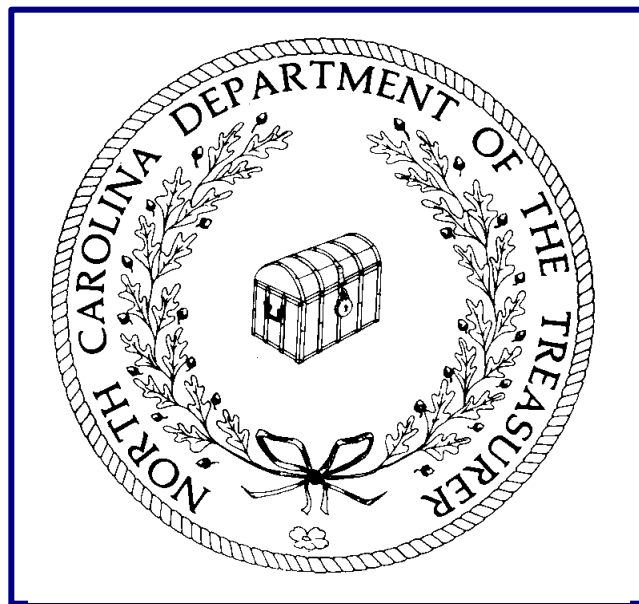

The State Treasurer's

Annual Report

To The People of North Carolina



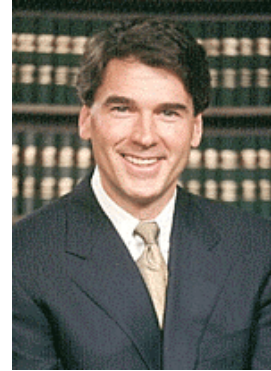
North Carolina
Department of State Treasurer
Fiscal Year 2001-2002

325 North Salisbury Street
Raleigh, North Carolina 27603-1385

North Carolina Department of State Treasurer

RICHARD H. MOORE
STATE TREASURER

325 NORTH SALISBURY STREET
RALEIGH, NORTH CAROLINA 27603-1385



To the People of North Carolina:

It is with pleasure that I submit to you the 2001-02 Annual Report for the Department of the State Treasurer. I hope you find this useful in developing a deeper understanding of the Department.

As the 13th popularly elected State Treasurer (and only the 3^d in 51 years), it is both a great honor and a challenge to follow a long line of respected public servants who have held this office. While the Department's duties are varied and complex, our mission is simple –preserving and protecting the fiscal integrity of our great State.

The Department of the State Treasurer is committed to maintaining North Carolina's hard-earned reputation for credit worthiness and continuing a conservative and prudent investment strategy for the \$62 billion in public funds entrusted to us. So long as we maintain this commitment we will continue the tradition of making sure that "good government is indeed a habit."

With the help of wonderful colleagues, I look forward to continuing to serve the people of North Carolina.

This report is available on our website www.nctreasurer.com and on disk. Please call (919) 508-5176 or write the Department to request a copy.

Sincerely,

A handwritten signature in black ink that reads "Richard H. Moore". The signature is written in a cursive, flowing style.

Richard H. Moore

Fax: (919) 508-5167

Phone: (919) 508-5176

website: www.treasurer.state.nc.us

Department of State Treasurer includes Local Government Commission Teachers' and State Employees' Retirement System, Local Governmental Employee Retirement System, Public Employees' Social Security Agency, Legislative Retirement Fund, Escheats Fund, and Tax Review Board.
An Affirmative Action/Equal Opportunity Employer

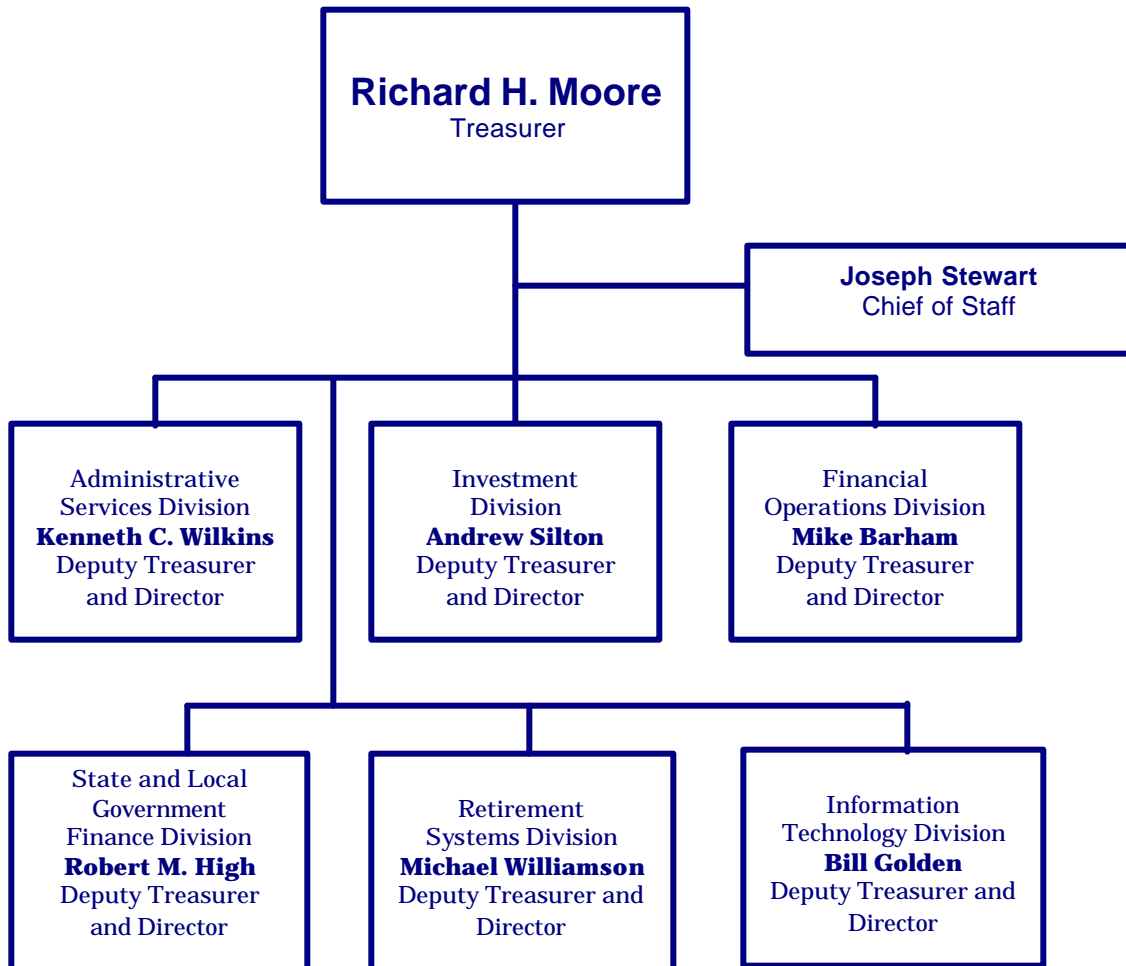
Table of Contents

LETTER OF TRANSMITTAL	1
TABLE OF CONTENTS	2
STATE TREASURER	
Table of Organization.....	4
RETIREMENT SYSTEMS DIVISION	
Operational Highlights	5
The Basic Functions	6
General Administration.....	6
Benefits Processing Section.....	6
Accounting/Data Control Section.....	7
Retirees' Health Insurance.....	7
Direct Deposit Accounts/Address Changes.....	7
Batch Posting and Systems Transfers	7
Error Checking.....	7
Member Services Section.....	7
Records Section.....	7
Significant Accomplishments	
Legislation.....	8
Communications	9
Functional	9
The Retirement Systems and Trust Funds	
Actuarial Valuation	10
Actuarial Assumptions	10
Funding of the Systems.....	10
Funded Status.....	11
Funded Ratio of the Retirement Systems	11
Teachers' and State Employees' Retirement System of North Carolina.....	12
Local Governmental Employees' Retirement System of North Carolina.....	13
Consolidated Judicial Retirement System of North Carolina	14
Teachers' and State Employees' Benefit Trust.....	15
Firemen's and Rescue Squad Workers' Pension Fund.....	16
Retirees' Health Premiums Fund.....	16
Legislative Retirement Fund.....	17
Legislative Retirement System.....	17
Disability Income Plan.....	17
Public Employees' Social Security Agency	17
National Guard Pension Plan.....	18
Supplemental Retirement Income Plan of North Carolina.....	18
Registers of Deeds' Supplemental Pension Fund.....	18
STATE AND LOCAL GOVERNMENT FINANCE DIVISION	
Operational Highlights	19
The State of Tax-Exempt Financing	20
The Basic Functions	
Debt Management.....	21
Fiscal Management.....	22
Significant Accomplishments	
Debt Management.....	23
North Carolina General Obligation Bonds	23
Installment and Lease Purchase Agreements	23
Revenue Bonds	23
North Carolina Medical Care Commission Bonds	23
North Carolina Housing Finance Agency.....	23
Industrial Revenue Bonds.....	24
Volume Cap Allocation	24
"Triple-A" General Obligation Bond Ratings	24
North Carolina Educational Facilities Finance Agency.....	24
North Carolina Clean Water Revolving Loan and Grant Funds	25
Fiscal Management.....	28
The North Carolina Capital Management Trust.....	28
Review of Semi-annual Reports of Deposits and Investments	28
Financial Section of Bond Offering Statements	28
Analysis of Official Pronouncements	28
State Treasurer's conference on Local Government, Auditing and Financial Management and Other Continuing Education Courses and Conferences	28
Monitoring Compliance with "Yellow Book" Requirements	29

<u>Audit Manual for Governmental Auditors</u>	29
Audit Review Process	29
Memoranda and Other Publications	29
State Treasurer's Governmental Accounting/Financial Management Awards Program	30
Monitoring Compliance with New Economic Development Laws	30
Arbitrage Requirements for State Bonds	30
Financial Reporting of Public School Expenditures	30
Municipal Electric Systems.....	30
Monitoring Revenue Bond Compliance.....	31
Adherence to Continuing Disclosure Requirements of The Securities and Exchange Commission	31
White Goods Disposal Tax.....	31
Compliance Supplements for Local Government Auditors	31
Electronic Submission of the Report of Investments and Deposits.....	31
County and Municipal Information Website.....	31
Projects in Progress	
Internet Website.....	31
The Town of East Spencer	32
Monitoring the Impact of the State Budget Upon Cities and Counties	32
Policies Manual Update.....	32
Charter Schools	32
New Financial Reporting Model.....	32
Local Government Commission Expanded Oversight	33
Qualified Zone Academy Bonds Authorized	33
INVESTMENT MANAGEMENT DIVISION	
Operational Highlights	34
Investment Management	
Serving as the State's Chief Investment Officer	35
General Investment Objectives.....	35
Operating Policy.....	35
The State Treasurer's Investment Pool.....	36
Cash Management Program	37
Short-term Investment Portfolio.....	38
Bond Proceeds Investment Pool.....	40
Trust Funds Investment Program	40
Equity Investment Portfolio.....	41
Long-term Investment Portfolio.....	43
Real Estate Investment Portfolio	45
Alternative Investment Portfolio.....	47
FINANCIAL OPERATIONS DIVISION	
Banking Operations	
Receiving State Moneys	50
Disbursing State Moneys	51
Specialized Banking Functions	51
Bank Reconciliation Unit.....	51
Statewide Operations	51
Investment Accounting.....	51
Retirement and Escheat Fund Accounting	51
Departmental Operations	51
ADMINISTRATIVE SERVICES DIVISION	
Operational Highlights	52
Departmental Services	52
Personnel Management.....	52
Unclaimed Property Program.....	53
STATISTICAL TABLES — TABLE OF CONTENTS	A-1

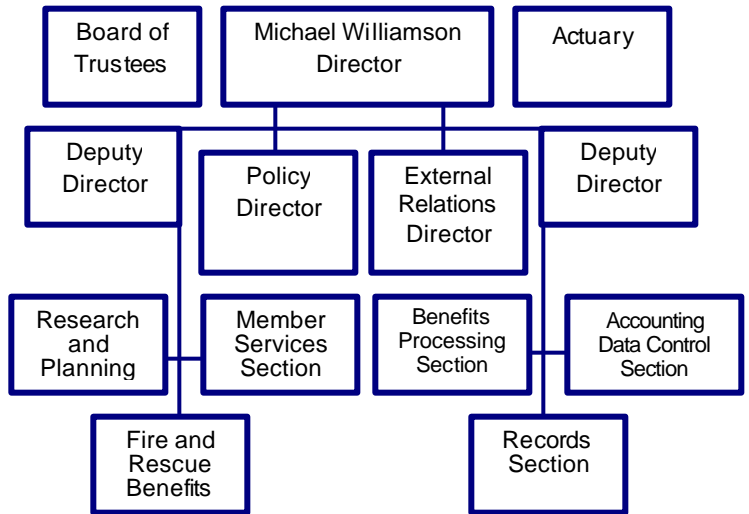
North Carolina Department of State Treasurer

Table of Organization



Retirement Systems Division

The Retirement Systems Division of the Department of State Treasurer administers the statutory retirement and fringe benefit plans, as authorized by the General Assembly of North Carolina, which cover the State's public employees. The administration of the several retirement systems requires a high level of fiduciary responsibility for the employees' trust funds with prudent, honest and efficient use of employees' and taxpayers' contributions. The public purpose of the existence of retirement systems and benefit plans is to recruit and retain competent employees for a career in public service, by providing a replacement income for retirement, disability, or at death for an employee's survivors. The organizational structure herein shows the functional arrangement of the tasks performed in this Division.



Operational Highlights

- Presented recommendations and draft legislation to the 2002 Session of the General Assembly which resulted in the enactment of laws to:
 - provide cost-of-living adjustments equal to 1.4% to retirees of the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System, Legislative Retirement System and Local Governmental Employees' Retirement System;
 - increase the defined benefit accrual rate from 1.81% to 1.82% in the Teachers' and State Employees' Retirement System and the Local Governmental Employees' Retirement System with a corresponding benefit adjustment to retirees equal to 0.6%;
 - allow retired members of the Teachers' and State Employees' Retirement System to be reemployed to teach in public schools without earnings restrictions until July 1, 2004 under certain circumstances;
 - modify reemployment earnings restrictions in the Teachers' and State Employees' Retirement System and Local Governmental Employees' Retirement System during the 12-month period immediately following the effective date of retirement;
 - amend the retirement statutes to conform to provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001; as a result of this legislation, effective January 1, 2003, pre-tax money from an eligible retirement plan or IRA may be accepted to purchase creditable service;
 - amend withdrawn service purchase provisions in the Local Governmental Employees' Retirement System for purchases on and after January 1, 2003;
 - increase the monthly benefit payment to beneficiaries of the Firemen's and Rescue Squad Workers' Pension Fund from \$151.00 to \$156.00 per month.
- Processed benefits for 10,261 new retirees.
- Processed refunds for 19,823 former employees.
- Established approximately 48,072 new active member accounts.
- Increased utilization of direct deposit of monthly benefit payments from 139,000 to approximately 147,000 retirees.
- Continued the development and testing of the Disability Automation System. This project is ongoing.
- Remodeled the Accounting, Benefits and Records Sections with new carpet, paint, and work stations.
- Installed new computers for each employee.
- Updated the Retirement Systems Division Section of the State Treasurer's Web page (www.treasurer.state.nc.us) to include the most currently revised editions of retirement forms, handbooks, and the Frequently Asked Questions.
- Added a map and directions to Retirement System offices to Web page.
- Added a Legislation Highlights summary to Hot Topics section on the Web page.
- Completed installation of new electronic document management system (imaging system) in June, 2002.

The Basic Functions

The retirement systems administered by this Division are the:

- Teachers' and State Employees' Retirement System
- Local Governmental Employees' Retirement System
- Consolidated Judicial Retirement System
- Legislative Retirement System

The systems are governed by two boards of trustees. The State Treasurer is ex-officio chairman of each board. The board of the Teachers' and State Employees' Retirement System is composed of 14 members, including actively working employees, retirees and public members. The Local Governmental Employees' Retirement System Board, while legally separate, is composed of the same 14 members plus 3 members representing local governments. The Board of Trustees of the Teachers' and State Employees' Retirement System is the governing board of the Consolidated Judicial and Legislative Retirement Systems and all of the other programs listed herein, except for the Firemen's and Rescue Squad Workers' Pension Fund. That fund is governed by a board of trustees, of which the State Treasurer is ex-officio chairman, and is composed of six members, including actively working employees, volunteers, and a public member.

In addition to the retirement systems administered through this Division, responsibility for administration of other programs covers the:

- Firemen's and Rescue Squad Workers' Pension Fund
- Public Employees' Social Security Agency
- Disability Income Plan
- Legislative Retirement Fund
- National Guard Pension Plan
- Teachers' and State Employees' Benefit Trust
- Supplemental Retirement Income Plan
- Registers of Deeds' Supplemental Pension Fund
- Contributory Death Benefit for Retired Members

All retirement systems and other programs administered by this Division are operated on a calendar year basis from January 1 to December 31, rather than the State's fiscal year, except for the Firemen's and Rescue Squad Workers' Pension Fund. For this reason, much of the data shown for the Division is for the captioned year ending December 31.

