.77% to 1.78%. The Teachers' and State Employees' system and Legislative Retirement system provided a 3.6% cost of living increase for retirees in these systems, and an increase in the benefit accrual rate in the Teachers' and State Employees' system from 1.80% to 1.81%. The Consolidated Judicial system gave a 2.6% cost of living increase to its retirees. All of these benefit enhancements reflect legislation enacted by the North Carolina General Assembly and were effective July 1, 2000. These enhancements are either reflected as liabilities in the December 31, 1999 valuations or the systems will pay for them with actuarial gains developed in prior valuations. The Firemen's and Rescue Squad Worker's Fund increased its monthly payments from \$146.00 to \$151.00 and also temporarily amended its membership eligibility criteria. The cost of these amendments are covered by actuarial gains in the 1999 valuation and an increase in the amortization period reflected in the 2000 valuation.

NOTES TO THE FINANCIAL STATEMENTS
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 follows:

	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund
Annual required contribution.....	\$ 9,071,000	\$ 861,037	\$ 12,104,780	\$ 2,075,000
Interest on net pension obligation.....	—	(26,725)	—	—
Adjustment to annual required contribution.....	—	90,569	—	—
Annual pension cost.....	<u>9,071,000</u>	<u>924,881</u>	<u>12,104,780</u>	<u>2,075,000</u>
Contributions made.....	<u>5,239,000</u>	<u>472,138</u>	<u>11,079,000</u>	<u>2,075,000</u>
Increase (decrease) in net pension obligation.....		452,743	1,025,780	
Net pension (asset) obligation beginning of year....	—	(368,615)	—	—
Net pension (asset) obligation end of year.....	<u>\$ 3,832,000</u>	<u>\$ 84,128</u>	<u>\$ 1,025,780</u>	<u>\$ —</u>

NOTES TO THE FINANCIAL STATEMENTS

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 required contributions the State made to the Teachers' and State Employees' Retirement System (the System), a cost-sharing, multiple-employer plan. The State's contribution equals its pension expense/expenditures for the System. 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, 1999 through June 30, 2001 (in thousands)

	<u>Teachers' and State Employees'</u>	<u>Judicial</u>	<u>Legislative</u>	<u>Firemen's, Rescue</u>	<u>National Guard</u>
Primary Government:					
2001	\$ 136,224	\$ 9,071	\$ 925	\$ 12,105	\$ 2,075
2000	197,480	8,435	889	12,105	2,545
1999	173,989	7,263	857	12,105	2,533
Component units:					
Universities:					
2001	\$ 63,356				
2000	91,805				
1999	79,770				
Community Colleges:					
2001	\$ 25,644				
2000	35,746				
1999	29,772				
Proprietary Funds:					
2001	\$ 926				
2000	1,250				
1999	1,114				
Total Primary Government and Component Units:					
2001	\$ 226,150	\$ 9,071	\$ 925	\$ 12,105	\$ 2,075
2000	326,281	8,435	889	12,105	2,545
1999	284,645	7,263	857	12,105	2,533
Percentage of APC Contributed:					
2001		58%	51%	92%	100%
2000		100%	91%	100%	100%
1999		100%	94%	100%	100%
Percentage of ARC Contributed:					
2001	100%				
2000	100%				
1999	100%				
Net Pension (Asset) Obligation:					
2001		\$ 3,832	\$ 84	\$ 1,026	\$ —
2000		—	(369)	—	—
1999		—	(446)	—	—

Yearly pension liabilities for the systems are shown in the *Required Supplementary* 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.

NOTES TO THE FINANCIAL STATEMENTS
E. Optional Retirement Plan

The Optional Retirement Program (Program) is a defined contribution retirement plan which 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, 2001, the Plan had 8,420 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 \$46,423,748 for the 2000-01 fiscal year. Annual covered payroll was \$678,709,768 and employer contributions expressed as a percentage of annual covered payroll were 6.84% for the fiscal year ended June 30, 2001. Employee contributions expressed as a percentage of annual covered payroll were 6%, with an actual employee contribution of \$40,722,586 for the 2000-01 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, 2001, the State and its component units paid \$8,609,206 for 669 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 state agency or paid from the component unit's operations for those employers who have eligible, retired law enforcement officers. These benefits are established in G.S. 143-166.41 and may be amended only by the General Assembly.

NOTE 10: 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 an expendable trust fund. All costs of

administering and funding the Plan are the responsibility of the plan participants.

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 \$10,500 in 2000) 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, 2000, are

NOTES TO THE FINANCIAL STATEMENTS

presented in this financial report as a pension 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. The Branch Banking and Trust Company (BB&T) administers the Plan, and the Plan's financial statements are available by contacting the N.C. 401(k) Plan, P.O. Box 29541, Raleigh, NC 27626.

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, 2000, 52 state agencies and component units along with 549 local governmental units outside our reporting entity contributed the required 5%. In addition, 324 local government employers contributed to the Plan on a voluntary basis.

At December 31, 2000, the Plan disclosed the following investments (at fair value) exceeding five percent of the Plan's net assets:

Fidelity Magellan Fund	\$ 937,482,000
BB&T Bank Investment Contracts.....	313,844,000
Fidelity Equity-Income Fund.....	309,889,000
Money Market Fund	214,220,000
Fidelity Spartan U.S. Equity	191,551,000

The Plan also reported total member contributions of \$156,245,000. The payrolls for law enforcement officers, on which the required contributions were based for the year ended December 31, 2000, amounted to \$129,202,969 for the State, \$13,175,696 for universities, and \$819,075 for the other miscellaneous component units. The required 5% employer's contribution was made by the State for \$6,460,148, by universities for \$658,785, and by the remaining component units for \$40,954. In addition, the State contributed \$480,059 for the required court cost assessments.