The administrative expenses of the Division for the retirement systems are paid from the General Fund of the State. These costs are reimbursed monthly to the General Fund from the assets of each trust fund benefited, in proportion to the estimated benefit received.

General Administration

The Director and his immediate staff are responsible for the overall general operation of the Division, and carry out the policies and directives of the State Treasurer and the governing boards. They provide assistance to legislators and committees of the General Assembly, including the drafting of proposed legislation and the acquisition of actuarial notes for introduced bills; response to news media inquiries; action and administrative appeals by individual

members of the retirement systems; a working relationship with associations and organizations of employees and employers; and information to State departments, agencies, institutions, and local governments. The staff provides assistance to local governments for Social Security coverage and acts as liaison between the State and the Social Security Administration. The staff also performs planning and research functions, and directs special projects.

Benefits Processing Section

This Section is responsible for the determination of eligibility for monthly retirement allowances and processing payment of all benefits for all retirement systems governed by the boards of trustees and administered by this Department. Responsibilities include the calculation and processing of payments of all retirement allowances under the various systems. For the period July 2001 through June 2002, 10,261 retirements were processed for payment.

The administration and determination of disability benefits through the System's Medical Board under the provisions of the Disability Income Plan for teachers and State employees, and the determination of eligibility for disability benefits from the other retirement

systems are incumbent upon this Section. Approximately 5,172 disability claims were reviewed by the Medical Review Board during the 2001-2002 fiscal year. Responsibilities include the calculation and payment of monthly disability benefits as well as the calculation and payment of reimbursements for short-term disability benefits paid by the various employers under the provisions of the Plan. Reimbursements numbering 273 were issued from July 2001 through June 2002 totaling \$1,966,410.

The various death benefit programs related to the Retirement Systems and the Separate Insurance Benefits Fund are managed by this Section. Responsibilities include the calculation and payment of

death benefits, return of members' contributions, survivor's alternate benefits, and other lump sum payments. Beneficiary changes for deceased retired members who selected an optional payment plan at retirement that provides for a beneficiary after the death of the member are handled in this Section. Approximately 6,505 death reports were received and processed during this period.

This Section is also responsible for the calculation and the payment of returns of accumulated

contributions to terminated employees. A total of 19,823 refunds were processed for the period July 2001 through June 2002.

The calculation of service purchase costs under the provisions of the various retirement systems administered by the Division is performed by this Section. In excess of 11,233 cost calculations were generated by the Benefits Processing Section for the period July 2001 through June 2002.

Accounting/Data Control Section

Maintaining the accounting records for the retirement systems is the responsibility of this Section. Another major responsibility is receiving and processing payroll contribution reports from some 1,600 participating State and local units of government. Contribution information from these payroll reports is electronically posted to the individual accounts for more than 415,000 members.

This Section is responsible for the administration of the Contributory Death Benefit Plan for Retired Members including the notification of eligibility under the Plan, enrollment of members electing coverage, and collection of the required contributions.

Brief descriptions of the other functions performed by this Section are as follows:

- **Retirees' Health Insurance** — Duties pertaining to this program include the receipt and processing of enrollment applications, and coverage change requests for more than 110,000 retirees.

- **Direct Deposit Accounts/Address Changes** — Activities involved in these areas relate to the receipt and processing of Electronic Funds Transfer (EFT) account applications, and changes to direct deposit accounts. Approximately 147,000 retirees' benefits are processed through EFT. Also, over 9,000 address change requests for retirees were processed in this Section.
- **Batch Posting and Systems Transfers** — These duties consist of the deposit and recording of special member contributions, and transfer of funds between systems.
- **Error Checking** — The correction of errors detected by computer edit in the processing of employers' payroll reports is an important function of the Section. Over 47,000 errors were detected and corrected this past year.

Member Services Section

This Section handles written correspondence, telephone communications, and e-mail inquiries with members and employers participating in the retirement systems and other benefit programs, responding to a multitude of questions about fringe benefits. Accordingly, during the past year approximately 42,964 letters were written in this Section, approximately 13,206 e-mail inquiries were addressed, and approximately 312,132 telephone communications were handled by personal contact with an additional 52,350 handled by the Interactive Voice Response Unit (IVR Unit). In addition, annual pre-retirement planning seminars are conducted by the staff of this Section, as well as retirement and fringe benefit conferences at the request of employers, and employee associations. All visitors to the Division requiring individual counseling about their benefits are referred to this Section. More than 9,817 persons were interviewed during the past 12 months.

The calculation of monthly retirement benefit estimates for future retirees is also a duty of this Section. Responsibilities include service and salary projections to an anticipated date of retirement.

Another important function of this Section is coordinating the participation of local government employers electing to become members of the Local Governmental Employees' Retirement System. This involves meetings with local governing bodies, collecting data for transmission to the Systems' consulting actuary, enrollment of eligible employees and explanation of monthly reporting procedures. Ancillary to this function is assistance to local governments in the adoption of tax shelter and death benefit coverage agreements. During the past year, 5 local government employers elected to become participants, and consequently their employees were enrolled in the Local Governmental Employees' Retirement System.

Records Section

The Records Section is primarily responsible for the creation, maintenance and storage of files for individuals who are currently, or have been at one

time, members of any of the State-administered retirement systems.

The Records Section currently maintains approximately 1,216,618 records. These records,

heretofore, had been maintained in the form of jacketed microfiche and stored in seven power file cabinets in the Records Section.

The records retention and storage functions have completely changed since January 1, 1996, with the implementation of the Division's electronic document management system (imaging system). All active and retired member jacketed microfiche records have been

converted to the imaging system, while all new records plus updates to existing files are now automatically processed as digital images. Over 12.3 million images have been converted to the imaging system.

The Division completed installation of a new imaging system with advanced capabilities in June, 2002.

Significant Accomplishments Legislation

Prior to the convening of the 2002 Session of the General Assembly, the Director and staff identified all proposals for benefit enhancements and changes recommended by the various associations of educators, employees and retirees. Also identified were measures to enhance administrative ability. Cost estimates for the recommendations were acquired from the Division's consulting actuary. The staff then assisted the State Treasurer and the Retirement Systems' Boards of Trustees in the formulation of their legislative recommendations.

During the 2002 Session, the Director and staff provided technical assistance and bill drafting services for the standing Senate and House Committees on Pensions and Retirement and communicated the Boards of Trustees' recommendations. The staff also acquired, as provided by State law, 38 actuarial notes disclosing the fiscal impact of every bill introduced which affected a State-administered retirement system or pension plan.

Recommendations of benefits and administrative enhancements by the board of trustees which were acted upon favorably by the General Assembly were to: (1) provide, effective July 1, 2002, in the Teachers' and State Employees' Retirement System, a 1.4% post-retirement increase in the allowances of beneficiaries in receipt of allowances on and before July 1, 2001, and for beneficiaries who commenced retirement with effective dates of August 1, 2001 to June 1, 2002, a prorated portion of the 1.4% post-retirement increase in their allowances based on the number of months a retirement allowance was paid; (2) provide, effective July 1, 2002, in the Local Governmental Employees' Retirement System, a 1.4% post-retirement increase in the allowances of beneficiaries in receipt of allowances on and before July 1, 2001, and for beneficiaries who commenced retirement with effective dates of August 1, 2001 to June 1, 2002, a prorated portion of the 1.4% post-retirement increase in their allowances based on the number of months a

retirement allowance was paid; (4) provide effective July 1, 2002, in the Legislative Retirement System, a 1.4% post-retirement increase in the allowances of beneficiaries in receipt of allowances on and before January 1, 2002, and for beneficiaries who commenced retirement with effective dates of February 1, 2002 to June 1, 2002, a prorated portion of the 1.4% post-retirement increase in their allowances based on the number of months a retirement allowance was paid; (5) increase, effective July 1, 2002, the defined benefit formula accrual rate in the Teachers' and State Employees' Retirement System from 1.81% to 1.82% of a member's average final compensation multiplied by a member's creditable service for service and early retirements; (6) provide for an adjustment, on account of the above defined benefit formula increase, to or on account of beneficiaries on the Teachers' and State Employees' Retirement System retirement roll as of June 1, 2002, equal to 0.6% of their June allowances; (7) increase, effective July 1, 2002, the defined benefit formula accrual rate in the Local Governmental Employees' Retirement System from 1.81% to 1.82% of a member's average final compensation multiplied by a member's creditable service for service and early retirements; (8) provide for an adjustment, on account of the above defined benefit formula increase, to or on account of beneficiaries on the Local Governmental Employees' Retirement System retirement roll as of June 1, 2002, equal to 0.6% of their June allowances; (9) permit retired members of the Teachers' and State Employees' Retirement System to be reemployed to teach in public schools without earnings restrictions. This provision is effective until July 1, 2004 and applies only to members who have been retired at least 6 months and have not been employed in any capacity, except as a substitute teacher or part-time tutor, with a public school for at least 6 months immediately preceding the effective date of re-employment; (10) amend, effective January 1, 2003, withdrawn service purchase provisions in the Local Governmental Employees' Retirement System, to provide that after five years of membership service, the service credit under the withdrawn account may be restored upon repayment of the amount withdrawn plus interest at the rate of 6½% compounded annually from the year of withdrawal to the year of repayment, plus a \$25.00 administrative fee; and (11) amend the retirement statutes to conform to provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001; as a

result of this legislation, effective January 1, 2003, pre-tax money from an eligible retirement plan or IRA may be accepted via rollover or in-service plan-to-plan transfer to purchase creditable service in the Teachers' and State Employees' Retirement System, Local Governmental Employees' Retirement System,

Consolidated Judicial Retirement System, and Legislative Retirement System.

The cost of these amendments in the affected retirement systems was funded by the gains realized from favorable investment and actuarial experience of each.

Communications

The Research and Planning Officer, in conjunction with other staff, revised forms for purposes of: notice of enrollment in the Consolidated Judicial Retirement System, election of benefits in the Consolidated Judicial Retirement System, election of benefits in the Legislative Retirement System, purchase of withdrawn service in the Teachers' and State Employees' Retirement System, application for retirement, retired group health insurance enrollment, and medical report for disability benefits. The "Things Retirees Need to Know" pamphlet was also updated.

Seven brochures describing the plan provisions of the Teachers' and State Employees' Retirement System, Local Governmental Employees' Retirement System, Consolidated Judicial Retirement System, the Firemen's and Rescue Squad Workers' Pension Fund, and Legislative Retirement System were revised in January, 2002 and updated on the Web page.

In addition, a Legislation Highlights summary was added to the Hot Topics section on the Web page, and a map and directions to the Retirement System office was added to the Web page.

Subsequent to adjournment of the General Assembly, a digest of all legislative changes was provided to all employing units, including some 1,800 fire departments and rescue squad units, and various employee associations. In addition, Divisional staff

contributed various articles which were published in the publications of the State Employees' Association, the Retired Governmental Employees' Association, and other organizations.

The staff of the Member Services Section periodically works with the staff of the State Agency for Public Telecommunications in revising the video programs utilized by the State and Local retirement systems. These programs, which can be used by anyone to explain the basic benefits structure of those retirement systems, are especially suited to the informational requirements of members nearing retirement age. Videos are used in the Division's statewide pre-retirement counseling meetings which are publicized throughout the State by the press, radio, and television. In the spring of 2002, the Member Services staff conducted 10 pre-retirement meetings statewide with some 3,570 members in attendance. In addition, the staff also participated in 93 other meetings, seminars, benefit fairs, and conferences relating to retirement benefits, including PREPARE workshops with 8,746 attendees.

The PREPARE workshop program was a joint venture with the Office of State Personnel and the community college system. This program covered legal, health, financial, housing, and family aspects of retirement.

Functional

The Division has continued to promote direct deposit of monthly benefit payments. Between July 1, 2001 and June 30, 2002, the benefit payments of 7,039 retirees were added to the direct deposit group, bringing the total number of monthly payments made by direct deposit to 146,921. This means that about 90% of the monthly benefit payments made by the Department are on direct deposit. The annualized savings to the State, relative only to the benefit payments placed on direct deposit during the twelve-month period ended June 30, 2002, is estimated to be approximately \$25,000.

The Firemen's and Rescue Squad Workers' Pension Fund implemented a new system to allow volunteer fire departments to submit their rosters of members electronically.

In the Local Governmental Employees' Retirement System, 5 local governments elected to become participating employers with the System. The participation of these employers involved the staff of the Member Services Section in meeting with their governing bodies and employees, acquiring

prevaluations from the consulting actuary to determine an employer's contribution rate, and providing all legal documents and agreements for their execution.

During this past year progress continued in the enhancement of computer programs utilized by the Benefits Processing System to provide timely and accurate service to the membership of the Retirement System.

- Continued the development and testing of the Disability Automation System. This project is ongoing.
- Began converting Excel spreadsheets that were serving as databases to actual databases, thereby providing for multiple simultaneous updates and user access. This project is ongoing.

Each of the foregoing were important steps in the Division's ultimate goal of automating, to the greatest possible extent, all activities relating to the processing and payment of benefits.

The Division continued the conversion of member withdrawn account records that were on microfilm to digital images.

The enrollment of members function and the change of beneficiaries function now being processed as digital images in the electronic document management system have been further refined so as to permit faster processing. The Division installed a new electronic document management system (imaging system) with advanced capabilities in June, 2002.

Implementation of the new imaging system is not the final step in the automation process for the Department. Additional initiatives, such as optical character recognition and bar coding will allow information to be read by the imaging system from paper. Payroll history and other historical information may eventually be stored on the imaging system in order to provide faster access. The new system is flexible and expandable such that new users and applications may be added. To date, most of the

various retirement processes have been incorporated in automated workflows.

The office receives numerous verbal and written requests for information, from both attorneys and the general public, as to how the retirement law impacts individual members and their spouses with respect to the equitable distribution of their retirement income. Attorneys are required to submit proposed Domestic Relations Orders to the Retirement System for review by the Attorney General's office before any payment of retirement income can be made to a member's ex-spouse in a divorce situation. The office continues to process these requests on a timely basis, thereby providing financial certainty to all parties involved.

The Lotus program that handles equitable distribution affidavits has a real and direct benefit to the members and their ex-spouses by providing them up to the minute information as to the status of a member's account and the financial consequences of a divorce action, thus assisting them and the courts in determining the fair and equitable distribution of a member's retirement income.

The Retirement Systems and Trust Funds Actuarial Valuation

The actuarial valuation is prepared by an actuary to assess the funding progress of a retirement system and the adequacy of the contribution rates which have been established to fund the system. An actuarial valuation is an inventory of the assets and liabilities of a retirement system at a specific point in time. Information collected covers all of the active (both in-service and terminated) members and all of the retired members and other beneficiaries who are receiving benefit payments. In this way, everyone who has been promised a benefit from the system is included in the actuarial calculations to determine the present value of the system's liabilities. These liabilities are then

compared to the system's assets, and calculations are made to determine whether the contribution rates will be adequate to fund the uncovered liabilities in the time period originally established. Annual valuations are made to permit gradual changes in the contribution level and/or funding period and keep the funding on a proper course. The annual valuation is also used by the actuary to compare actual separation, compensation, and investment experience with the actuarial assumptions used in the valuation of the liabilities of the system. The actuarial valuation balance sheets for each retirement system are included with the tables.

Actuarial Assumptions

The economic assumptions used for the actuarial valuation of all retirement systems are an interest rate of 7.25% per year and average rates of salary increase of about 6.00% per year, varying at different ages. The

assumed rates for mortality, withdrawals, disabilities, and service retirements are based on actual past experience. The asset valuation method is based on a modified market related value.

Funding of the Systems

The retirement systems described in this report, except the Legislative Retirement System, are being funded on a full actuarial reserve basis and use the entry age normal cost method as the actuarial cost approach. Under the entry age normal cost method, the normal contribution percentage rate is calculated on the basis of the adopted actuarial assumptions as the level percentage of the compensation of the average new member which, if contributed throughout the entire period of active service, would be sufficient, together with his/her contributions, to support all the benefits payable on his/her account. The accrued

liability is the difference between total liabilities and the present value of future normal cost contributions and the members' future contributions. All experience gains and losses are reflected in the amount of the unfunded accrued liability and thereby affect the period of liquidation, except in the Local Governmental Employees' Retirement System, where they are reflected in the normal contribution rate. The Legislative Retirement System is also being funded on a full actuarial reserve basis, but uses the projected unit credit cost method with unfunded accrued liability as the actuarial cost approach.

All retirement systems are joint contributory, defined benefit plans with contributions made by both employees and employers. Each active member contributes 6% of his/her compensation for creditable service by monthly payroll deduction. The only exception to this member contribution rate is the

Legislative Retirement System to which each active member contributes 7% of his/her compensation.

Employers make monthly contributions based on a percentage rate of the members' compensation for the month. Employer contribution rates are actuarially calculated.

Funded Status

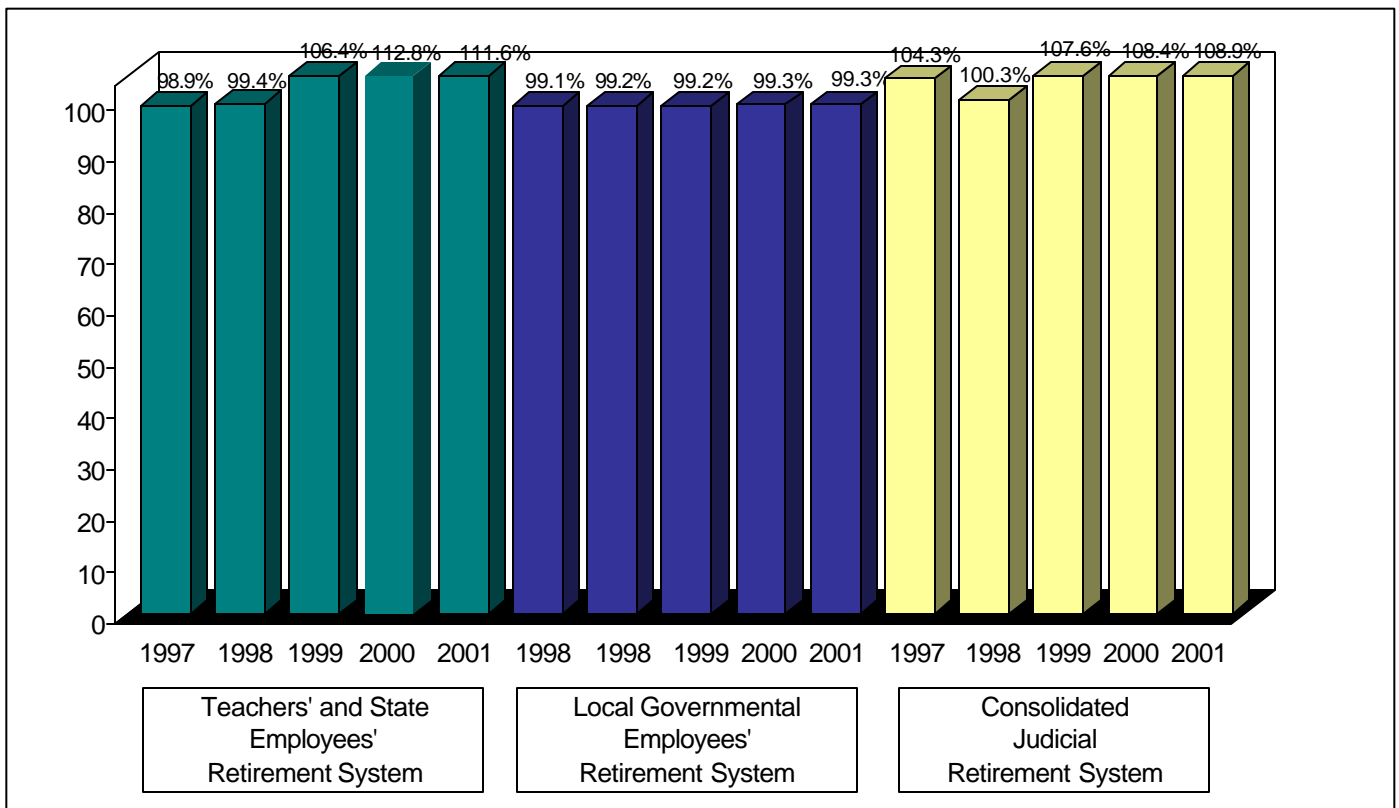
The consistent use of conservative actuarial assumptions and an approved actuarial cost method over the years since the establishment of the retirement systems, and the recognition of all promised benefits in the actuarial liabilities, have resulted in retirement systems which can be labeled as "actuarially sound." A simple measure for determining the funded status of a system is to relate the total

present assets to total accrued liabilities to determine a funded ratio.

The total accrued liabilities are found by adding the assets and the unfunded accrued liabilities. For purposes of comparison, the funded ratios for the major retirement systems are graphically illustrated in Chart 1. When the ratio equals 100%, a system is considered to be "fully funded" on a current basis.

Chart 1

Funded Ratio of the Retirement Systems



**Teachers' and State Employees' Retirement
System of North Carolina (State System)
N.C.G.S. 135-1 Through 135-18.5**

The Teachers' and State Employees' Retirement System has the largest assets and membership of the retirement systems administered by the Division. Created by the General Assembly effective July 1, 1941, the State System provides benefits to all full-time teachers and State employees in all public school systems, universities, departments, institutions, and agencies of the State.

This System began operations with a membership of 42,878 teachers and State employees, and with appropriations from the State of \$1,838,000. The membership has grown over the years in proportion to the growth in size and complexity of the public schools and State government. The active membership at December 31, 2001 was 349,340, and in addition there were 112,482 retired members and beneficiaries of deceased retired members. Invested assets at market value amounted to about \$44.0 billion.

The distribution of the investments of the assets of the State System as of December 31, 2001 was:

Long-Term Fixed Income Investment Fund	\$18,413,935,278
Short-Term Fixed Income Investment Fund	155,690,328
Real Estate Investment Fund	1,237,620,739
Equity Investment Fund	24,148,376,315
Venture Capital	<u>70,507,495</u>
Total	<u>\$44,026,130,155</u>

Operations of the State System during the calendar year 2001 resulted in total receipts of \$(7,788,463) and total expenditures of \$1,852,139,484. Chart 2 presents the distribution of revenues by source and expenditures by purpose.

The latest Actuary's Valuation Balance Sheet for the State System, as of December 31, 2001, is shown in Table 11. Based on the latest actuary's report, the General Assembly set the employer contribution rate at 1.97% of covered payroll, effective July 1, 2001, and at .00% of covered payroll, effective July 1, 2002. On this basis, the total of employee and employer rates of contribution is adequate to fund all future benefits

presently authorized, based on current service, and to fund, over a period of 9 years from January 1, 2002, the remaining accrued liability for past service.

Chart 2

**Teachers' and State Employees'
Retirement System of North Carolina
Year Ended December 31, 2001**

Sources of Funds	
Employee Contributions	\$606,695,436
Employer Contributions	\$224,705,629
Other Income	\$ 1,591,915
Investment Income	(\$840,781,443)

Applications of Funds	
Retirement Benefits	\$1,769,822,982
Refunds	\$ 74,303,196
Administrative Expenses	\$ 7,940,299
Other Expenses	\$ 73,007
Addition to Reserves For Future Benefits	(\$1,859,927,947)

**Local Governmental Employees' Retirement
System of North Carolina (Local System)
N.C.G.S. 128-21 Through 128-38**

The Local System is maintained for the employees of cities, towns, counties, boards, commissions, and other entities of local government in North Carolina.

Because participation by local governments is voluntary, the operation of the Local System is dependent upon the acceptance and continuing financial support of the governing bodies and employees of local governments. Approval and acceptance are evidenced by the fact that as of December 31, 2001, a total of 879 cities, towns, counties, and local commissions were participating in the Local System.

This System began operations in 1945, with 18 participating local governments, 2,102 members, and assets of \$178,053. The active membership as of December 31, 2001 was 134,679; in addition there were 31,352 retired members and beneficiaries of deceased members. Invested assets at market value amounted to about \$11.4 billion.

The distribution of investments of the assets of the Local System as of December 31, 2001 was:

Long-Term Fixed Income Investment Fund	\$4,956,185,382
Short-Term Fixed Income Investment Fund	16,873,206
Real Estate Investment Fund	327,634,716
Equity Investment Fund	6,101,349,739
Venture Capital	<u>17,739,482</u>
Total	<u>\$11,419,782,525</u>

Operations of the Local System during the calendar year 2001 resulted in total receipts of \$221,536,949 and total expenditures of \$434,822,183. Chart 3 presents the distribution of revenues by source and expenditures by purpose.

The latest Actuary's Valuation Balance Sheet for the Local System, as of December 31, 2001, is shown in Table 12.

Based on the actuary's latest report, the Board of Trustees set the employer normal contribution rate at 4.80% of covered payroll for general employees and at 5.27% of covered payroll for law enforcement officers, effective July 1, 2002. The accrued liability rate, if any, varies with each employing unit depending on the amount of prior service that was awarded to the members.

In accordance with the provisions of the legislation that caused the merger of the Law Enforcement Officers' Retirement System and the Local Governmental Employees' Retirement System on January 1, 1986, the normal contribution rates are separate for each of the two groups of employees while the accrued liability rate is the same.

Chart 3

**Local Governmental Employees'
Retirement System of North Carolina
Year Ended December 31, 2001**

Sources of Funds	
Employee Contributions	\$226,787,046
Employer Contributions	\$187,962,135
Other Income	\$ 4,722,944
Investment Income	(\$197,935,175)

Applications of Funds	
Retirement Benefits	\$378,766,233
Refunds	\$ 53,185,486
Administrative Expenses	\$ 2,842,905
Other Expenses	\$ 27,559
Addition to Reserves For Future Benefits	(\$213,285,233)

**Consolidated Judicial Retirement System
of North Carolina (Judicial System)
N.C.G.S. 135-50 Through 135-72**

The Judicial System was created by the 1983 Session (Regular Session, 1984) of the General Assembly, effective January 1, 1985. This System was formed by combining the previously existing Uniform Judicial, Uniform Solicitorial, and Uniform Clerks of Superior Court Retirement Systems. The Courts Commission was responsible for the design of the benefit structure of the previous systems, which was carried forward to the new consolidated system.

The membership of the Judicial System is composed of the elected judges and justices, district attorneys, and clerks of superior court of the General Court of Justice. As of December 31, 2001, there were 487 active members and 382 retired members and beneficiaries of deceased retired members. The invested assets at market value were about \$331.4 million.

The distribution of the investments of the Judicial System as of December 31, 2001, was:

Long-Term Fixed Income	
Investment Fund	\$139,678,979
Short-Term Fixed	
Investment Fund	2,878,904
Real Estate Investment Fund	9,386,208
Equity Investment Fund	179,001,247
Venture Capital	484,413
Total	<u>\$331,429,751</u>

Operations of the Judicial System during the calendar year 2001 resulted in total receipts of \$3,255,278 and total expenditures of \$15,965,627. Chart 4 presents the distribution of revenues by source and expenditures by purpose.

The latest Actuary's Valuation Balance Sheet for the Judicial System, as of December 31, 2001, is shown in Table 13. Based on the actuary's latest report, the General Assembly set the employer contribution rate at 13.92% of covered members'

payroll, effective July 1, 2002. On this basis, the total of member and employer rates of contribution is more than adequate to fund all future benefits presently authorized based on current service.

Chart 4

**Consolidated Judicial
Retirement System of North Carolina
Year Ended December 31, 2001**

Sources of Funds	
Employee Contributions	\$3,243,975
Employer Contributions	\$5,963,188
Investment Income	(\$5,951,885)

Applications of Funds	
Retirement Benefits	\$15,904,755
Refunds	\$ 37,012
Administrative Expenses	\$ 23,860
Addition to Reserves For Future Benefits	(\$12,710,348)

**Teachers' and State Employees' Benefit Trust
(Benefit Trust)
N.C.G.S. 135-5(I) ; 128-27(I); 143-166.20; And 143-166.60**

Chart 5

The Benefit Trust was established January 1, 1980, by the Board of Trustees of the Teachers' and State Employees' Retirement System, after enabling legislation was enacted in the 1979 Session of the General Assembly. The Board of Trustees of the Local Governmental Employees' Retirement System elected to become a participating affiliate in the Trust at the same date. The purpose of the Benefit Trust is to provide group life insurance benefits for members of these two retirement systems. Formerly, identical type death benefits were provided directly by these retirement systems.

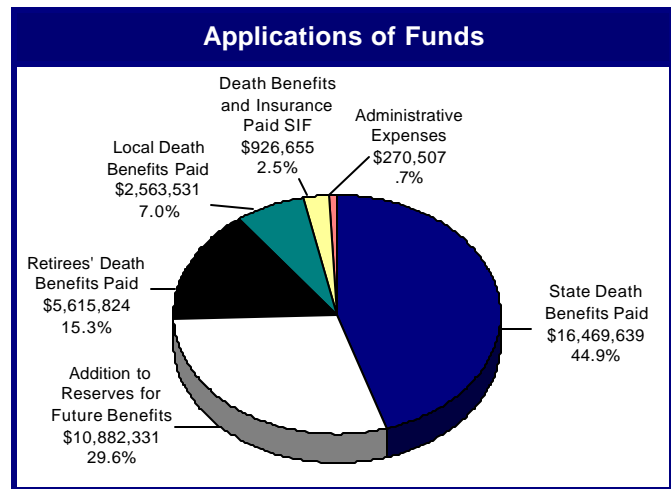
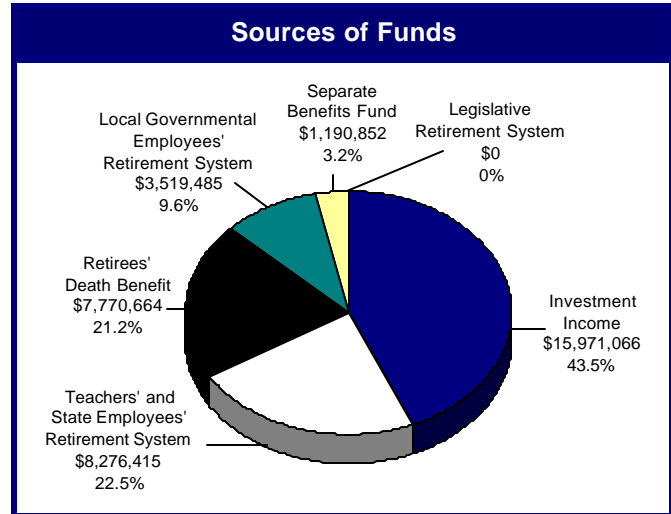
All contributions to fund life insurance benefits are paid by the State and local governments, participating in one of the two retirement systems, to the Trust and held separate and apart from any pension or retirement funds. The funding method adopted for the Benefit Trust is one-year term cost. The employer contribution rate to fund this benefit for members of the Teachers' and State Employees' Retirement System is .16% of covered payroll. The employer contribution rate for members of the Local Governmental Employees' Retirement System is actuarially determined and varies among employers.

The Benefit Trust further includes the Separate Insurance Benefits Plan for State and Local Governmental Law Enforcement Officers. The Plan provides additional life insurance benefits to active and retired law enforcement officers and additional accident and sickness insurance coverage for law enforcement officers. These benefits are funded by a \$1.00 cost-of-court assessment in each criminal case conviction in the State.

Additionally, the Benefit Trust includes the Retiree Death Benefit Plan. This plan is funded by participant contributions. The benefit is \$6,000 after 24 months of contributions. If a participant's death occurs before 24 months of contributions, the benefit is limited to a refund of contributions.

Chart 5 graphically presents the distribution of revenues by source and expenditures by purpose. The number of deaths and amounts of benefit payments, according to member group, during 2001 were:

**North Carolina Teachers' and State Employees' Benefit Trust
Year Ended December 31, 2002**



**Life Insurance Payments
Calendar Year 2001**

<u>Retirement System Membership</u>	<u>Number of Payments</u>	<u>Payment Amount</u>
Teachers' and State Employees'	467	\$16,469,639
Local Governmental Employees'	127	2,563,531

**Firemen's and Rescue Squad Workers' Pension Fund
(Pension Fund)
N.C.G.S. 58-86-1 Through 58-86-90**

The Pension Fund was created by the 1959 Session of the General Assembly to provide benefits for certified firemen. The statutes were amended to include certified rescue squad workers beginning January 1, 1982. Both volunteer and paid personnel are included in the membership.

Funded by an initial appropriation of \$235,000, retroactive benefit payments amounting to \$210,700 were made to 362 retirees during August of 1962, to cover all benefits due and payable since July 1, 1961. At June 30, 2002, the active membership of the fund was 31,492 while the number of retired members was 8,619. Invested assets at book value amounted to about \$242.9 million.

The distribution of the investments of the assets as of June 30, 2002, was:

Long-Term Fixed Income Investment Fund	\$ 112,928,873
Short-Term Fixed Income Investment Fund	709,036
Real Estate Investment Fund	7,179,066
Equity Investment Fund	121,706,059
Venture Capital	330,683
Total	<u>\$ 242,853,717</u>

Operations of the Pension Fund during the 2002 fiscal year resulted in total receipts of \$4,129,293 and total expenditures of \$16,564,173. Chart 6 presents the distribution of revenues by source and expenditures by purpose.

The latest Actuary's Valuation Balance Sheet, as of June 30, 2001, is shown in Table 14. Based on the latest actuary's report, the General Assembly

appropriated \$10,026,897 for the 2001-02 fiscal year. The yearly appropriation will fund all future benefits, based on current service, and will fund, over a period of nine years from June 30, 2001, the remaining accrued liabilities for past service.

**Chart 6
Firemen's and Rescue Squad Workers'
Pension Fund
Year Ended June 30, 2002**

Sources of Funds	
Appropriation	\$10,026,897
Member Contributions	\$ 4,196,356
Investment Income	(\$ 5,951,885)
Other Income	\$ 52

Applications of Funds	
Pension Benefits	\$15,385,672
Refunds	\$ 570,758
Administrative Expenses	\$ 607,742
Addition to Reserves For Future Benefits	(\$12,434,880)

Retirees' Health Premiums Fund

This fund is used as a conduit of moneys flowing from employers to pay individual coverage cost of retirees' health insurance. This coverage can be under either the State's health plan or approved health maintenance organizations. Retirees from the Teachers' and State Employees', Consolidated Judicial, and Legislative Retirement Systems are eligible for coverage. The method of collecting the employers' payments is a surcharge on active members' payroll payable with the employer contribution rate to the affected retirement system.