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.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 11: 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, 2001, the number of participants currently eligible to receive health care as an other postemployment benefit are 44,459 TSERS and DIPNC members (excluding LEA members), 258 CJRS members, 129 LRS members, and 705 UEORP members. The health insurance plan is the same as for active employees as described in Note 12, except that the coverage becomes secondary when former employees become eligible for Medicare. These former employees are eligible to participate in either the self-funded Comprehensive Major Medical Plan (Plan) or one of the health maintenance organization (HMO) plans.

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 1.28% 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 and makes similar contributions for long-term disability beneficiaries and retirees enrolled in the HMO plans. Long-term disability beneficiaries and retirees pay for the additional cost of HMO coverage in excess of the Reserve's contribution and for the entire cost of coverage for their spouses and dependents. For the fiscal year ended June 30, 2001, the Reserve paid \$1,717.20 for each Medicare-eligible long-term disability beneficiary and retiree and \$2,255.76 for each non-Medicare-eligible long-term disability beneficiary and retiree. At June 30, 2001, the Reserve had net assets at fair value of \$65,466,315. The net assets are available for future benefit payments.

For the fiscal year ended June 30, 2001, contributions on behalf of former employees of the reporting entity were made to the Reserve as follows:

Primary government	\$ 33,385,104
University of North Carolina system	23,229,917
Community colleges	6,158,426
Certain participating proprietary component units	<u>222,407</u>
Total contributions	<u>\$ 62,995,854</u>

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 12, 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), a component unit of the State. 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 the DIPNC's plan year, (the calendar year ended December 31, 2000), the State, the University of North Carolina system, community colleges, and certain participating proprietary component units, and LEAs contributed .52% of active employees' salaries to fund the disability benefits. The contributions cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees.

At December 31, 2000 (the most recent actuarial valuation date), DIPNC had 2,363 members, excluding LEA members, who were currently eligible to receive disability benefits as an other postemployment benefit out of a total of 301,030 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.

The basis for estimating the actuarial liabilities for unpaid claims is discussed in Note 12. The market related actuarial value of the assets of DIPNC at December 31, 2000, was \$219,730,674 creating an actuarial deficit of \$51,336,768. The actual fair value of the assets for DIPNC at December 31, 2000 was \$226,785,448. The assets are available for future other postemployment benefits and benefits for eligible active employees.

Actuarial Assumptions for the calendar year ended

December 31, 2000:

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	\$24,709,923
Actual contribution made by:	
Primary Government	\$12,927,009
University of North Carolina system	9,295,081
Community Colleges	2,399,896
Certain participating proprietary component units	\$87,937
Total actual contribution made	<u>\$24,709,923</u>

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

NOTES TO THE FINANCIAL STATEMENTS

NOTE 12: RISK MANAGEMENT AND INSURANCE

A. Public Entity Risk Pool**1. 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), which are not a part of the reporting entity. 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 104 out of 117 LEAs and 24 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 six 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	
	2001	2000
Unpaid claims at beginning of year	\$ 5,778	\$ 1,312
Incurred claims:		
Provision for insured events		
of the current year	1,589	17,719
Increases (decreases) in provision		
for insured events of prior years	1,606	1,886
Total incurred claims	<u>3,195</u>	<u>19,605</u>
Payments:		
Claims attributable to insured		
events of the current year	426	13,401
Claims attributable to insured		
events of the prior years	2,872	1,738
Total payments	<u>3,298</u>	<u>15,139</u>
Total unpaid claims at end		
of the year	<u>\$ 5,675</u>	<u>\$ 5,778</u>

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 (up to \$30 million maximum per insured location) are covered by reinsurance policies. Aggregate payments by the Fund over \$20 million a year (March 20, 2001 - March 20, 2002) are recoverable by reinsurance. Maximum recoverable from one catastrophic event is \$1 billion per occurrence. Annual aggregate limits of \$400 million apply separately with respect to flood and earthquake. Coverage applies to "all risk", excluding boiler and machinery. Incurred losses are reduced by estimated amounts recoverable under the Fund's reinsurance policies. Currently, there no claims from the reinsurers.

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 for employees and retirees of the State and its participating component units, as well as their dependents. 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 proprietary component unit of the State. 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 11, coverage is also extended to certain individuals as an other postemployment benefit. The Plan is administered by a third party who is responsible for the processing of claims and administration of

NOTES TO THE FINANCIAL STATEMENTS

cost containment. Health care is also made available through contractual agreements with three health maintenance organizations (HMO). Monthly premium payments transfer the risk for health coverage to the Plan. The Plan does not assume risk for HMO contracts.

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 \$2 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):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1999-00	\$ 136,401	\$ 816,842	\$ 820,076	\$ 133,167
2000-01	133,167	1,127,394	1,069,234	191,327

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) is provided through the Death Benefit Plan, an internal service 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.

For the period January 1, 2000 to June 30, 2000, death benefits were funded by actuarially based employer contributions that are established in the biennial appropriation bill by the General Assembly. The State, the University of North Carolina system, community colleges, and certain participating proprietary component units and LEAs contributed .16% of active employees' salaries to fund the Death Benefit Plan for the period January 2000 to June 2000. Effective July 1, 2000, funding for the Death Benefit Plan was suspended by the General Assembly for the State's fiscal year.

These benefits are established by Chapter 135, Section 5(I), 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):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1999-00	\$ 1,813	\$ 23,091	\$ 23,366	\$ 1,538
2000-01	1,538	23,879	23,847	1,570

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 proprietary component unit of the State, 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 11, 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 11. Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1999-00	\$ 216,432	\$ 43,105	\$ 41,010	\$ 218,527
2000-01	218,527	98,860	46,320	271,067

NOTES TO THE FINANCIAL STATEMENTS

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.

The Fund purchases excess insurance from a private insurer to cover losses over the amounts insured by the Fund. If aggregate uninsured losses sustained by the Fund, 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 are paid when the Council of State approves the request for payment. 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, 2001 are disclosed on the balance sheet as a combination of claims and benefits payable of \$272 thousand, due to other funds of \$1.016 million, and due to component units of \$903 thousand. Changes in the balances of claims liabilities for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1999-00	\$ 2,060	\$ 981	\$ 1,817	\$ 1,224
2000-01	1,224	7,488	6,521	2,191

NOTES TO THE FINANCIAL STATEMENTS

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 University of North Carolina Hospitals at Chapel Hill (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.

Coverage is provided on an occurrence basis. The Trust Fund limits the coverage to \$3 million per occurrence and to \$8 million in the annual aggregate. Commercial excess insurance is purchased with \$25 million per occurrence and \$50 million annual aggregate retention limits provided above the self-insurance retentions (excluding UNC Hospitals). 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 \$29,658,203 and \$29,598,435 are the present values of the aggregate actuarially determined claims liabilities of \$33,518,241 and \$29,965,805, discounted at rates ranging from 7% to 6%, at June 30, 2000 and 2001, 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):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1999-00	\$ 33,558	\$ 6,729	\$ 10,629	\$ 29,658
2000-01	29,658	8,740	8,800	29,598

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 \$11 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

NOTES TO THE FINANCIAL STATEMENTS

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. 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, 2001, workers' compensation costs were recognized as follows (dollars in thousands):

Primary government	\$	41,321
University of North Carolina system		3,644
All other component units		<u>47</u>
Total	\$	<u><u>45,012</u></u>

NOTES TO THE FINANCIAL STATEMENTS**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, 2001 was \$4.5 million. As of June 30, 2001, the Fund consisted of 1,225 eligible units representing approximately 39,282 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, 2001, 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 \$350,000 per occurrence and a \$1 million limit for employer's liability above the Program's retention of \$350,000 per occurrence. The aggregate reinsurance provides for \$3 million of coverage above aggregate Program losses of \$5.6 million for policy year 2000-2001. Incurred losses are reduced by estimated amounts recoverable under the Program's excess of loss and aggregate reinsurance policies. As of June 30, 2001, there are claims recoverable from reinsurers in the amount of \$558,805.

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

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1999-00	\$ 5,560	\$ 4,500	\$ 2,419	\$ 7,641
2000-01	7,641	3,856	2,679	8,818

7. Health Insurance Program for Children

The Health Insurance Program for Children (the Program) is an insurance enterprise reported within the enterprise funds. 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. Health benefits coverage provided to children eligible under the Program is equivalent to coverage provided for dependents under the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan (the Plan) which is discussed in part B.1. of this note. In addition to the benefits provided under the Plan, the Program also provides 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, 2001, \$23,167,929 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 may be enrolled by DHHS based on the availability of funds. 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, copayments, or other cost-sharing charges are determined by family income. However, there are no enrollment fees, deductibles, copayments, 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. As of June 30, 2001, 58,611 children were insured under the Program.

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
1999-00	\$ 6,214	\$ 79,491	\$ 69,728	\$ 15,977
2000-01	15,977	91,799	95,581	\$ 12,195

NOTE 13: SEGMENT INFORMATION FOR ENTERPRISE FUNDS

Segment information for the State's enterprise funds for the year ended June 30, 2001 is presented below (dollars in thousands).

	Public School Insurance [1]	Child Health Insurance Program [2]	Town of Butner Water and Sewer [3]	N.C. State Fair [4]	USS North Carolina Battleship Commission [5]	Agricultural Farmers Market [6]	Workers' Comp. [7]	Other Funds [8]	Total
Operating revenues.....	\$ 8,741	\$ 2,666	\$ 3,855	\$ 8,643	\$ 2,096	\$ 951	\$ 4,254	\$ 1,695	\$ 32,901
Depreciation/amortization.....	—	—	602	509	182	609	—	73	1,975
Operating income (loss).....	3,065	(99,696)	1,106	848	(186)	(625)	(1,194)	33	(96,649)
Operating transfers in.....	—	23,168	858	1	—	126	—	205	24,358
Operating transfers (out).....	—	—	(95)	(788)	—	(63)	—	(7)	(953)
Net income (loss).....	3,065	(1,803)	2,232	148	208	(556)	(1,194)	319	2,419
Current capital contribution...	—	—	—	1,773	—	—	4,500	—	6,273
Fixed assets:									
Additions.....	—	—	23,444	1,773	317	—	—	25	25,559
Deletions.....	—	—	—	—	—	13	—	—	13
Current assets.....	36,245	20,681	16,953	6,663	5,512	959	33,532	1,209	121,754
Current liabilities.....	17,703	17,678	2,250	1,184	85	57	20,607	155	59,719
Net working capital.....	18,542	3,003	14,703	5,479	5,427	902	12,925	1,054	62,035
Total assets.....	36,245	20,681	33,452	16,693	7,738	9,225	33,532	3,391	160,957
Total equity (deficit).....	18,542	3,003	21,297	15,509	7,653	9,168	12,925	3,236	91,333

Principal enterprise fund activities:

[1] The **Public School Insurance** fund provides fire, theft and vandalism insurance for public school buildings and contents and offers risk management services.

[2] The **Child Health Insurance Program** provides comprehensive health insurance coverage to uninsured low-income children who are residents of this State.

[3] The **Town of Butner Water and Sewer Authority** operates under the jurisdiction of the State. The Town has issued revenue bonds in order to finance improvements in the system.

[4] The **N.C. State Fair** in Raleigh provides annual competitive exhibition of North Carolina agricultural products as well as rural arts and crafts.

[5] The **USS North Carolina Battleship Commission** in Wilmington is open for public exhibition all year. The Commission administers the maintenance and exhibition costs of the battleship.

[6] The **Agricultural Farmers Market** in Raleigh provides a site where state farmers can sell fresh produce and other agricultural products directly to the public.