Financial Information for 2001

Beginning Fund Balance	\$87,960,591
Additions:	
Employer Contributions	\$ 188,228,165
Investment Income	<u>0</u>
	<u>188,228,165</u>
Deductions:	
Health Premiums Paid	\$ 216,891,616
Administrative Expense	<u>165,804</u>
	<u>217,057,420</u>
Ending Fund Balance	<u>\$59,131,336</u>

Legislative Retirement Fund (Fund)
N.C.G.S. 120-4.1 Through 120-4.2

The Fund was created by the 1969 Session of the General Assembly as a retirement plan for members and elected officers of the North Carolina General Assembly. The Fund was abolished, prospectively, by the 1973 Session (Second Session 1974). The abolishing Act preserved the vested and inchoate rights of the members in the Fund so that all members and former members of the General Assembly, who had qualified by virtue of service as of 1974, are still in receipt of monthly allowances or may apply for and

receive monthly allowances at age 65. There were 30 former members and officers of the General Assembly in receipt of allowances, with a cost in the year ended December 31, 2001, of some \$43,500. The cost is funded by a contribution of 5% of compensation paid by members at retirement and an annual general fund appropriation made to the General Assembly. The Fund is not operated as a retirement fund, but as an expendable trust fund.

Legislative Retirement System (System)
N.C.G.S. 120-4.8 Through 120-4.29

The Legislative Retirement System was created by the 1983 Session of the General Assembly as a retirement plan for members of the General Assembly. The membership also includes: (1) members who were vested or had maintained contributions in the Legislative Retirement Fund; and (2) those retirees receiving a benefit from the Legislative Fund who elect to transfer to the Legislative Retirement System.

As of December 31, 2001, the System had 169 active members, 88 inactive members, and 204 retired

members. Assets on that date totaled \$26,444.654. Operations of the System during calendar year 2001 resulted in total receipts of \$511,952 and disbursements of \$1,149,348.

Based on the latest actuarial report, the employer contribution rate was set by the General Assembly at .00% of covered payroll, effective July 1, 2002. On this basis, the total of employee and employer rates of contribution is adequate to fund all future benefits presently authorized.

Disability Income Plan
N.C.G.S. 135-100 Through 135-113

The Disability Income Plan of North Carolina was created in 1987 by the North Carolina General Assembly with an effective date of January 1, 1988. This plan replaced the former provisions for disability retirement under the Teachers' and State Employees' Retirement System and replaced the benefits provided under the former Disability Salary Continuation Plan.

The purpose of this plan is to provide equitable replacement income for eligible teachers and State employees who become temporarily or permanently disabled for the performance of their duty prior to retirement. Based on the latest actuarial report, the General Assembly set the employer contribution rate to fund this benefit at .52% of the covered payroll of

members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program, effective July 1, 2002.

The following are certain statistics relating to the number of disabled members, number of new claims, employer contributions, investment earnings, and amount of benefit payments during the calendar years ended 2000 and 2001.

	<u>2000</u>	<u>2001</u>
Number of Disabled Members	4,285	4,490
New Claims During the Year	865	838
Employer Contributions	\$52,268,811	\$55,638,722
Investment Income	\$25,988,037	\$18,465,752
Amount of Benefit Payments	\$36,793,409	\$40,311,759

Public Employees' Social Security Agency
(Social Security Agency)
N.C.G.S. 135-19 Through 135-26

The Social Security Agency administers the State's responsibility under the Social Security Agreement between the State of North Carolina and the United States Secretary of Health and Human Services. This Agreement was entered into on July 16, 1951 and executed pursuant to authority in Section 218 of the

Federal Social Security Act and Article 2, Chapter 135, of the General Statutes of North Carolina.

The provisions of the Agreement require the Social Security Agency to provide the mechanics of coverage for the State and its qualified political subdivisions, and to act as liaison between the State and the Social Security Administration.

**National Guard Pension Plan (Guard Plan)
N.C.G.S. 127A-40**

The Guard Plan was transferred to the Department of State Treasurer for payment of monthly benefits by the 1979 Session of the General Assembly, effective July 1, 1979. This Division pays allowances based on the certification of eligibility of former national guardsmen by the Secretary of the Department of Crime Control and Public Safety. The payments of benefits are funded by State General Fund appropriations by the General Assembly. As of December 31, 2001, there were 2,060 beneficiaries in

receipt of monthly allowances from the Guard Plan at a cost that calendar year of \$1,976,450.

The 1983 Session of the General Assembly enacted legislation, effective July 1, 1983, creating a trust fund for financing National Guard Plan payments and requiring that the Plan be maintained on a generally accepted actuarial basis. Based on an actuarial study after passage of this legislation, the June 1984 Session appropriated \$1,717,977 to begin actuarial reserve funding. The funding appropriated for 2001-02 was \$899,758.

**Supplemental Retirement Income
Plan of North Carolina [401(k) Plan]
N.C.G.S. 135-90 Through 135-95; 143-166.30; And 143-166.50**

The 1983 Session (Regular Session, 1984) enacted enabling-type legislation creating the State's Internal Revenue Code Section 401(k) Plan effective as of January 1, 1985. The Plan is a voluntary tax-deferred savings/investment program designed to supplement members' replacement income in retirement. The Plan is governed jointly by the State Treasurer and a Board of Trustees composed of members of the Boards of Trustees of the Teachers' and State Employees' and Local Governmental Employees' Retirement Systems.

Branch Banking and Trust Company (BB&T), the Plan's third-party administrator, is responsible under the Plan document adopted by the Board, and the terms of the contract with the Board, for all aspects of operating the Plan. This responsibility includes communications, record keeping, and investment products.

The Plan's number of participating members rose from 169,549 as of July 1, 2001, to 178,058 members as of June 30, 2002, for an increase of over 5.0%. Contributions by employers during this fiscal year

totalled \$102,458,171 while salary deferred contributions by members were over \$175,675,467. The total assets at book value of the Plan increased by 8.7% to \$2,456,468,057.

Under the current contract, members may select from a bank investment contract, a money market account, and eight mutual funds. As of June 30, 2002, 16.57% of the assets were invested in the bank investment contract, 66.41% were invested in the mutual funds, and 11.41% were invested in the money market account. In addition, 5.14% of the assets were loans receivable and 0.47% of the assets were cash on deposit.

A portion of court cost receipts are deposited into the account of each State and local government law enforcement officer. For the year ended June 30, 2002, court cost receipts of \$1,848,217 were transferred and credited to the State and local law enforcement officers' accounts.

The Supplemental Retirement Income Plan of North Carolina continues to be the largest State governmental 401(k) Plan in the United States.

**Registers of Deeds' Supplemental Pension Fund
N.C.G.S. 161-50 Through 161-50.5**

The Registers of Deeds' Supplemental Pension Fund was created by the 1987 Session of the General Assembly for the purpose of providing a supplement to Local Governmental Employees' Retirement System benefits for Registers of Deeds. The stated purpose of the Act was to attract the most highly qualified talent available within the State to that county office.

In October of 1987 each county board of commissioners began remitting monthly, to the Department of State Treasurer, an amount equal to

4.5% of the receipts collected pursuant to Article 1 of Chapter 161 of the General Statutes for deposit to the credit of the Register of Deeds' Supplemental Pension Fund. As of December 31, 2001, the Fund had total assets in the amount of \$13,164,403.

Benefits from the Fund became payable beginning July 1, 1988. For the year ending December 31, 2001, the Fund paid total benefits in the amount of \$728,520 to 68 retired Registers of Deeds.

State and Local Government Finance Division

The State and Local Government Finance Division is organized to provide the State Treasurer, the Local Government Commission, the North Carolina Solid Waste Management Capital Projects Financing Agency, and the North Carolina Capital Facilities Finance Agency with staff assistance in fulfilling their respective statutory functions. The Division is organized along functional lines into two major groups of services: Debt Management and Fiscal Management.

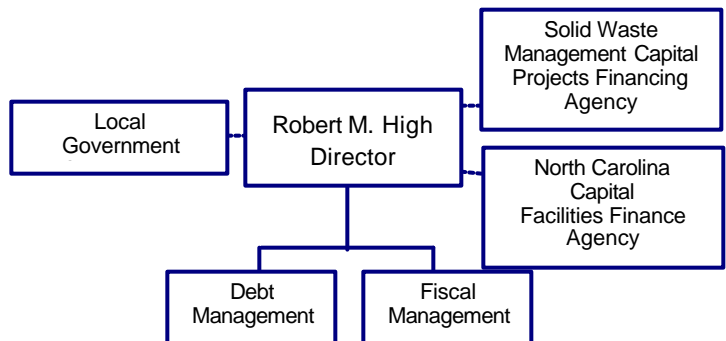
The Local Government Commission (LGC) renders assistance to local governments and public authorities in North Carolina. The LGC, staffed by the Department of State Treasurer, approves the issuance of debt for all units of local government and assists these units with fiscal management. The Commission is composed of nine members: the State Treasurer, the Secretary of State, the State Auditor, the Secretary of Revenue, and five others by appointment (three by the Governor, one by the General Assembly upon the recommendation of the President Pro Tempore and one by the General Assembly upon the recommendation of the Speaker of the House.) The State Treasurer serves as Chairman and selects the Secretary of the Commission, who heads the administrative staff serving the Commission.

The North Carolina Solid Waste Management Capital Projects Financing Agency provides a loan fund for financing the capital expenses incurred in implementing local and regional solid waste management programs. The Agency Board of Directors consists of five members: the State Treasurer and four others by appointment (two by the Governor and two by the General Assembly upon the

recommendation of one each by the Speaker of the House of Representatives and the President Pro Tempore of the Senate). Administrative staff for the Agency is provided by the Department of State Treasurer.

Nonprofit and for-profit corporations providing certain services may receive financing assistance through bonds issued by the North Carolina Capital Facilities Finance Agency. The Agency Board of Directors is composed of seven members: the State Treasurer, the State Auditor, and five others by appointment (three by the Governor, one by the President Pro Tempore of the Senate and one by the Speaker of the House of Representatives). The administrative staff for the Agency is provided by the Department of State Treasurer.

The Division handles the sale and delivery of all State and local debt and monitors the repayment of State and local government debt.



Operational Highlights

- Competitive tax-exempt general obligation bonds for the State were sold totaling \$605 million. On March 12, 2002, \$204.4 million tax-exempt public school building, clean water and higher education bonds (6.32 years average life) were sold competitively at a true interest cost 114 basis points below the national Bond Buyer's Index (the "BBI"), resulting in interest savings of approximately \$14.7 million over the life of the bonds. On April 3, 2002, \$10.6 million tax-exempt clean water bonds (2.89 years average life) were sold at a true interest cost of 3.4911%. In addition, the State sold \$35 million taxable natural gas bonds on March 12, 2002 at a true interest cost of 3.6317%.
- Variable interest rate bonds for the State were sold on May 1, 2002 totaling \$355 million. These

bonds were for public schools, higher education and clean water. The variable rate bonds will allow the State to take advantage of low short-term rates on longer-term debt, and an estimated \$45 million savings over the lifetime of the variable rate bonds is expected.

- The staff continued its efforts to distribute and receive information electronically. Memorandums, manuals and comparative financial data for all counties and municipalities are available through the Department's homepage. Annual financial information reports were received electronically from 98 counties and 335 municipalities.
- The State continued to retain its excellent bond rating of "Triple-A," one of only nine states in the nation with this coveted rating from all three national rating agencies.

- Of the \$1.0 billion in general obligation bonds sold for local governments \$.9 billion were sold competitively with rates averaging 95 basis points under the national Bond Buyer's Index, which resulted in savings in excess of \$53.5 million over the life of these bonds.
- Bond issues totaling \$293 million were approved and sold for the North Carolina Housing Finance Agency, thus increasing the supply of affordable housing for North Carolinians of moderate and low income.
- Industrial revenue and pollution control bonds in excess of \$81 million were issued to finance or refinance 10 projects which created 189 jobs and saved 7 jobs.
- Members of the staff worked with the Institute of Government to present the First Annual State Treasurer's Conference on Local Government Accounting, Auditing and Financial management for local government auditors and officials.
- Memorandums were issued to local governments and their auditors concerning numerous GASB Statement No. 34 topics, legislative changes, audit issues, and Single Audit and financial reporting issues. Memorandums were also issued comparing tax collection efforts, operation of water and sewer systems, operation of electric systems, operation of public hospitals and school capital outlay spending among units.
- Installment purchase contracts were sold for over \$493 million, typically for smaller projects.
- The staff has developed the County and Municipal Information Website: (<http://www.treasurer.state.nc.us/lgc/units/unitlistjs.htm>) . The site displays detailed financial, population and property tax data for the latest six year period for all North Carolina counties and municipalities.
- Twenty-three revenue bonds for over \$611 million were sold for local governments, mainly for hospitals, airports and water and sewer projects.
- Over \$497 million in hospital revenue bonds was sold for the North Carolina Medical Care Commission through thirteen bond issues.
- Over \$422 million was provided for capital projects to private schools, colleges and other nonprofit corporations through 19 bond issues by

the North Carolina Capital Facilities Finance Agency.

- The staff reviewed the financial statements of 1,143 local governments and public authorities. These audit reviews included 613 single audits and 200 yellow book audits required by federal and State laws.
- The staff worked with local governments and public authorities whose debt is subject to secondary market disclosure requirements established by the Securities Exchange Commission to be certain that all required disclosures were made by the date required. Failure to meet those requirements would negatively impact a unit's ability to borrow in the future. Two hundred and twelve units were required to make this disclosure for the fiscal year ended June 30, 2001.
- The thirteenth annual State Treasurer's Awards were presented to local governments and public authorities that demonstrated significant improvements in accounting or financial management programs, systems, methods and procedures. A State Treasurer's Awards Program was also established for nonprofit organizations that provide valuable services to the citizens of the State.
- In October the Local Government Commission voted to assume control of the fiscal affairs of the Town of East Spencer. The staff worked with local officials to restore the fiscal integrity of the Town, establish a sound system of fiscal management and provide services essential to the health and safety of the citizens of the Town.
- The staff worked with 19 State agencies to compile and distribute more than 350 compliance supplements for program grants administered by the agencies. These supplements will be used by auditors of local governmental units.
- The Staff closely monitored the impact of the State budget upon the fiscal condition of cities and counties.
- The LGC 203 Reports, Report of Investments and Deposits, was updated to permit local governments to submit the report electronically.

The State of Tax-Exempt Financing

As one of the few remaining tax shelters, governmental bonds continue to be an attractive means of financing for local governments. Without tax-exempt financing, the interest rates charged on borrowed funds could increase from 1 to 3 percentage points resulting in a 20 to 30 percent increase in the

cost of financing. Utility customers and taxpayers would ultimately pay this increase.

Market conditions were favorable for tax-exempt debt during the fiscal year. The Bond Buyer's Index of 20 General Obligation Bonds ranged from a low of 4.91% on November 8, 2001 to a high of 5.34% on March 11, 2002.

The Basic Functions Debt Management

The Division issues and monitors all State debt secured by a pledge of the taxing power of the State. After voter approval of a bond issue and with the assistance of other State agencies, the Division determines the cash needs, plans for the repayment of debt (maturity schedules), and schedules bond sales at the most appropriate time. An official statement describing the bond issue and other required disclosures about the State is prepared with the advice and cooperation of bond counsel. Finally, the Division handles the actual sale and delivery of the bonds, maintains the State bond records and register of bonds, and monitors the debt service payments. At June 30, 2002, the State had general obligation bonds outstanding of \$3,458 billion. (See Tables 8 and 9.)

The Division also is responsible for the authorization and sale of revenue bonds for the North Carolina Medical Care Commission, the Municipal Power Agencies, the North Carolina Capital Facilities Finance Agency, the North Carolina Housing Finance Agency and the North Carolina Solid Waste Management Capital Projects Financing Agency. Only the specific revenues pledged in payment thereof secure these bonds. The staff works with these agencies' personnel in determining the feasibility and scheduling of the bond offering, in structuring the issue and the underlying security documents, and in preparing the data that must be presented to the Local Government Commission for its approval.

The Division assists the State Treasurer in representing the State in all presentations to Moody's Investors Service, Inc.; Standard and Poor's Corporation; and Fitch, Inc., the three national bond rating agencies used by the State and local governmental units in North Carolina. At June 30, 2002, the State had a "Triple-A" rating, the highest rating attainable, from all three national rating agencies. These favorable ratings has enabled the State to sell its bonds at an interest rate considerably below the Bond Buyer's Index, thereby providing tremendous savings to North Carolina's taxpayers.

Another important function of the Division is the approval, sale, and delivery of all North Carolina local government bonds and notes. The Division staff counsels and assists local governmental units in determining the necessity of the project, the size of the issue, and the most expedient form of financing. A review is made of the debt management policies of the unit, the effect of the financing on the tax rate, and the unit's compliance with The Local Government Budget and Fiscal Control Act. Sale dates are scheduled depending on the need for the money, the anticipated interest rates, and the times when the bonds can be sold with a minimum of competition. The staff strives to resolve all problems and determine that all statutory

requirements are met before applications are presented to the Local Government Commission for approval.