[7] The **Workers' Compensation Fund**, provides benefits to volunteer safety workers for workers' compensation. This fund is administered by the N.C. Department of Insurance.

[8] **Other Governmental Enterprise Funds** have been organized to operate a tourist center, concession stands, bookstores, and vending and sales desks.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 14: COMPONENT UNITS — CONDENSED FINANCIAL INFORMATION

Condensed financial statements for the governmental component unit funds as of and for the fiscal year ended June 30, 2001 are presented below (dollars in thousands).

**Condensed Balance Sheet
Component Units - Governmental Funds**

	<i>Golden LEAF</i>	<i>NC Phase II Tobacco Certification Entity</i>	<i>Totals</i>
Current assets.....	169,606	1,863	171,469
Fixed assets.....	41	25	66
Total Assets.....	<u>\$ 169,647</u>	<u>\$ 1,888</u>	<u>\$ 171,535</u>
Liabilities.....	\$ 2,506	\$ 1,154	\$ 3,660
Fund balance and other credits			
Investment in fixed assets.....	41	25	66
Fund balance.....	167,100	709	167,809
Total fund balance and other credits...	<u>167,141</u>	<u>734</u>	<u>167,875</u>
Total liabilities and fund balance.....	<u>\$ 169,647</u>	<u>\$ 1,888</u>	<u>\$ 171,535</u>

**Condensed Statement of Revenues, Expenditures
and Changes in Fund Balances
Component Units - Governmental Funds**

	<i>Golden LEAF</i>	<i>NC Phase II Tobacco Certification Entity</i>	<i>Totals</i>
Revenues.....	\$ 6,570	\$ 4,112	\$ 10,682
Expenditures.....	6,112	4,036	10,148
Excess of revenues over expenditures.....	458	76	534
Operating transfers from primary government.....	70,136	—	70,136
Fund balance - July 1.....	96,506	633	97,139
Other changes in fund balance.....	—	—	—
Fund balance - June 30.....	<u>\$ 167,100</u>	<u>\$ 709</u>	<u>\$ 167,809</u>

NOTES TO THE FINANCIAL STATEMENTS

Condensed financial statements for the proprietary component unit funds as of and for the fiscal year ended June 30, 2001 are presented below (dollars in thousands).

Condensed Balance Sheet Component Units - Proprietary Funds

	N.C. Housing Finance Agency	State Education Assistance Authority	State Health Plan	N.C. State Ports Authority	North Carolina Railroad Company	N.C. Global TransPark Authority	MCNC	Other Component Units	Total Proprietary Component Units
Current assets									
Due from primary government.....	\$ —	\$ 18,645	\$ —	\$ 499	\$ —	\$ —	\$ —	\$ —	\$ 19,144
Other.....	47,260	608,143	53,200	38,840	17,470	32,095	180,498	267,885	1,245,391
Non-current assets.....	1,394,131	796,865	—	187	—	—	1,608	—	2,192,791
Fixed assets.....	329	1,031	6	125,444	11,769	44,803	17,401	1,848	202,631
Total Assets.....	\$ 1,441,720	\$ 1,424,684	\$ 53,206	\$ 164,970	\$ 29,239	\$ 76,898	\$ 199,507	\$ 269,733	\$ 3,659,957
Current liabilities									
Due to primary government.....	\$ —	\$ —	\$ 2	\$ —	\$ 9,500	\$ 1,763	\$ —	\$ 3,124	\$ 14,389
Other.....	48,106	15,344	212,876	4,710	312	3,310	15,971	272,509	573,138
Long-term liabilities									
Advance from primary government.....	—	—	—	—	41,082	25,000	—	—	66,082
Bonds payable.....	1,216,293	888,631	—	9,440	—	—	—	—	2,114,364
Other.....	—	23,585	—	484	—	661	26,074	—	50,804
Fund equity.....	177,321	497,124	(159,672)	150,336	(21,655)	46,164	157,462	(5,900)	841,180
Total liabilities and fund equity.....	\$ 1,441,720	\$ 1,424,684	\$ 53,206	\$ 164,970	\$ 29,239	\$ 76,898	\$ 199,507	\$ 269,733	\$ 3,659,957

Condensed Statement of Revenues, Expenses and Changes in Fund Equity Component Units - Proprietary Funds

	N.C. Housing Finance Agency	State Education Assistance Authority	State Health Plan	N.C. State Ports Authority	North Carolina Railroad Company	N.C. Global TransPark Authority	MCNC	Other Component Units	Total Proprietary Component Units
Operating revenues.....	\$ 105,545	\$ 99,172	\$ 947,128	\$ 27,502	\$ 11,344	\$ 304	\$ 33,168	\$ 79,459	\$ 1,303,622
Operating expenses									
Depreciation/amortization.....	136	819	3	7,764	23	1,251	4,918	318	15,232
All other.....	86,299	94,894	1,159,145	22,750	1,593	2,596	34,424	112,185	1,513,886
Operating income.....	19,110	3,459	(212,020)	(3,012)	9,728	(3,543)	(6,174)	(33,044)	(225,496)
Operating transfers from component units.....	—	18,063	—	—	—	—	—	—	18,063
Operating transfers from primary government.....	2,300	18,645	—	6,000	26,590	5,259	—	184,589	243,383
Operating transfers to component units.....	—	(345)	—	—	—	—	—	—	(345)
Operating transfers to primary government.....	(53)	—	—	(3,002)	(9,500)	(1)	—	(570)	(13,126)
Other nonoperating revenues (expenses).....	—	(687)	—	1,101	908	3,318	(44,195)	(171,060)	(210,615)
Net income (loss).....	21,357	39,135	(212,020)	1,087	27,726	5,033	(50,369)	(20,085)	(188,136)
Excess of revenues over (under) expenditures from governmental operations.....	(1,781)	—	—	—	—	—	—	—	(1,781)
Fund equity - July 1.....	157,745	457,989	52,348	149,281	(49,321)	41,131	238,601	13,956	1,061,730
Other changes in equity.....	—	—	—	(32)	(60)	—	(30,770)	229	(30,633)
Fund equity - June 30.....	\$ 177,321	\$ 497,124	\$ (159,672)	\$ 150,336	\$ (21,655)	\$ 46,164	\$ 157,462	\$ (5,900)	\$ 841,180