After approval is granted, the governmental unit and its bond counsel assist the staff in gathering and assembling information for an official statement, which is mailed to a large group of potential bidders nationwide. The general obligation bonds are awarded through the competitive bid process on the basis of lowest total net interest cost to the governmental unit. After the sale, the staff delivers and validates the definitive bonds and ensures that the moneys are promptly transferred from the buying brokers to the governmental unit.

In addition to bond sales, the staff assists the units in selling certain short-term debt obligations. These may be bond anticipation notes to provide interim funding of projects until the definitive bonds are sold, or they may be other notes secured by specific pledges of taxes, grants, or future revenues. Authorization for short-term debt obligations also is based upon Local Government Commission approval.

Debt records are maintained for all units on principal and interest payments coming due in the current and future years. All debt service payments are monitored through a system of monthly reports.

At June 30, 2002, authorized and unissued general obligation bonds for local governments amounted to \$2.7 billion; and general obligation debt outstanding amounted to over \$7.5 billion. (See Table 8.) During the 2001-2002 fiscal year, bonds and notes were sold in the amount of \$1,774,459,850. (See Chart 31.) Of the \$1,040,178,160 in general obligation bonds marketed for local units, over \$.9 billion were sold competitively at tax-exempt rates averaging approximately 95 basis points below the national average (according to the Bond Buyer's Index). Over the life of these bonds, the issuers are expected to save in excess of \$53.5 million in interest costs. Such savings are a result, in part, of the Division's successful efforts in maintaining and upgrading the bond ratings of the State and local units and in monitoring the fiscal soundness of the individual local units.

The Division's staff also assists in the sale of revenue bonds, which must have the Commission's approval in order to be issued by municipalities, joint municipal electric power agencies, and county industrial facilities and pollution control financing authorities. These bonds are secured only by specific revenue pledged in payment of the bonds. (See Charts 31 and 32.)

Another responsibility of the Division's staff is assisting units that desire to enter into agreements to finance the lease or installment purchase of capital assets. Local Government Commission approval is required when the contract or agreement extends for five or more years; and obligates the unit to pay sums of money to another, without regard to whether the payee is a party to the contract; and obligates the unit to the extent of \$500,000 or a sum equal to one tenth of one percent (.001) of the appraised value of property subject to taxation by the unit, whichever is less. Local Government Commission approval also is required when the contract or agreement involves the construction or repair of fixtures or improvements on real property and it is not exempted in G.S. 159-148(b).

Before approving such agreements, the Local Government Commission must find that the proposed project is necessary and expedient, the proposed undertaking cannot be economically financed by a bond issue, and the contract will not require an excessive increase in taxes. During the fiscal year

ended June 30, 2002, the Local Government Commission approved contracts or other agreements totaling \$493.9 million. (See Tables 6 and 7.)

The Division also serves as staff to the North Carolina Capital Facilities Finance Agency, an agency established by the General Assembly in 1986. Originally named the North Carolina Educational Facilities Finance Agency, the act creating the Agency has been amended several times and its ability to finance capital projects significantly expanded. Following initial contact from an applicant, the staff generally begins the process of determining project feasibility and desirability with a preliminary conference. Upon receipt of an application, financial capability and responsibility is reviewed through ratio and trend analysis. The staff presents the project and its recommendations to the seven-member North Carolina Capital Facilities Finance Agency and subsequently to the Local Government Commission for approval. (All debt issued by the Agency also must be approved by the Local Government Commission.)

Fiscal Management

Another function of the Division involves monitoring certain fiscal and accounting standards prescribed for local governmental units by The Local Government Budget and Fiscal Control Act. As a part of its role in assisting local units and monitoring their fiscal programs, the Division provides guidance in following generally accepted accounting principles. The Local Government Budget and Fiscal Control Act requires each unit of local government to have its accounts audited annually by a Certified Public Accountant or by an accountant certified by the Commission as qualified to audit local government accounts. That audit must be performed in accordance with Generally Accepted Auditing Standards promulgated by the AICPA. If a governmental unit is required to have an expanded audit performed in accordance with Government Auditing Standards, the auditor is required to provide the unit and the Local Government Commission with a copy of the audit firm's most recent peer review report prior to contracting for the audit. Each local government is required to file a copy of its annual audit report with the Division and submit all invoices to the Division for approval. The Division monitors the annual audit reports for compliance with generally accepted accounting principles and single audit disclosure requirements. Also, a detailed analysis is made of the financial condition of each unit. In analyzing a unit's financial condition, staff members look not only at financial ratios and budgetary indicators, but also at possible trends that may be early warning signs of potential financial difficulties. Problems or concerns are brought to the attention of the governmental units and, if problems persist or become more serious, unit visits are made by staff members in order to provide hands-on technical assistance.

In providing assistance to local governments, units are counseled in accounting systems and internal controls, cash and investment management, budget preparation, risk management, capital planning, and changes in laws and regulations. Staff members also perform research and provide technical assistance to local governments with specific questions in these areas. On-site assistance is furnished to local governments with regard to financial and accounting systems and management services. Educational programs, in the form of seminars and classes, also are provided in order to accomplish these tasks. Staff members make presentations throughout the year at various workshops sponsored by the Institute of Government; the North Carolina Government Finance Officers Association; the North Carolina Association of County Finance Officers; the Association of Government Accountants; the N.C. Local Government Investment Association; and numerous other county, municipal, and school organizations. The Staff also worked with the Institute of Government to present the First Annual State Treasurer's Conference on Local Government Accounting, Auditing and Financial Management to provide training to local government auditors and officials.

The Division has expanded its assistance role by maintaining computerized databases of historical information from local government audit reports, city and county Annual Financial Information Reports, and Reports of Deposits and Investments. The information collected is used in a variety of ways to automate operations and enhance the assistance provided to local governments. The files also are utilized in special projects that benefit the operations of the State. Upon request, data is provided to such organizations as the

U.S. Bureau of the Census, the N.C. Department of Revenue, the General Assembly, the N.C. League of Municipalities, the Institute of Government, and the N.C. Association of County Commissioners to assist these groups in their activities.

Because of recent changes in the field of governmental accounting and the enactment of the Federal Single Audit Act and the State Single Audit Act, continuing assistance is provided to the independent auditors of local governments, particularly in the area of professional education. The Staff reviewed and compiled over 350 compliance supplements from State agencies to be used by local government auditors. A member of the

staff serves on the Governmental Accounting and Auditing Committee of the North Carolina Association of Certified Public Accountants. Staff members provide additional assistance to independent auditors by researching their questions concerning governmental accounting, auditing, and budgeting, as well as North Carolina laws. In addition, all exposure drafts of the Governmental Accounting Standards Board (GASB) are analyzed, and any comments and recommendations that staff may have on these drafts are submitted to the GASB.

Significant Accomplishments

Debt Management

North Carolina General Obligation Bonds — In 2001-02 the State sold general obligation bonds totaling \$605 million. On March 12, 2002, \$204.4 million tax-exempt public school building, clean water and higher education bonds (6.32 years average life) were sold at a true interest cost 114 basis points below the national Bond Buyer's Index (the "BBI"), resulting in interest savings of approximately \$14.7 million over the life of the bonds. The State also sold \$35 million taxable natural gas bonds on March 12, 2002 at a true interest cost of 3.6317%. On April 3, 2002, \$10.6 million tax-exempt clean water bonds (2.89 years average life) were sold at a true interest cost of 3.4911%. Variable interest rate bonds for the State were sold on May 1, 2002 totaling \$355 million. These variable rate bonds consisted of public school building, clean water bonds and higher education bonds. The variable rate bonds will allow the State to take advantage of short-term rates on longer-term debt, and approximately a \$45 million savings over the lifetime of the variable rate bonds is expected. The public school building bonds were approved by the voters of the State in November 1996, the clean water and natural gas bonds each in November 1998 and the higher education bonds in November 2000.

Installment and Lease Purchase Agreements — The installment and lease purchase method of financing continues to be used by local governments, typically for smaller projects for which a bond referendum is not cost effective and for essential projects for which units of government face mandates. The number of installment and lease purchase agreements approved decreased from 102 to 96 and the dollar volume approved decreased from \$706.9 million in FY 2000-2001 to \$493.9 million in FY 2001-02. (See Tables 6 and 7.) The actual amount of installment and lease purchase agreements closed during the year totaled \$461.9 million. (See Chart 32.)

Revenue Bonds --- Interest in revenue bond financing continued. These bonds are secured by the revenues of the projects being financed rather than property taxes and do not require a vote of the people.

During 2001-2002 the Local Government Commission sold over \$611 million in revenue bonds in 23 separate issues for local governments. Economic growth, viable enterprise activities and the narrowing of rate differential between general obligation bonds and revenue bonds have been factors in the increased interest in this type of financing. However, revenue bonds are more costly than general obligation bonds because of both higher interest rates and increased issuance costs. Most of the revenue bonds in 2001-2002 continued to be for water and sewer projects.

North Carolina Medical Care Commission Bonds — During 2001-2002 the Local Government Commission approved and sold thirteen separate issues of bonds and notes for the North Carolina Medical Care Commission totaling over \$497 million. This activity continues to reflect the rapidly changing environment of health-care as facilities continue to position themselves for an uncertain future with Medicare/Medicaid adjustments, further changes in the managed care industry and an aging population demanding more services at lower costs. The largest issue was for Mission St. Joseph's Health System for \$110 million to provide for construction and other renovations. In attempting to meet the needs of our aging population, eight independent living/assisted living issues providing for the acquisition or financing of eight separate facilities were successfully completed during 2001-2002. Diverse issue needs were met through fixed rate revenue bonds and variable rate demand revenue bonds. In attempting to better address the continuum of health-care, careful planning and evaluation will continue to be given to additional project risks and innovative techniques used in their financing to insure both project success and bondholder confidence.

North Carolina Housing Finance Agency — The North Carolina Housing Finance Agency (NCHFA) is a self-supporting State agency created by the General Assembly in 1973 to increase the supply of

affordable housing for North Carolinians of moderate and low income. The agency sells tax-exempt revenue bonds to finance mortgages for first-time homebuyers at interest rates below conventional market rates. In a companion program, it converts part of its bond authority to provide tax credits (Mortgage Credit Certificates) which first-time homebuyers use in conjunction with conventional loans to lower the cost of home ownership. The agency also issues bonds to finance privately owned rental housing for low-income households. In addition, it finances affordable housing through the federal Housing Credit Program, HOME Investment Partnership Program, and the State's Housing Trust Fund. In its history, the agency has issued more than \$5.9 billion in tax-exempt bonds and tax credits to produce and provide housing for over 153,500 households. In FY 2001-2002, financing and tax credits were provided to support total development of \$642 million. This includes \$293 million through bond sales and 2 mortgage credit certificate elections totaling \$151 million. The Agency also issued \$9.7 million in multifamily revenue bonds for housing for the elderly.

Industrial Revenue Bonds — The use of industrial revenue bonds has contributed to North Carolina's impressive record of industrial development. These bonds provide tax-exempt financing and are used to attract manufacturing industries to the State. Since 1976, there have been 1,097 issues totaling over \$6.1 billion. These 1,097 issues have created over 97,000 jobs and saved over 39,000 jobs. In the fiscal year ended June 30, 2002, 10 issues of Industrial Revenue and Pollution Control Facilities Bonds were issued for a total of \$81,705,000. This resulted in the creation of 189 jobs and 7 jobs saved. Additionally, \$40,885,000 of special purpose bonds were issued by local industrial and pollution control authorities on behalf of non-profit corporations.

Volume Cap Allocation — Legislation was approved by the 1987 Session of the General Assembly to maintain a State pool of the federal volume cap from which projects for industry, low and moderate income housing, low-interest rate student loans, etc., could be approved, thus giving maximum flexibility in use of the volume cap. The volume cap allocation affords tax-exempt financing for projects of this type. For the calendar year 2002, the State was allotted \$614 million to use for private activity bonds. In 2003, the volume cap is expected to increase slightly. The Tax and Trade Relief Act increased the per capita allotment from \$50 to \$75 with the increase phased-in from 2003 to 2007.

"Triple-A" General Obligation Bond Ratings — A "Triple-A" general obligation bond rating is the highest attainable and reflects strengths in debt position, economic base, administrative variables, and financial performance. Standard & Poor's rating agency has assigned "Triple-A" general obligation long-term debt ratings to states, counties, and cities throughout the entire United States; approximately one out of every four of those are North Carolina units. The

following North Carolina units have "Triple-A" bond ratings issued by Standard & Poor's: the State of North Carolina; the counties of Durham, Forsyth, Guilford, Mecklenburg, and Wake; and the cities of Cary, Charlotte, Durham, Greensboro, Raleigh, and Winston-Salem. In addition, the Special Airport District of Durham and Wake counties also enjoy a "Triple-A" rating. To quote from Standard & Poor's Credit Surveys: "The 'AAA' General Obligation rating for cities, counties, and states indicates that very high standards have been achieved and maintained."

North Carolina Capital Facilities Finance Agency — The North Carolina Capital Facilities Finance Agency (NCCFFA) was created in 1986, was originally named the North Carolina Educational Facilities Finance Agency, and provided the benefits of tax-exempt financing to nonprofit private institutions of higher education in the State of North Carolina. This act was amended in 1998 session of the General Assembly to broaden its powers to permit financing facilities of kindergarten, elementary and secondary nonprofit private schools again in the 1999-2000 session and change its name to its present name and to allow it to finance additional types of capital projects. The additional types of capital projects able to be financed include student housing facilities when owned or operated by an institution other than an institution of higher education or elementary or secondary education. Also included within the authority of the NCCFFA are special purpose projects which are defined to include water systems or facilities, including all plants, works, instrumentalities, and properties used or useful in obtaining, conserving, treating, and distributing water for domestic or industrial use, irrigation, sanitation, fire protection, or any other public or private use; sewage disposal systems or facilities, including all plants, works, instrumentalities, and properties used or useful in the collection, treatment, purification, or disposal of sewage, other than facilities constituting a water pollution control facility; public transportation systems, facilities, or equipment, including bus, truck, ferry, and railroad terminals, depots, trackages, vehicles, and ferries, and mass transit systems; public parking lots, areas, garages, and other public vehicular parking structures and facilities; public auditoriums, gymnasiums, stadiums, and convention centers; recreational facilities; land, equipment, and facilities for the disposal, treatment, or recycling of solid or other waste that are described in G.S. 159I-8; facilities for the provision of rehabilitation services, education, training, and employment opportunities for persons with disabilities and the disadvantaged not to include a retail facility, however, unless the proposed operator of the facility certifies that at least seventy-five percent of its employees will be disadvantaged or disabled persons and at least seventy-five percent of its inventory will be composed of used, donated items and items manufactured by disadvantaged or disabled persons. While the 1999-2000 amendments, effective July 1, 2000, made significant changes in the scope of activities of the

agency, they did not affect the bonds outstanding in any material respect.

The NCCFFA has provided \$1,611,289,979 in tax-exempt capital financing through 112 issues. This amount includes \$23,600,000 in tax-exempt financing originally issued by the North Carolina Industrial Facilities and Pollution Control Facilities Financing Authority in three issues on behalf of 12 corporations. There have been no defaults. At June 30, 2002, there were \$1,257,164,275 in outstanding obligations. Each issue is payable solely from revenues derived from each corporate entity financed, is separately secured, and is separate and independent from all other series of bonds as to source of payment and security. During the fiscal year ended June 30, 2002, the NCCFFA issued \$422,728,000 for 18 institutions. The Annual Report of the NCEFFA is available from the Office of the State Treasurer.

North Carolina Clean Water Revolving Loan and Grant Funds — The North Carolina Clean Water

Revolving Loan and Grant Fund was established by the 1987 General Assembly to provide low-interest rate loans to local governments constructing or improving water and sewer operations. Demand for the funds has far exceeded the amount appropriated. The intent is for this fund to become self-perpetuating and for a permanent water and sewer loan fund to be made available.

The staff is responsible for reviewing the applicant's fiscal/debt management policies; determining the feasibility of the project; and coordinating the loan offers with the Department of Environment and Natural Resources. Maturity schedules are prepared for each loan, and the staff oversees the signing of the promissory notes.

In 2001-2002, a total of sixteen units were selected to receive revolving loans ranging from \$54,466 to \$13,566,459. Additionally, five State bond loans were approved ranging from \$36,850 to \$2,875,000.

	School	Utilities	Refunding	Other	No.	Total Amount
G.O. Bonds						
Counties	\$ 439,850,000	\$ 15,010,000	\$ 138,840,000	\$ 132,600,000	23	\$ 726,300,000
Municipalities	\$ -	\$ 40,408,000	\$ 74,258,000	\$ 150,260,000	24	\$ 264,926,000
Districts and Authorities	\$ -	\$ 41,954,300	\$ 6,997,800	\$ -	13	\$ 48,952,100
Total G.O. Bonds	\$ 439,850,000	\$ 97,372,300	\$ 220,095,800	\$ 282,860,000	60	\$ 1,040,178,100
Revenue Bonds						
Counties	\$ -	\$ -	\$ -	\$ 31,780,000	2	\$ 31,780,000
Municipalities	\$ -	\$ -	\$ 84,250,000	\$ 225,685,000	7	\$ 309,935,000
Districts and Authorities	\$ -	\$ 21,865,000	\$ 152,483,000	\$ 95,810,000	14	\$ 270,158,000
Total Revenue Bonds	\$ -	\$ 21,865,000	\$ 236,733,000	\$ 353,275,000	23	\$ 611,873,000
Special Obligation Bonds						
Solid Waste	-	-	-	-		\$ -
Total Special Obligation Bonds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
State Bond and Revolving Loans						
Counties	\$ -	\$ 7,478,415	\$ -	\$ -	2	\$ 7,478,415
Municipalities	\$ -	\$ 25,223,085	\$ -	\$ -	12	\$ 25,223,085
Districts	\$ -	\$ 6,713,746	\$ -	\$ -	2	\$ 6,713,746
Total State Bond and Revolving Loans	\$ -	\$ 39,415,246	\$ -	\$ -	16	\$ 39,415,246
Notes						
G.O. Bond Anticipation						
Notes	\$ -	\$ 59,684,000	\$ -	\$ 26,725,000	28	\$ 86,409,000
Revenue Notes	-	-	-	-	0	\$ -
Total	\$ -	\$ 59,684,000	\$ -	\$ 26,725,000	28	\$ 86,409,000
Total Bonds and Notes	\$ 439,850,000	\$ 218,336,546	\$ 456,828,800	\$ 662,860,000	127	\$ 1,777,875,346

Debt Management Activities – State and Local (In Millions)

	FY	2001-02	FY	2000-01	FY	1999-00
	No.	Amt.	No.	Amt.	No.	Amt.
<u>Bonds Sold for State</u>						
G.O. Bonds (General Fund)	4	\$ 605.0	2	\$ 680.0	3	\$ 200.0
G.O. Bonds (Highway Fund)	0	-	0	-	0	-
Total	4	\$ 605.0	2	\$ 680.0	3	\$ 200.0
<u>Bonds and Notes Sold for Local Government Units:</u>						
G.O. Bonds	60	1,040.2	42	1,290.5	37	587.8
Revenue Bonds	23	611.8	26	786.8	19	487.4
State Bond and Revolving Loans	16	39.4	13	17.6	17	30.0
Special Obligation Bonds - Solid Waste	0	-	0	-	4	16.4
G.O. Notes	28	86.4	33	82.1	21	39.0
Revenue Notes	0	-	0	-	0	-
Total	127	\$ 1,777.8	98	\$ 2,177.0	173	\$ 1,160.6
<u>Installment/Lease Contracts Sold for Local Units:</u>						
	70	\$ 461.9	104	\$ 627.2	110	\$ 571.6
<u>Revenue Bonds Sold for:</u>						
Medical Care Commission	13	497.1	12	435.1	12	281.3
Housing Finance Agency	3	302.8	4	152.2	4	265.0
Power Agencies	0	-	3	-	3	420.9
Industrial Facilities and Pollution Control						
Financing Authorities	15	122.9	26	578.9	26	247.5
Capital Facilities Finance Agency	19	455.9	16	196.1	16	224.6
Total	50	\$ 1,378.7	61	\$ 1,362.3	65	\$ 1,439.3
Grand Total	251	\$ 4,223.4	265	\$ 4,846.5	351	\$ 3,371.5

Fiscal Management

The North Carolina Capital Management Trust — The balance of the Cash Portfolio in the North Carolina Capital Management Trust (NCCMT) decreased approximately 3.4% from June 30, 2001 to June 30, 2002. This decrease occurred because units had less funds available for investment. At fiscal year-end, the Cash Portfolio totaled \$3.9 billion, while the Term Portfolio had a year-end balance of \$71.5 million. The North Carolina Capital Management Trust (NCCMT) is a SEC-registered mutual fund, organized in April 1982 as an investment available only to North Carolina units of government and public authorities. The Trust is under the direction of a Board of Trustees, the majority of which are elected by the participating shareholders (units of government and public authorities) based upon their ownership shares of the Trust. There were 562 participants in the Cash Portfolio at June 30, 2002, compared to 556 at June 30, 2001. The number of participants in the Term Portfolio was 43 at June 30, 2002. The NCCMT, a AAAM rated fund by Standard and Poor's, is one of the largest local government investment pools in the nation.

Review of Semi-annual Reports of Deposits and Investments — The semi-annual Reports of Deposits and Investments for the six months ended June 30, 2001, and December 31, 2001, submitted by local governments and public authorities, were examined by the staff of the Division. The reports were reviewed to determine strengths and weaknesses in the units' investment portfolios and to identify instances of noncompliance with the North Carolina General Statutes. Weaknesses were communicated in writing to the units along with suggestions for improvement.

Financial Section of Bond Offering Statements — The staff prepared or assisted in the preparation of the financial section of 37 bond offering statements during the fiscal year. The purpose of the financial section of a bond offering statement is to provide users with several years' financial information about a unit of local government. In order to be most meaningful, the presentation of this multi-year information must be consistent in its application of generally accepted accounting principles (GAAP), a particular unit's accounting policies, and the requirements of the General Statutes.

The financial section of a local government's bond offering statement includes: 1) a copy of the unit's most recently audited and issued general purpose financial statements, including the notes; 2) compiled financial statements of the governmental and enterprise fund types of the unit for the three most recent fiscal years, also including notes; and 3) compiled budget statements for all annually budgeted governmental and enterprise fund types that summarize the budgets adopted subsequent to the most recently audited fiscal year.

The preparation of the financial section of bond offering statements requires a careful analysis and can be a very complex process. First, the staff reviews the most recent year's general purpose financial statements for presentation in accordance with GAAP and compliance with North Carolina statutes, and sometimes requests that changes be made in order for the statements to be of the highest possible quality. Next, the staff prepares compiled financial statements of governmental and enterprise fund types for the three most recent fiscal years. Adjustments must often be made for changes in presentation, changes in GAAP, changes in the reporting entity, or corrections of errors. Any material adjustments made are fully disclosed in the notes to the compiled financial statements. Finally, the staff reviews compiled budgets prepared by the unit. With the pending implementation of Governmental Accounting Standards Board Statement No. 34, this section of the offering statement may undergo some changes in the coming years to accommodate the transition to the new reporting format dictated by this Statement.

Analysis of Official Pronouncements — Each year the staff analyzes proposed changes or additions to accounting standards that would eventually affect State and local government financial reporting. The majority of such changes are issued by the Governmental Accounting Standards Board (GASB), which has the authority to set GAAP for state and local governments. The purpose of the staff's responses is to provide input into the development of governmental accounting standards in light of the impact they would have on North Carolina local governments and the State as well. During the past year, the staff analyzed proposed GASB standards dealing with reporting requirements for affiliated organizations of local governments.

State Treasurer's Conference on Local Government Accounting, Auditing and Financial Management, and Other Continuing Education Courses and Conferences. — Staff members worked with the Institute of Government to present the first annual conference. The conference was intended for both local government auditors and officials. The conference provided much needed training at a very reasonable cost. It was conducted on two sites, and drew nearly 200 participants at each site. Topics covered included GASB Statement 34, Governmental Auditing Standards, budgeting, purchasing, reporting and audit issues.

Staff members spoke at approximately 25 continuing education courses and conferences sponsored by organizations such as the Institute of Government, the North Carolina Government Finance Officers Association, the North Carolina Association of County Finance Officers, the North Carolina Local Government Investment Association, the Association of Government Accountants, the North Carolina Association of Council of Governments Finance

Directors, and the North Carolina Association of Certified Public Accountants. Instruction was provided by the staff at the beginning, intermediate, and advanced levels for a wide range of local government employees and board members as well as independent auditors of local governments.

Monitoring Compliance with “Yellow Book” Requirements — Paragraph 3.36 of the 1994 edition of *Government Auditing Standards* issued by the Comptroller General of the United States, commonly known as the “Yellow Book,” contains a requirement that auditors submit a copy of their most recent peer review report to the party contracting for the audit. This requirement was first effective for audits of financial statements for the fiscal year ended June 30, 1995. Auditors are required by the “Yellow Book” to have an external review of their quality control procedures once every three years. In order for audit contracts to be approved, auditors are required to submit a copy of their most recent report to the unit of government and to our staff. External quality review reports have been received from 286 offices of CPA firms.

Audit Manual for Governmental Auditors — The audit manual issued to CPAs performing governmental audits in North Carolina contains the following: references to authoritative sources and literature, a sample request for proposal for audit services, checklists for statutory compliance with The Local Government Budget and Fiscal Control Act and The School Budget and Fiscal Control Act, a governmental audit program, illustrative financial statements (for a municipality, a county, a county board of education, a housing authority, and a charter school), sample independent auditor’s reports as well as single audit reports, memoranda and publications, and compliance supplements written by State agencies for various federal and State grants. The State Single Audit legislation mandates the preparation of compliance supplements by State agencies, their review, compilation, and issuance by the Department of State Treasurer. Checklist for North Carolina requirements related to purchasing, and contracting, and related party transactions were added this year. Audit procedures for unclaimed property were also added. In addition, the manual is updated each year to reflect the pronouncements of the GASB, Statements of Position of the AICPA, circulars issued by the Federal Office of Management and Budget, and other newly available information. During the past year, the illustrative Financial Statements were revised for the implementation of GASB Statement No. 33 and Statements No. 34, No. 37, No. 38 and GASB Interpretation No. 6.

Audit Review Process — The staff of the Division annually reviews the audit reports of approximately 1,143 units of local government. Each review consists of the following: an analysis of proper presentation of the financial statements in accordance with generally accepted accounting principles; an analysis of proper reporting in accordance with single audit requirements, where applicable; and an evaluation of the financial

condition of the unit and its compliance with The Local Government Budget and Fiscal Control Act, as well as other State laws. Where problems are noted, local governments and public authorities, as well as their independent auditors, receive written communication expressing the staff’s concerns, suggestions for improvements, and an offer of further assistance, if needed. A response detailing the unit’s plans to take corrective action is requested. Approximately 200 of these letters were sent to units of local government during the 2001-2002 fiscal year.

As a part of the audit review process, the Division’s staff reviewed approximately 613 single audits. An extensive review is performed to ensure that audits performed under the federal and State single audit acts meet all the provisions of the law, as well as federal and State requirements. This is necessary before auditors’ invoices can be approved for payment, and so State departments and agencies can rely on the reports as a basis for compliance with applicable federal and State regulations.

Local governments and public authorities receiving a certain amount of federal and/or State financial assistance must have a financial statement audit done in accordance with Government Auditing Standards (the “Yellow Book”). The Division’s staff reviewed approximately 200 “Yellow Book” audits.

Memoranda and Other Publications — A significant service provided by the staff of the Division is the preparation and distribution of memoranda to units of local government and their independent auditors. These memoranda are of an informational, technical, or statistical nature and are distributed to finance officers, elected officials, and independent auditors periodically throughout the year.

Topics of particular interest this year include numerous memoranda related to the implementation of GASB Statement No. 34, legislative changes, audit issues, and Single Audit and financial reporting. Other topics include the collateralization of public deposits, and procedures for the approval of audit contracts and invoices.

Other memoranda distributed by the staff throughout the year contain statistical data of use to the governmental units, their independent auditors, and elected officials. Examples include a report and analysis of cash and taxes of municipalities and counties as reported at June 30, 2000; fund balance available for appropriation in the General Fund of municipalities and counties at June 30, 2000; county spending for public school capital outlay; statistical information on electric system operations; statistical information on water and sewer system operations; and statistical information on public hospital operations. Governmental units may use these reports to compare their operations to those of other units of like-size, geographic location, or to statewide averages. Independent auditors use this information to assist in the audit process. The report on county spending for schools is required by the N.C. General

Statutes to be prepared and provided to the General Assembly.

Another publication updated annually is an illustrative comprehensive annual financial report (CAFR), prepared in cooperation with the Institute of Government in Chapel Hill. The CAFR is utilized as supporting material for educational programs conducted by the Institute.

State Treasurer's Governmental Accounting/Financial Management Awards Program — The Department sponsored the thirteenth annual "State Treasurer's Governmental Accounting/Financial Management Awards Program." This awards program is designed to recognize units of government that have enhanced their current operations through the implementation of new and improved accounting and financial management programs.

Entries addressing a variety of topics were submitted for this year's awards program. The applications were evaluated by the Governmental Accounting and Auditing Committee of the North Carolina Association of Certified Public Accountants (NCACPA). The awards are presented by a representative of the Department and the NCACPA during board meetings of the individual units.

The awards program benefits applicant units that are recognized for their efforts and accomplishments. Also, an exchange of ideas between local governments occurs as a result of the publicity surrounding this program. Application forms are sent electronically annually to all local units of government.

State Treasurer's Accounting/Financial Management Awards Program for Nonprofit Organizations — The Department established the awards program for nonprofit organizations to recognize the valuable work done by these organizations for the citizens of the State. Improvements in their accounting/financial management systems allow them to provide greater benefits to our citizens. Entries for the year ended December 31, 2001 were received from private schools, private colleges and nonprofit hospitals.

Monitoring Compliance with New Economic Development Laws — General Statute 158-7.1 requires municipalities and counties to report economic development activities to the staff of the Local Government Commission, and requires the Commission to monitor their compliance within the limits on economic development activities imposed by the Statute. Municipalities and counties are required to report these activities in their Annual Financial Information Report. The staff then reviews the reports to determine that units have complied with the Statute. If it is discovered that a unit is in violation of the requirements of that Statute, the municipality or county must submit all appropriations and expenditures for economic development activities to the Commission for approval for the next three fiscal years.

Arbitrage Rebate Requirements for State Bonds — In order to preserve the tax-exempt status of the general obligation bond issues of the State that are

currently outstanding, the staff continues to perform several tasks which are necessary to ensure compliance with arbitrage regulations of the Internal Revenue Service. The projects involve monitoring investment yields, monitoring penalties in lieu of rebate requirements, preparing monthly status reports on each bond issue, and preparing information for use by bond counsel and other outside professionals, who in turn provide technical assistance to the staff.

Financial Reporting of Public School Expenditures — Each year the staff prepares a report for the General Assembly, the Department of Public Instruction and other organizations on county funding for public school capital outlays. This report is used in analyzing the level of county spending for public schools. In addition, the staff works with the Department of Public Instruction on various accounting issues to help ensure the proper accounting of current expenses, capital outlay, and other issues.

Municipal Electric Systems — The staff, in conjunction with the ElectricCities organization, has been working with municipalities that operate electric systems to help them identify ways to make their electric rates more competitive with investor-owned utilities. Because of the dramatic changes in the electric power industry, municipal electric systems may have to begin competing directly with investor-owned utilities in the sale of electric power. The North Carolina General Assembly has created the Study Commission on the Future of Electric Service in North Carolina to investigate how to best implement retail competition in our State. The Commission has submitted a report to the General Assembly recommending retail choice for all customers by January 1, 2006. No recommendation concerning the debt or stranded cost of the municipal power were made. The Commission did not present legislation to the 2001 General Assembly. The staff will continue to monitor their activities to determine how any proposed legislation will impact the municipal electric systems in North Carolina.

In response to the efforts of the staff, all 51 units that participate in one of the two power agencies (N.C. Eastern Municipal Power Agency or N.C. Power Agency No. 1) have adopted formal transfer policies that will reduce or eliminate subsidies to the General Fund. The goal of the transfer limitation policies is to promote a more self-supporting electrical fund within the unit. With the adoption of these transfer policies, the staff is able to provide timely analysis of a unit's transfer history and policy compliance based upon the information contained in the financial statements. The monitoring of compliance with the transfer policies also shows the development of general trends in cash management, statewide, among the units with electrical systems.

The staff has also worked with units and their auditors to promote adherence to generally accepted accounting principles in reporting transfers, reimbursement and quasi-external transactions in the unit's financial statements. Consistency in reporting

these transactions is needed so unit management and statement users may accurately evaluate the operations of the electric systems. The staff has also stressed the importance of disclosing assets in the appropriate funds in accordance with generally accepted accounting principles. These units will also include a note to the financial statements disclosing the status of the activities of the study commission and the potential for deregulation of electric services in the State.

Monitoring Revenue Bond Compliance — The staff continues to monitor local governments for compliance with revenue bond covenants. For each bond, the staff analyzes bond documents and determines the covenants that must be met and the compliance statements that must be issued by the unit's auditor. When the annual report is received, the staff verifies that covenants have been met and compliance statements have been issued. The staff also receives statements for accounts in which the bond proceeds are invested and verifies that the investments comply with the bond covenants and the General Statutes.

Adherence to Continuing Disclosure Requirements of the Securities and Exchange Commission — The staff continues to prepare resource information to assist units that are subject to Rule 15c2-12 of the Securities and Exchange Commission. The Rule, which applies to units that issued certain debt after July 3, 1995, requires the units to make disclosures to the secondary market, both annually and possibly more frequently, for as long as their applicable debt is outstanding. As the number of units affected by Rule 15c2-12 increases each year, the staff's role in providing assistance is also expected to grow. For the fiscal year ended June 30, 2001, 212 units were required to make an annual information filing.

White Goods Disposal Tax — General Statute 130A-309 has been amended to require those counties receiving distributions under the White Goods Disposal Tax program to list certain information regarding total receipts, expenditures and tonnage handled. The format of the AFIR continues to comply with this legislation while also providing the Department of Environment and Natural Resources with the required

data. The data allows the Department of Environment and Natural Resources to determine which counties are managing their white goods programs in accordance with the General Statutes.