NOTES TO THE FINANCIAL STATEMENTS

Condensed Balance Sheet
Component Units - College and University Funds

	<i>University</i>	<i>Community Colleges</i>	<i>University and Community Colleges</i>
Assets			
Due from other funds.....	\$ 71,943	\$ 407	\$ 72,350
Due from component units.....	4,117	—	4,117
Due from primary government.....	119,119	23,732	142,851
Fixed assets.....	5,853,746	1,395,390	7,249,136
Other.....	4,329,143	286,430	4,615,573
Total assets.....	\$ 10,378,068	\$ 1,705,959	\$ 12,084,027
Liabilities			
Due to other funds.....	\$ 71,943	\$ 407	\$ 72,350
Due to component units.....	3,570	—	3,570
Due to primary government.....	916	26	942
Bonds payable.....	1,299,568	—	1,299,568
Notes payable.....	14,995	2,995	17,990
Other.....	930,606	56,645	987,251
Total liabilities.....	2,321,598	60,073	2,381,671
Fund equity			
Total fund equity.....	8,056,470	1,645,886	9,702,356
Total liabilities and fund equity.....	\$ 10,378,068	\$ 1,705,959	\$ 12,084,027

Condensed Statement of Revenues, Expenditures, and Changes in Fund Equity
Component Units - College and University Funds

	<i>University</i>	<i>Community Colleges</i>	<i>University and Community Colleges</i>
Revenues.....	\$ 3,831,408	\$ 657,857	\$ 4,489,265
Expenditures.....	5,334,646	1,185,345	6,519,991
Operating transfers from primary government.....	1,916,973	630,874	2,547,847
Operating transfers to primary government.....	(24,675)	—	(24,675)
Operating transfers from component units.....	345	—	345
Operating transfers to component units.....	(18,063)	—	(18,063)
Net increase in fund equity.....	371,342	103,386	474,728
Fund equity - July 1.....	7,594,527	1,544,635	9,139,162
Other changes in equity.....	90,601	(2,135)	88,466
Fund equity - June 30.....	\$ 8,056,470	\$ 1,645,886	\$ 9,702,356

Condensed Statement of Current Funds Revenues, Expenditures, and Transfers
Component Units - College and University Funds

	<i>University</i>	<i>Community Colleges</i>	<i>University and Community Colleges</i>
Revenues.....	\$ 2,549,696	\$ 471,887	\$ 3,021,583
Expenditures.....	4,060,826	1,056,730	5,117,556
Transfers and Additions (Deductions):			
Refunded to grantors.....	(1,862)	(19)	(1,881)
Mandatory transfers.....	(74,721)	—	(74,721)
Non-mandatory transfers.....	(2,377)	(638)	(3,015)
Interinstitutional transfers.....	(2,672)	—	(2,672)
Operating transfers from primary government.....	1,717,923	592,050	2,309,973
Operating transfers to primary government.....	(2,504)	—	(2,504)
Operating transfers from component units.....	345	—	345
Operating transfers to component units.....	(18,063)	—	(18,063)
Net increase in fund equity.....	\$ 104,939	\$ 6,550	\$ 111,489

NOTES TO THE FINANCIAL STATEMENTS

NOTE 15: RESERVED AND UNRESERVED DESIGNATED FUND BALANCES

Reserved Fund Balance. The State and its component units' reserved fund balances represent those portions of fund balance that are (1) not available for appropriation or expenditure, which includes loans receivable and long-term portion of advances to other funds, or (2) fund balances that are legally segregated by third parties for a specific use. The reserved fund balances at June 30, 2001, are (dollars in thousands):

	Governmental Fund Types			Governmental Component Units	
	General	Special Revenue	Capital Projects	NC Phase II Tobacco	
				Golden LEAF	Certification Entity
Inventories.....	\$ 44,691	\$ 19,489	\$ —	\$ —	\$ —
Reserved for specific encumbrances.....	28,045	10,343	—	—	—
Retirees' health premiums.....	65,467	—	—	—	—
Investments.....	51	—	—	—	—
Other purposes.....	13,123	39,410	—	—	—
Medicaid programs.....	—	—	—	—	—
Continuing programs.....	6,192	—	—	—	—
Advances to component units.....	31,582	—	—	—	—
Vacation, sick leave.....	—	43,236	—	—	—
Notes receivable.....	3,335	125,185	—	—	—
Prepaid items.....	3	60	—	17	5
Capital projects.....	—	22	48,067	—	—
Loan and grant commitments.....	—	145,054	—	—	—
Total Fund Balances					
Reserved.....	<u>\$ 192,489</u>	<u>\$ 382,799</u>	<u>\$ 48,067</u>	<u>\$ 17</u>	<u>\$ 5</u>

	Fiduciary Funds				
	Non-Expendable Trust		Pension Trust	Investment Trust	Fiduciary Totals
	Expendable Trust	Non-Expendable Trust			
Inventories.....	\$ 1,324	\$ —	\$ —	\$ —	\$ 1,324
Energy conservation.....	1,206	—	—	—	1,206
Other purposes.....	500	—	—	—	500
Advances to component units.....	25,000	—	—	—	25,000
Notes receivable.....	—	363,310	—	—	363,310
Claims and benefits.....	633,778	—	—	—	633,778
Loan and grant commitments.....	6,577	234,090	—	—	240,667
Abandoned property.....	281,243	—	—	—	281,243
Wildlife endowment.....	—	46,785	—	—	46,785
Investment pool participants.....	—	—	—	497,149	497,149
Employees' pension benefits.....	—	—	59,130,838	—	59,130,838
Total Fund Balances					
Reserved.....	<u>\$ 949,628</u>	<u>\$ 644,185</u>	<u>\$ 59,130,838</u>	<u>\$ 497,149</u>	<u>\$ 61,221,800</u>