Compliance Supplements for Local Government Auditors — The General Assembly amended G.S. 159-34 to transfer responsibility for reviewing and compiling compliance supplements prepared by State agencies from the Department of State Auditor to the Staff of the Department of State Treasurer. The staff must verify that supplements have been prepared for all programs and that all are properly formatted. The staff reviewed and compiled over 350 compliance supplements from 19 State agencies. The supplements are used to audit federal and state monies passed on to local governments. The supplements were made available through the Department's web site (www.state.treasurer.nc.us).

Electronic Submission of the Report of Investments and Deposits — Local governmental units were able to transmit their LGC 203 and 203S, Report of Investments and Deposits, electronically for the first time during the 2001 fiscal year. Notification of the report containing a link to the Treasurer's web page was sent via fax and email to the units. The report is submitted on a Excel spreadsheet which reduces preparation time and eliminates mathematical errors. After completing the report, the unit could submit it to the LGC attached to an e-mail. The LGC was able to process the file and add the data to its files through the use of a macro.

County and Municipal Information Website — The staff has developed the County and Municipal Information website (www.treasurer.state.nc.us/lgc/units/unitlist.htm). The site displays detailed financial, population and property tax data for the latest six year period for all North Carolina counties and municipalities. The financial information is obtained from the annual financial information report submitted by the unit and summary information taken from the annual independent audit of the unit. Unit financial information can be accessed by location on a North Carolina map or by unit name. Summary financial information by population groupings is also displayed.

Projects In Progress

Internet Web Site — The staff continues to enhance the information available on the Division's section of the Department's home page. The staff updated LGC memorandums, information compiled from county and municipal Annual Financial Information Reports (AFIR), single audit resources and the employee directory during the year. Data from city and county AFIRs for the fiscal years ended June 30, 1996 through June 30, 2001 are now on the homepage. The illustrative financial statements for a county, municipality, board of education, housing authority, and a charter school are published on the

web pages to assist local governments in preparing their financial statements. Several more sections of the policy manual and the audit manual were also added during the fiscal year. Users can download most of this information in Microsoft Word or Excel, which can assist in preparing audit reports and statistical information. Electronic formats for the LGC Form 203 — Report of Deposits and Investments, the Annual Financial Information Report (AFIR), and the Contract to Audit Accounts have been added to the web site. Local governments with Internet capability can download the selected documents and complete them

using the unit's computer. The LGC Form 203 and the AFIR can be electronically filed with the Department.

In an attempt to deliver information as efficiently as possible, the staff has offered to notify units and their auditors by e-mail of new memorandums and updates to the audit and policies manuals that have been placed on the Department's home page. These users can then access that information immediately through the Internet rather than waiting for printed copies to be mailed to them. Information is distributed more quickly at a lower cost. Currently, 1,057 units and 174 auditors are taking advantage of this service. As more units and auditors gain access to the internet, this practice should eliminate the need to mail printed material to most, if not all, units and auditors.

The Town of East Spencer — In October the Local Government Commission voted to assume control of the fiscal affairs of the Town of East Spencer. The staff has worked with local officials to be certain that services essential to the health and safety of citizens were provided. These services include water and sewer, police, fire and garbage collection. A financial management system was put into place which produces reliable accounting records and controls expenditures. The staff worked with vendors to identify the liabilities of the Town, determine which liabilities were in truly debts of the Town and schedule payments on those liabilities. Work to pay all debts of the Town and establish a good financial management system for the Town continues.

Monitoring the Impact of the State Budget Upon Cities and Counties — The staff closely monitored the impact of the State budget upon cities and counties. The amount of escrowed revenues were compared to the unit's General Fund fund balance available to appropriation and total expenditures from the prior fiscal year to identify units that were most significantly impacted and that might have difficulties meeting their obligations. These units were contacted to determine if they had incurred financial difficulties and what activities to their budgets had been made. This monitoring will continue as the current year's budget also impacts local governments.

Policies Manual Update — The staff continues to work on the Department of State Treasurer Policies Manual, a manual designed to provide guidance in accounting and other administrative issues to governmental units in North Carolina. It is being revised to delete obsolete sections and to incorporate updated information such as: 1) applicable legislative changes, as well as new legislation; 2) information contained in LGC memoranda, publications and technical memoranda; 3) accounting changes mandated and/or suggested by authoritative bodies such as GASB, FASB, etc.; and 4) other accounting issues not previously included in the manual.

The manual now includes a section on financial reporting with copies of the illustrative financial statements to assist units in preparing financial statements. Sections on budgeting, the chart of accounts, and tax billing and collection are currently

being updated. As sections are updated, they are made available through the Department's web site. In addition, other sections that have not required an update have been added to the home page.

Charter Schools — Actions taken by the General Assembly and State Board of Education have resulted in the audit process of charter schools becoming subject to the audit requirements of The School Budget and Fiscal Control Act. As a result, the staff has established audit and financial reporting requirements for charter schools and has informed schools and auditors of these requirements. The staff has also prepared illustrative financial statements for a charter school. Charter school contracts to audit accounts, invoices, and audited financial statements are subject to approval by the staff. Eighty-seven charter schools submitted audited financial statements for the fiscal year ended June 30, 2001. Eighty-nine charter schools will have audits for the year ended June 30, 2002 and more may be added in subsequent years.

The New Financial Reporting Model — In June 1999 the GASB issued Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. This statement will greatly change the financial statements of local governments and public authorities in this State. Under the Statement the financial statements of units will consist of management's discussion and analysis, entity-wide financial statements prepared on the accrual basis of accounting, fund financial statements prepared on the accrual or modified accrual basis of accounting, required supplementary information and notes to the financial statements.

The implementation date for Statement No. 34 will be determined by the total revenues of the governmental and enterprise fund types of the unit for the first fiscal year ending after June 15, 1999. Units with revenues of \$100 million or more will implement the new reporting model for the fiscal year ending June 30, 2002. Units with revenues of \$10 million or more but less than \$100 million will implement the new reporting model for the fiscal year ending June 30, 2003. Units with revenues of less than \$10 million will implement the new reporting model for the fiscal year ending June 30, 2004.

Using data from the financial statements for the fiscal year ended June 30, 1999 the staff has determined the implementation date and retroactive infrastructure reporting requirements for individual units. A limited number of units will be in the first implementation phase. Most counties and school boards will implement during Phase 2. Most cities and public authorities will implement during Phase 3 and will not be subject to retroactive infrastructure requirements.

Guidance on how to implement infrastructure reporting has been issued. The staff worked with local governments and their auditors, and have made changes to the chart of accounts, categorized revenue sources, established revenue recognition criteria under the modified and full accrual basis and updated the

illustrative financial statements. The staff has also worked with units and auditors to implement reporting standards to check comparability between financial statements. Memorandums have been issued on GASB Statements No. 37, No. 38 and Interpretation 6 which will be implemented with Statement No. 34. Guidance is being developed to help units and auditors determine major funds, allocate internal service fund activities, and prepare cash flow statements on the direct method. A conversion worksheet to adjust from fund financial statements to government-wide financial statements has been developed. The staff will also work with debt analysts and rating agencies to determine how to clearly and concisely present financial statements in the official statements for debt sales. While at the same time helping the analysts and agencies develop an understanding of reporting situations unique to North Carolina local governments.

Local Government Commission Expanded Oversight — During 1999, the responsibility of the Local Government Commission was expanded to include approval of indebtedness or other similar types of financing arrangements of public bodies, agencies or similar entities created by the action of a unit of local government. In certain instances, units of local government can issue tax-exempt debt on behalf of nonprofit organizations. Examples of this include the issuance of debt of nonprofit hospitals by the Medical Care Commission and issuance of debt for private schools and colleges by the Capital Facilities Finance Agency. In each of these cases, the issuance of the debt is approved by the Local Government Commission. However, similar debt issued by local housing authorities, or by nonprofit corporations on behalf of units of local government was not subject to Local Government Commission oversight. These debt issues tend to be more complex transactions that require additional analysis by staff members. The staff is currently developing checklists, applications and other guidance regarding these transactions. In the fiscal year ended June 30, 2001, nine issues totaling \$80 million for housing authorities were approved under this authority.

Qualified Zone Academy Bonds Authorized — In the 1999-2000 session of the General Assembly,

legislation was enacted to designate the State Board of Education as the state education agency responsible for administering the Qualified Zone Academy Bond program. This designation permits the State to fund school improvements meeting certain criteria through the issuance of taxable bonds known as Qualified Zone Academy Bonds (QZABs). As with other local government debt the Division will approve, sell and deliver the bonds. Although QZABs are taxable bonds, the purchasers receive a tax credit, rather than an interest payment, for each full year they hold the bond equal to a percentage of the face amount of the bond. In this regard, the intent of Congress was that the QZABs would be sold at par value without interest cost providing the issuer the ability to save the money that would otherwise have been spent on interest payments. However, a particular issue may be sold at a discount from par value or with a stated interest rate to increase the return for a less creditworthy issuer or to compensate for interest rate fluctuations between pricing and closing.

Proceeds from QZABs may only be used for qualified purposes consistent with both the Federal and North Carolina statutes regarding bond issuances. Consequently, in North Carolina, QZABs would be available to rehabilitate or repair a public school facility in which the qualified zone academy is located or to provide equipment for use at such facility. Construction of new school facilities is not a qualified purpose. Additionally, issuers must certify that they have received written commitments from one or more private entities to make qualified contributions valued at not less than ten percent of the proceeds of the issue. This requirement is intended to promote partnerships between private entities and local schools.

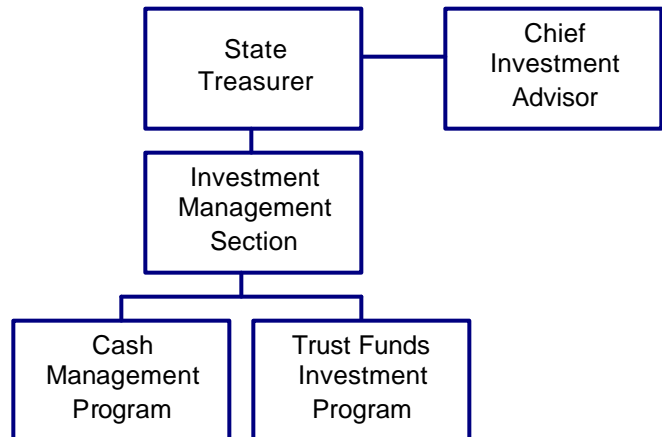
Currently, North Carolina has been allocated \$41 million which may be issued in QZABs. For the calendar year 2001, the State has been allocated \$1.9 million. The State has issued \$12.3 million as of the fiscal year ended June 30, 2001. Issuers must comply with state and local laws, as well as the Federal laws, when issuing QZABs. To achieve more effective results for small school districts, the staff is developing a pool program to combine several small issuers.

Investment Management Division

The Investment Management Division serves as the investment arm for the Department of State Treasurer. Its functions can be categorized into two major areas of responsibility:

1. Management of the combined assets of the North Carolina Retirement Systems. This is referred to as the Trust Fund Investment Program.
2. Management of the assets of the Cash Management Program.

The Division is designed so that the organizational structure is as flat as possible. This allows for greater efficiencies in managing a very complex investment program.



Highlights

- **Assets under management at June 30, 2002 amounted to \$62.1 billion.**
- **Assets of the Cash Management Program totaled \$8.1 billion (at book value) generating a cash return of 5.2%.**
- **Assets of the Trust Funds Investment Program totaled \$54.7 billion at market value producing a total return of (4.04%).**
- **The Long-term Investment Portfolio (fixed-income securities) held assets valued at \$25.6 billion and generated a total return of 9.96 % for the fiscal year, while generating an annualized total return of 8.67% during the trailing three-year period.**
- **The Equity Investment Portfolio with assets of \$27.4 billion produced a total return of (14.67%) for the fiscal year, while generating an annualized total return of (5.54%) during the trailing 36 months.**
- **Legislative authority was granted to increase the maximum amount of alternative investments up to 5% of the total market value of the total pension plan assets.**
- **A formal Investment Policy was implemented during the year. This policy provides the overall guidance and philosophies for management of assets.**
- **State Street was hired as a master custodian and recordkeeper. This relationship not only serves as the “book of record”, but also generates performance and attribution analysis for the Division.**
- **A front-end database system was developed that allowed potential managers in the real estate and alternative area to send in their proposals electronically. This was a significant efficiency enhancement for the Division.**
- **The Division completely revamped the process on external manager selection. This process is much more vigorous and thorough and provides a consistent framework for manager selection.**
- **During the year, \$4.2 billion of assets were restructured within the Equity Investment Fund. A transition manager was hired to manage the assets on an interim basis while new managers were selected utilizing the new search process.**
- **Savings to the Equity Investment Fund approximated \$22 million using transition management.**

Investment Management Serving as the State's Chief Investment Officer

The State Treasurer administers the Cash Management and Trust Funds Investment Programs. As such, the Treasurer is directed by statute to "establish, maintain, administer, manage and operate" investment programs for all funds on deposit, pursuant to the applicable statutes. In so doing, the Treasurer "shall have full power as a fiduciary" and shall manage the investment programs so that the assets "may be readily converted into cash as needed."

At June 30, 2002, total assets under management were nearly \$62.1 billion. This total represents the aggregate assets of the several retirement systems, various other trust funds, and the General and Highway Funds. In establishing the comprehensive management program, the State Treasurer, utilizing a professional investment staff, has developed an investment strategy for each portfolio that recognizes the guidelines of the governing General Statutes, and provides diversification as appropriate for the participants. Through these investment programs, as modified from time to time, the investment management staff strives to enhance the performance of assets under the State Treasurer's control.

General Investment Objectives —

Cash Management Program

To generate maximum income consistent with the principles of safety and liquidity. Prudence in discharging this fiduciary obligation requires that all investments be reviewed continuously, so that opportunities in the secondary markets, to improve the quality and/or the income stream, are not overlooked.

Trust Funds Investment Program

To generate returns that match or exceed those of the appropriate benchmarks on a trailing three-year basis, thereby, assisting in maintaining actuarially sound funding levels for the retirement systems assets (the predominant participants), while maintaining the necessary diversification.

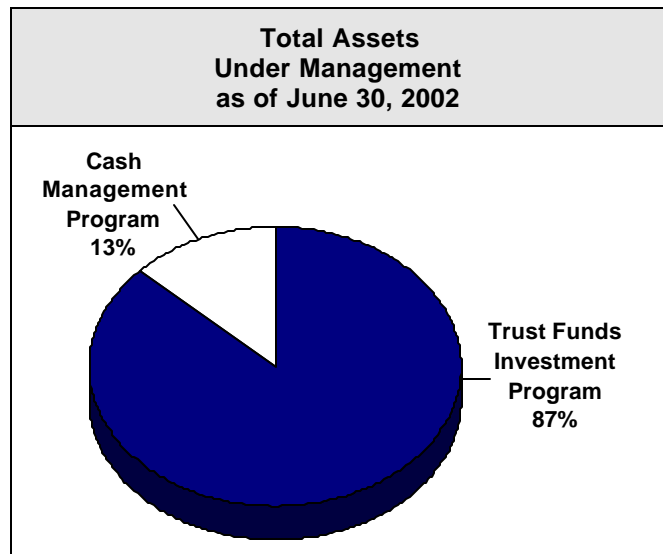
Operating Policy —

In all transactions executed for either investment program managed by the State Treasurer, the objective is to transact such business in the best interest of the beneficial owners of the trusts' assets.

Some of the business will be done with North Carolina institutions or with institutions having an office in this State, provided it can be done at no disadvantage to the interest of said trusts' assets.

Shown below is the percentage the Cash Management and Trust Funds Investment Programs represent of total assets under management:

Chart 9



The State Treasurer's Investment Pool

Most investable assets in the custody of the State Treasurer are held in the State Treasurer's Investment Pool. This investment pool is comprised of five portfolios:

- A short-term fixed income portfolio that invests in highly liquid money market instruments, treasuries, agencies and some liquid short-term corporate issues.
- A long-term fixed income portfolio that invests in longer-term, investment grade corporates, as well as treasuries, agencies and GNMA mortgage-backed securities.
- An equity portfolio that invests in equity securities through fiduciary relationships with a number of experienced equity money managers.
- A real estate portfolio that invests in real estate by purchasing shares of beneficial interests in various fiduciary relationships.
- An alternative portfolio that invests in private equity as a limited partner in partnerships managed by experienced private equity firms.

In addition, there is a Bond Proceeds pool of approximately \$663 million within the Cash Management Program to hold and invest moneys subject to federal arbitrage regulations.

Investment objectives are realized for the investor funds through participation in multiple portfolios when this is considered appropriate.

Management of the investments is separated between the Cash Management Program and the Trust Funds Investment Program. Cost of the total investment program is shared in an equitable manner among all portfolios administered by the State Treasurer.

The next two charts show the State Treasurer's Investment Pool participating entities' balances and earnings at fiscal year end.