NOTES TO THE FINANCIAL STATEMENTS

The universities and community colleges (*component units*) reserved fund balances at June 30, 2001, are (dollars in thousands):

	<i>University</i>	<i>Community Colleges</i>	<i>Total University and Community Colleges</i>
Loans.....	\$ 103,893	\$ 121	\$ 104,014
Endowments.....	1,022,479	18,686	1,041,165
Revenue bonds.....	61,774	—	61,774
Restricted funds.....	630,299	179,980	810,279
Total Fund Balances Reserved...	<u>\$1,818,445</u>	<u>\$ 198,787</u>	<u>\$ 2,017,232</u>

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 \$608.971 million. As shown in the table below, the fund balance available to be designated was a negative \$224.922 million on a modified accrual basis (dollars in thousands):

<u>Unreserved Designated Fund Balance</u>	<u>General Fund</u>
Disaster relief.....	\$ 448,608
Educational programs.....	77,918
Other purposes.....	25,159
Public safety, corrections, and regulation programs.....	22,749
Health and human services programs.....	22,415
General government programs.....	7,553
Economic development programs.....	3,399
Disproportionate share.....	1,170
Total designations.....	<u>\$ 608,971</u>
Unreserved fund balance, Exhibit A-1.....	<u>\$ (224,922)</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 16: FUND EQUITY RECLASSIFICATIONS AND RESTATEMENTS

As a result of review during the current reporting period, certain funds were reclassified from their June 30, 2000 presentation to more appropriate fund types. The most significant of these reclassifications resulted in the Town of Butner's activities being reported in the enterprise funds. The effects of these reclassifications appear in the "Entity Changes/Fund Reclassification" column. Some fund equity balances as of July 1, 2000, are restated for certain accounting changes or adjusted for the correction of errors in the reported balances of the fiscal year ended June 30, 2000. These changes are shown in the "Prior Year Adjustments and Restatements" column. The following table summarizes the above changes as they appear in the accompanying financial statements (dollars in thousands). As referred to in Note 1, the State implemented GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* and GASB Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues* for the fiscal year ended June 30 2001.

	June 30, 2000 Fund Equity as Previously Reported	GASB 33 and GASB 36 Implementation	Entity Changes/ Fund Reclass- ification	July 1, 2000 Fund Equity as Reported	Prior Year Adjustments/ Restatements	July 1, 2000 Fund Equity as Restated
<i>Primary Government</i>						
General Fund.....	\$ 265,675	\$ (50,260)	\$ 79	\$ 215,494	\$ (1,621)	\$ 213,873
Special Revenue.....	2,576,348	—	—	2,576,348	(68,542)	2,507,806
Capital Projects.....	206,694	—	(900)	205,794	(90)	205,704
Enterprise.....	63,434	—	19,065	82,499	142	82,641
Internal Service.....	528,392	—	(7,774)	520,618	192	520,810
Expendable Trust Funds.....	2,528,961	—	—	2,528,961	—	2,528,961
Nonexpendable Trust Funds.....	499,943	—	—	499,943	(9)	499,934
Pension Trust Funds.....	61,350,025	—	—	61,350,025	—	61,350,025
Investment Trust Fund.....	1,185,707	—	—	1,185,707	—	1,185,707
Total Primary Government.....	69,205,179	(50,260)	10,470	69,165,389	(69,928)	69,095,461
<i>Component Units</i>						
Governmental Funds.....	96,506	—	633	97,139	—	97,139
Proprietary Funds.....	1,083,482	6,665	(28,417)	1,061,730	(30,010)	1,031,720
College and University:						
University funds.....	7,594,309	(11,726)	11,944	7,594,527	90,601	7,685,128
Community colleges funds.....	1,547,008	(942)	(1,431)	1,544,635	(2,135)	1,542,500
Total Component Units.....	10,321,305	(6,003)	(17,271)	10,298,031	58,456	10,356,487
Total Reporting Entity.....	\$ 79,526,484	\$ (56,263)	\$ (6,801)	\$ 79,463,420	\$ (11,472)	\$ 79,451,948

NOTE 17: RESIDUAL EQUITY TRANSFERS

Residual equity transfers out exceed residual equity transfers in by \$5.103 million due to the following transactions: (1) \$4.5 million transferred out from the General Fund to the Workers' Compensation Fund (Enterprise Fund) recorded by the Workers' Compensation Fund as an increase in contributed capital. (2) \$572 thousand transferred out from the General Fund and \$31 thousand transferred out from the Special Revenue Fund to the Workers' Compensation Program (Internal Service Fund), recorded by the Program as a increase in contributed capital.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 18: 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, 2001, was \$3.9 billion with interest rates varying from 2.30 % to 7.57 %.

In 1977, the State created the North Carolina Industrial Facilities and Pollution Control Financing Authority which was authorized to issue tax-exempt bonds and notes to provide funds 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. The North Carolina Educational Facilities Finance Agency was created in 1986 and was authorized by the State to issue tax-exempt bonds and notes to finance facilities and structures at private nonprofit colleges and universities, which authority was subsequently expanded to include such institutions providing kindergarten, elementary and secondary education.

Effective July 1, 2000, the State renamed the North Carolina Educational Finance Agency as the North Carolina Capital Facilities Finance Agency. Its authority to issue bonds and notes was expanded to include financing private sector capital improvements for activities that constitute a public purpose. Additionally, all acts of the North Carolina Industrial Facilities and Pollution Control Financing Authority were ratified; all duties, powers, jurisdiction, and responsibilities vested by statute or contract in the Authority were transferred to the North Carolina Capital Facilities Finance Agency; and the Authority was dissolved.

The bonds of the North Carolina Capital Facilities Finance Agency 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 2032, the outstanding principal of such

bonds and notes as of June 30, 2001, was \$922.58 million with fixed interest rates varying from 4.15% to 7.1% and variable interest rates which can be reset weekly.

B. Litigation

Leandro et al v. State of North Carolina and State Board of Education — Right to a Sound Basic Education. 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. The result of this last proceeding is unknown at this time; however, the cost of future programs which the Court may order could exceed \$100 million.

N.C. School Boards Association, et. al. v. Harlan E. Boyles, 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.

NOTES TO THE FINANCIAL STATEMENTS

For the last fiscal year for which information was available to them, plaintiffs allege liability of approximately \$84 million. Until this matter is resolved, any refunds and interest will continue to accrue. The North Carolina Attorney General's Office believes that sound legal arguments support the State's position on the outstanding claims.

Faulkenbury v. Teachers' and State Employees' Retirement System, Peele v. Teachers' and State Employees' Retirement System, and Woodard v. Local Governmental Employees' Retirement System — Disability Retirement Benefits. The plaintiffs are disability retirees who brought class actions in State court challenging changes in the formula for payment of disability retirement benefits and claiming impairment of contract rights, breach of fiduciary duty, violation of other federal constitutional rights, and violation of state constitutional and statutory rights. The Superior Court ruled in favor of the plaintiffs. The Order was affirmed by the North Carolina Supreme Court in 1997. The case went back to the Superior Court for calculations of benefits and payment of retroactive benefits, along with determination of various remedial issues. As a result of the remedial proceedings, there have been two appeals to the appellate courts concerning calculation of the retroactive benefits. The plaintiffs previously submitted documentation to the court asserting that the cost in damages and higher prospective benefit payments to the plaintiffs and class members would amount to \$407 million. Calculations and payments so far indicate that retroactive benefits will be significantly less than estimated, depending in part on the pending appeal. Payments have been made by the State in excess of \$83 million. A liability of \$31.5 million for the retroactive benefits has been booked in the Teachers' and State Employees Retirement System.

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. The State expects the Compact to continue this litigation in another form.

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

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

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies, although it is believed that disallowances, if any, will be immaterial.

D. Highway Construction

The State may be liable for approximately \$88.6 million to contractors for highway construction claims that the State has contested. The State may also be liable for an additional \$54.1 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 \$11.2 million.

E. USDA-Donated Commodities

The State has custodial responsibility for \$3.48 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, 2001, the State had commitments of \$1,597.7 million for construction of highway facilities. Of this amount, \$1,185.9 million relates to the Highway Fund, and \$411.8 million relates to the Highway Trust Fund. The other commitments for construction and improvements of State government facilities totaled \$444.4 million (including \$393.1 million for the Department of Environment and Natural Resources, \$12.4 million for the Department of Correction, and \$11.5 million for the Department of Public Instruction).

At June 30, 2001, the University of North Carolina system (component unit) had outstanding construction commitments of \$392.4 million (including \$121.7 million for University of North Carolina - Chapel Hill, \$61.6 million for East Carolina University, and \$37.2 million for UNC Hospitals).

At June 30, 2001, community colleges (component units) had outstanding construction commitments of \$94.1 million (including \$21.3 million for Wake Technical Community

NOTES TO THE FINANCIAL STATEMENTS

College, \$20.4 million for Cape Fear Community College, and \$13.2 million for Johnston Community College).

At June 30, 2001, proprietary component units had outstanding commitments of \$31.6 million (including \$15.6 million for NC State Ports Authority and \$10.0 million for NC Global Transpark Authority).

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 receive initial payments that are distinct from annual payments. The initial payments are 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 these 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. Because the

present value of the future settlement payments is not measurable, the State has not recorded a receivable for the future payments at June 30.

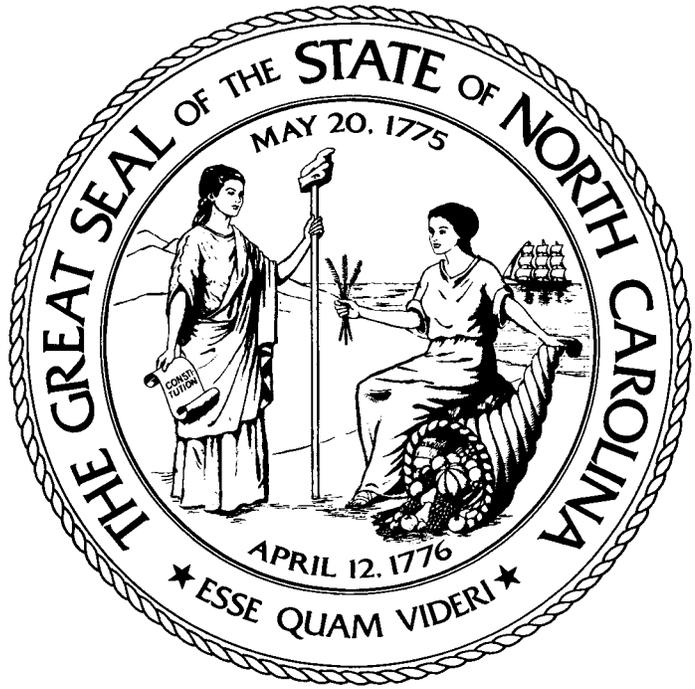
In 1999, the State approved legislation to implement the terms of the MSA in North Carolina. The State created a nonprofit corporation, the Golden LEAF, Inc., to distribute 50 percent of the settlement funds received by the State of North Carolina. The legislation directed that these funds be used for 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.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 19: OTHER ACCOUNTING CHANGES

Securities Lending Transactions – Certain component units of the State (colleges and universities and certain proprietary component units) deposit funds with the State Treasurer’s Investment Pool, which participates in securities lending activities. In prior years, it was the State’s policy to allocate the Investment Pool’s securities lending assets and liabilities to participating component units. For the fiscal year ended June 30, 2001, the State changed its policy to report the related securities lending assets and liabilities as part of the State’s agency funds rather than to allocate the securities lending transactions to component units. The effect of this change removes from the component units’ financial statements, the assets and liabilities associated with the State Treasurer’s securities lending program. The beginning asset and liability balances of the State’s agency funds have been restated for this change.



**REQUIRED
SUPPLEMENTARY
INFORMATION**

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

June 30, 2001

(Expressed in Thousands)

<i>Retirement System:</i>	<i>Valuation Date</i>	<i>Actuarial Value of Assets</i>	<i>Actuarial Accrued Liability (AAL)</i>	<i>Unfunded AAL (UAAL) (b) - (a)</i>	<i>Funded Ratio (a) / (b)</i>	<i>Annual Covered Payroll (c)</i>	<i>UAAL as a Percentage of Covered Payroll ((b-a)/c)</i>
		(a)	(b)	NOTE 1			
Teachers' and State Employees'	12-31-00 B	\$ 39,773,747	\$ 35,248,770	\$ (4,524,977)	112.8%	\$ 9,001,354	(50.3)%
	12-31-99 B	36,119,250	32,787,108	(3,332,142)	110.2%	8,437,649	(39.5)%
	12-31-98 B	31,847,438	30,354,222	(1,493,216)	104.9%	7,994,826	(18.7)%
	12-31-97	27,765,057	28,071,156	306,099	98.9%	7,373,713	4.2%
	12-31-96 A	25,357,460	25,478,193	120,733	99.5%	6,845,185	1.8%
	12-31-95	22,178,592	22,663,750	485,158	97.9%	6,595,618	7.4%
Consolidated Judicial	12-31-00	\$ 291,807	\$ 269,181	\$ (22,626)	108.4%	\$ 43,546	(52.0)%
	12-31-99 c	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)%
	12-31-97	207,706	199,204	(8,502)	104.3%	39,698	(21.4)%
	12-31-96 A	188,722	183,442	(5,280)	102.9%	36,608	(14.4)%
	12-31-95	164,358	175,126	10,768	93.9%	35,665	30.2%
Legislative	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)%
	12-31-97	16,186	14,761	(1,425)	109.7%	3,605	(39.5)%
	12-31-96 A	14,563	13,715	(848)	106.2%	3,573	(23.7)%
	12-31-95	12,883	12,685	(198)	101.6%	3,616	(5.5)%
Firemen's, Rescue Squad Workers'	6-30-00 c	\$ 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
	6-30-97 A	142,169	173,030	30,861	82.2%	N/A	N/A
	6-30-96	123,265	160,233	36,968	76.9%	N/A	N/A
	6-30-95	110,196	157,644	47,448	69.9%	N/A	N/A
National Guard	12-31-00	\$ 43,886	\$ 49,495	\$ 5,609	88.7%	N/A	N/A
	12-31-99 c	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
	12-31-97	30,274	42,766	12,492	70.8%	N/A	N/A
	12-31-96 A	26,648	39,421	12,773	67.6%	N/A	N/A
	12-31-95	22,643	37,559	14,916	60.3%	N/A	N/A
Local Governmental	12-31-00	\$ 9,892,805	\$ 9,967,548	\$ 74,743	99.3%	\$ 3,344,615	2.2%
	12-31-99 c	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%
	12-31-97	6,928,217	6,991,702	63,485	99.1%	2,742,504	2.3%
	12-31-96 A	6,258,674	6,321,622	62,948	99.0%	2,593,671	2.4%
	12-31-95	5,411,167	5,472,970	61,803	98.9%	2,429,402	2.5%

NOTE 1 a negative UAAL denotes excess actuarial asset

- A-** Actuarial value of assets was revised from cost to 5-year smoothed market
B- For 12-31-98, legislation directed the 5-yr smoothed market value to be capped at 77% of actual market value. The 2001 Session of the General Assembly removed this cap. The actuary reflected this legislation in the 12-31-00 valuation and restated the 12-31-99 valuation presented in the 2000 CAFR.
C- 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 90.

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

For the Six-Year Period 1996 to 2001 (July 1 to June 30)

(Expressed in Thousands)

<u>Retirement System.</u>	<u>State Fiscal Year</u>	<u>Annual Required Contributor</u>	<u>Percentage Contributed</u>
Teachers' and State Employees'	2001	\$ 513,907	60%
	2000	735,393	100%
	1999	630,049	100%
	1998	610,377	100%
	1997	593,481	100%
	1996	559,980	100%
Consolidated Judicial	2001	\$ 9,071	58%
	2000	8,435	100%
	1999	7,263	100%
	1998	8,485	100%
	1997	7,976	100%
	1996	7,536	100%
Legislative	2001	\$ 861	55%
	2000	811	100%
	1999	770	104%
	1998	741	108%
	1997	742	108%
	1996	725	104%
Firemen's, Rescue Squad Workers'	2001	\$ 12,105	92%
	2000	12,105	100%
	1999	12,105	100%
	1998	11,735	100%
	1997	11,735	100%
	1996	11,735	100%
National Guard	2001	\$ 2,075	100%
	2000	2,545	100%
	1999	2,533	100%
	1998	2,533	100%
	1997	2,303	100%
	1996	2,283	100%
Local Governmental Employees'	2001	\$ 179,238	100%
	2000	168,201	100%
	1999	157,764	100%
	1998	149,058	100%
	1997	142,952	100%
	1996	136,390	100%

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 90.