Chart 10

THE STATE TREASURER'S ASSETS UNDER MANAGEMENT PARTICIPATING ENTITIES' BALANCES BY TYPE AND SEGMENT as of June 30, 2002							
(Stated in \$ millions)							
	Cash Management Program	Trust Funds Investment Program					
	<u>STIF</u>	<u>LTIF</u>	<u>EIF</u>	<u>REIF</u>	<u>VCIF</u>	<u>Eliminations*</u>	
Pool Assets							
General Fund	\$2,965						\$ 2,965
Highway Funds	1,055						1,055
Retirement Funds	69	\$24,213	\$27,405	\$1,601	\$81		53,369
Various Special Funds	2,699	1,417					4,116
Other Investment Funds	<u>681</u>					<u>(681)</u>	
Total Pool Assets	<u>7,469</u>	<u>25,630</u>	<u>27,405</u>	<u>1,601</u>	<u>81</u>	<u>(681)</u>	<u>61,505</u>
Non-Pool Assets							
Bond Proceeds Fund	<u>663</u>						<u>663</u>
Assets Under Management	<u>\$8,132</u>	<u>\$25,630</u>	<u>\$27,405</u>	<u>\$1,601</u>	<u>\$81</u>	<u>\$(681)</u>	<u>\$62,168</u>

* Amount of investment by other portfolios within "STIF" and "LTIF" and included in the assets of the appropriate portfolio.

NOTE: Balances shown in this chart are at the Fund level as reported by the Departmental Accounting Section.

**THE STATE TREASURER'S ASSETS UNDER MANAGEMENT
PARTICIPATING ENTITIES' EARNINGS BY TYPE AND SEGMENT
as of June 30, 2002**

(Stated in \$ millions)

	<u>Cash Management Program</u>	<u>Trust Funds Investment Program</u>					<u>Eliminations*</u>	<u>Total</u>
	<u>STIF</u>	<u>LTIF</u>	<u>EIF</u>	<u>REIF</u>	<u>VCIF</u>			
Income on Pool Assets								
General Fund*	\$135						\$135	
Highway Funds	49						49	
Retirement Funds	10	\$1,745	\$61	\$83	\$ 7		1,906	
Various Special Funds	173	98					271	
Other	39	1				\$(40)		
Total Income Distributed and Distributable	406	1,844	61	83	7	(40)	2,361	
Changes in Undistributed Income		546	(4,725)	(41)	(26)		(4,246)	
Total Income of Pool		2,390	(4,664)	42	(19)	(40)	(1,885)	
Income on Non Pool Assets								
Bond Proceeds Fund	12						12	
Income on Assets Under Management	<u>\$418</u>	<u>\$2,390</u>	<u>\$(4,664)</u>	<u>\$42</u>	<u>\$(19)</u>	<u>\$(40)</u>	<u>\$(1,873)</u>	

*Amount of earnings distributed to other portfolios from "STIF" and "LTIF" and included in the appropriate portfolio earnings.

NOTE: Earnings shown in this chart are at the Fund level as reported by the Departmental Accounting Section.

Cash Management Program

The Cash Management Program is comprised of two portfolios:

- A short-term fixed income portfolio (the Short-Term Investment Portfolio), and
- The bond-arbitrage related investment pool consisting of the unexpended net proceeds of State general obligation bond issues, (the Bond Proceeds Investment Pool).

The investments of the Cash Management Program include primarily money market instruments and short-to-intermediate-term treasuries and agencies. All bank accounts of the State Treasurer are included in portfolios of the Cash Management Program. The Division tracks the flow of funds into and out of the accounts of the State Treasurer on a daily basis. From this is determined the amount of cash which is needed for operations during the day and the

amount of cash available for investment that day. Available cash is invested as authorized with due regard to projected future cash needs.

The benchmark objective of the Cash Management Program is for the year-to-date cash return to match or exceed the U.S. Treasury constant one-year maturity on a trailing three-year period. On this basis, the Cash Management Program generated a 5.2% return versus the benchmark return of %.

Because the Treasurer's cash balances are ultimately subject to disbursement upon presentation of valid warrants, the primary considerations in making investments are safety and liquidity; the secondary consideration is income. Revenues from the Cash Management Program were approximately \$417.7 million in the fiscal year ended June 30, 2002, again generating a cash return of 5.2%. Of the earnings, \$183.9 million was for the General and Highway Funds.

Short-Term Investment Portfolio

Performance Review
Fiscal Year Ended June 30, 2002

Chart 14

Short-Term Investment Portfolio (STIP)

Data as of June 30, 2002

Invested Assets: \$7,468,925,493

Benchmark: Two-year constant maturity Treasury Notes

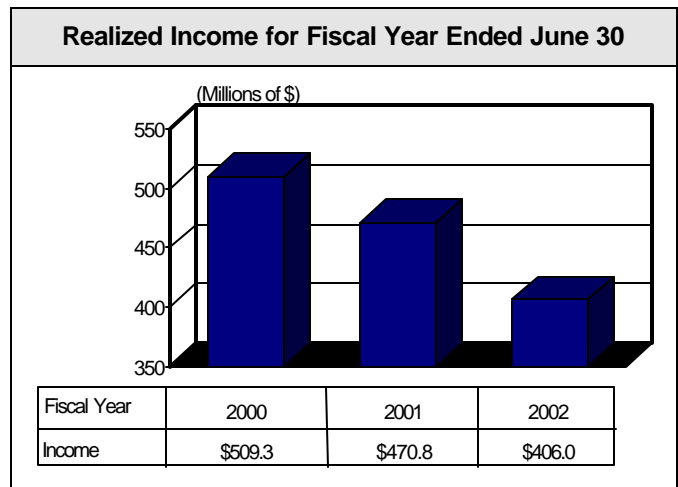
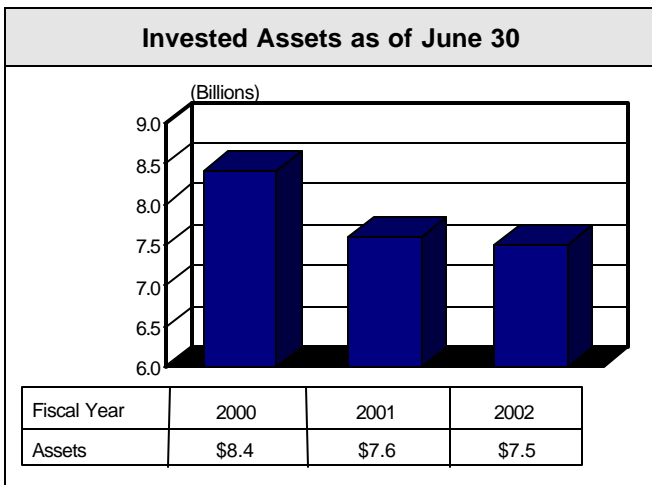
Management: Internal

Inception: 1949

Chart 12

Distribution by Maturity Range as of June 30, 2002	
0 — 1 years	49.82%
1 — 2 years	29.01%
2 — 3 years	11.61%
3 — 4 years	6.83%
4 — 5 years	2.73%
	100.00%

Chart 13



DESCRIPTION OF THE PORTFOLIO

The Short-Term Investment Portfolio is comprised of high quality money market investments and U.S. Government securities. Created in 1949, it serves as a cash management tool for funds required to be or voluntarily placed on deposit with the State Treasurer. The objective of the portfolio is to provide as high a level of current income as is consistent with safety of principal and sufficient liquidity to meet the daily cash flow requirements. The major participants in the portfolio are the General Fund, Highway Funds, and the cash balances of other trust portfolios managed by the State Treasurer.

The State Treasurer sets the broad investment policy and utilizes the professional in-house staff of the Investment Division to manage the assets. The current investment method for this portfolio is a laddering of maturities of securities authorized in G.S. 147-69.1. This strategy means that the assets are distributed fairly evenly over a stated maturity range. The maturity range for the Short-Term Investment Portfolio is from one day to seven years. The laddering strategy allows for sufficient liquidity for short-term cash needs, but allows the advantage of investing out the yield curve. Within this laddering strategy, there is an active management style, which takes advantages of opportunities in the marketplace.

The performance benchmark for the portfolio is the two-year constant maturity U.S. Treasury note. This benchmark correlates well with the average maturity of the securities held in the portfolio. The portfolio declined in size during the past fiscal year from \$7.6 billion to \$7.3 billion while net income decreased from \$471 million to \$406 million.

RISK PROFILE

The portfolio is subject to several forms of risks. These include, but are not limited to, purchasing power, default, reinvestment and market risks. However, the portfolio is considered low risk because of the high quality, highly liquid securities held. The laddered structure also minimizes risk and volatility. By maintaining this low risk approach, participants enter and exit the portfolio on a dollar-in, dollar-out basis.

Chart 15

Top Ten Largest Holdings as of June 30, 2002			
	<u>Issuer</u>	<u>Par Value</u>	<u>% of STIP</u>
	USTN 5.500 02/28/03	250,000,000	3.42%
	USTN 5.625 12/31/02	250,000,000	3.42%
	USTN 5.500 01/31/03	250,000,000	3.42%
	USTN 5.375 06/30/03	250,000,000	3.42%
	USTN 5.750 08/15/03	250,000,000	3.42%
	USTN 4.250 11/15/03	250,000,000	3.42%
	USTN 5.875 02/15/04	250,000,000	3.42%
	USTN 4.750 02/15/04	250,000,000	3.42%
	USTN 5.875 11/15/05	250,000,000	3.42%
	USTN 5.875 02/15/06	250,000,000	3.42%
	Total	2,500,000,000	34.20%

Chart 16

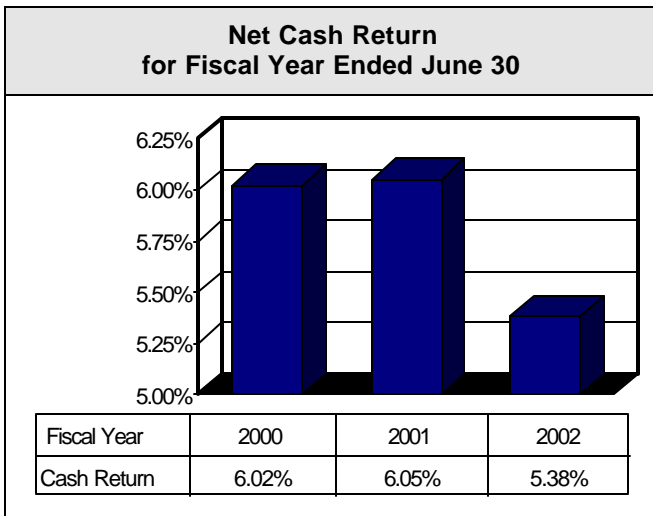
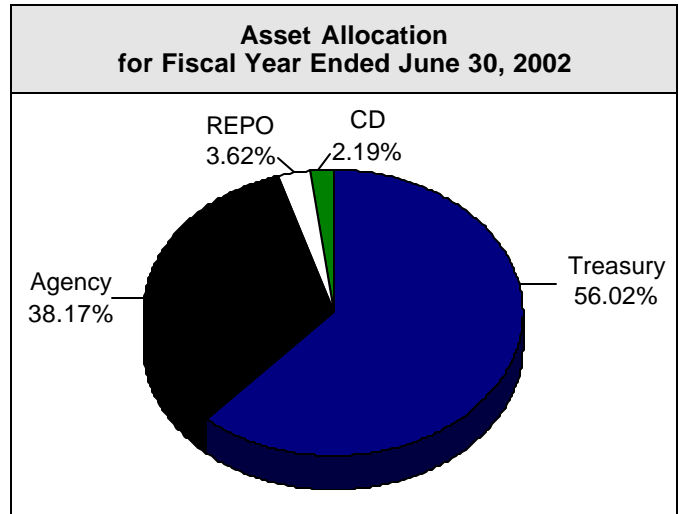


Chart 17



PORTFOLIO CHARACTERISTICS

The portfolio at June 30, 2002, was comprised of 56.02% U.S. Treasury securities, 38.17% U.S. Government agency securities, 2.19% in North Carolina Certificates of Deposit and 3.62% in Repurchase Agreements. The portfolio contained 126 different issues and had an average maturity of about 1.33 years. The portfolio's average duration was 1.25 years with an average coupon of 4.61%.

PERFORMANCE SUMMARY

The portfolio had a net cash return for the fiscal year of 5.38%. The return compares with the benchmark two-year constant maturity U.S. Treasury Note, which averaged 3.25% during the past fiscal year. One reason for the difference in returns is that some of the portfolio holdings were earning at rates higher than current interest rates. A large portion of the current portfolio holdings were purchased when interest rates were higher than they were during the past year.

Bond Proceeds Investment Pool

DESCRIPTION OF THE PORTFOLIO

The Bond Proceeds Investment Pool was established in 1987, as a separate portfolio, in order to comply with Internal Revenue Service (IRS) regulations on bond arbitrage. Sterling Capital Management serves as the managing agent for this portfolio. In addition to asset management, they provide bond arbitrage tracking and record keeping for the State and Local Government Finance Division.

The objective of the portfolio is to provide maximum income within the parameters of the IRS regulations on bond arbitrage.

RISK PROFILE

The portfolio's risk is minimal due to the short-term nature of the assets. Investment vehicles authorized in G.S. 147-69.1 are employed by the investment

manager to invest all cash in the portfolio in excess of the amount required to meet current needs, in such manner as to be "readily convertible into cash" as needed.

PORTFOLIO CHARACTERISTICS

At June 30, 2002, the Bond Proceeds portfolio was comprised of separate bond issues with a combined book value of approximately \$663 million. The average maturity of the portfolio was approximately five days. At June 30, the portfolio was comprised of 100% repurchase agreements.

PERFORMANCE SUMMARY

The portfolio generated earnings of over \$11.5 million and produced a net cash return of 2.41% for the fiscal year.

Trust Funds Investment Program

The Trust Funds Investment Program is comprised of four of the portfolios in the State Treasurer's Investment Pool providing diversification as follows:

- A long-term fixed income portfolio (the Long-Term Investment Portfolio) that invests in longer-term, investment grade corporates, as well as treasuries, agencies and GNMA mortgage-backed securities.
- An equity portfolio (the Equity Investment Portfolio) that invests in equity securities through trust relationships with a number of experienced equity money managers.
- A real estate portfolio (the Real Estate Investment Portfolio) that invests in real estate by purchasing shares of beneficial interest in various fiduciary relationships.
- An alternatives portfolio that invests, as a limited partner, in private equity partnerships managed by experienced private equity firms.

The investments in the Trust Funds Investment Program are primarily for the benefit of the long-term reserves of the pension funds administered by the Department. The two largest of the pension funds are the Teachers' and State Employees' Retirement System and the Local Governmental Employees' Retirement System. Of the trust funds under management, over 97% belongs to the retirement systems.

In addition to the assets of the various retirement systems and funds, numerous other trust funds are managed, including the North Carolina Employee Disability Fund, the Escheat and Abandoned Property

Fund, various educational trust funds, the State Property Fire Insurance Fund, the Insured Student Loan Program and the Wildlife Endowment Fund.

The benchmark objective for the Trust Funds Investment Program is for the four portfolios which make up the program to match or exceed their respective benchmarks on a trailing three-year period.

This program generated a total return of (4.04%) during the past fiscal year.

SPECIFIC CONSTITUTIONAL PROTECTION

The retirement systems' investment integrity is held inviolate by Article V, Section 6.(2) of the North Carolina Constitution, which provides:

"Neither the General Assembly nor any public officer, employee, or agency shall use or authorize to be used any part of the funds of the Teachers' and State Employees' Retirement System or the Local Governmental Employees' Retirement System for any purpose other than retirement system benefits and purposes, administrative expenses, and refunds; except that retirement system funds may be invested as authorized by law, subject to the investment limitation that the funds of the Teachers' and State Employees' Retirement System and the Local Governmental Employees' Retirement System shall not be applied, diverted, loaned to, or used by the State, any State agency, State officer, public officer, or public employee."

Equity Investment Portfolio

Performance Review Fiscal Year Ended June 30, 2002

EQUITY INVESTMENT PORTFOLIO (EIP)

Data as of June 30, 2002

Invested Assets: \$27,404,526,850

Benchmark: Blended; comprised of 63% S&P 500, 12% Russell Mid, 12% Russell 2000, and 11% Morgan Stanley All-Country Free ex U.S.

Management: Ten firms are utilized for the management of 28 separate equity portfolios

Inception: 1961

PORTFOLIO DESCRIPTION

The objective of the EIP is to provide long-term growth of capital while observing the requirements of applicable State law and the principles of prudent investment management. The EIP is expected to generate a "total return" which will equal or exceed that of a blended benchmark over a trailing 36-month time period. The blended benchmark will be constructed to reflect the midpoint or "neutral weightings" of various equity markets, encompassing both domestic and international markets.

This portfolio represents approximately 51.4% of the assets of the various North Carolina retirement systems. These systems are "defined benefit plans" and as such provide retirement benefits to retirees based on formulas prescribed by law.

The diversification represented by this portfolio provides positive benefits to the asset/liability mix during periods of low to moderate inflation due to the long duration of the asset class.

The EIP is constructed based on efficient frontier models that develop mid points or neutral weightings for various equity asset classes. These neutral weightings are designed to show how the portfolio can be constructed so that the best risk reward scenario is obtained. The model breaks the EIP into several components. First, the total portfolio is allocated

between domestic equities and international equities. From there the domestic component is divided between large-cap, mid-cap and small-cap stocks.

REVIEW OF FISCAL YEAR ACTIVITY

There was a significant amount of activity and change within the portfolio during the fiscal year. The first change involved the overall asset allocation within the portfolio. Based on the inputs used in an optimizer, it was determined that the portfolio should possess a higher exposure to domestic small cap stocks and non – U.S. stocks. The expected returns being projected from this new mix required that certain existing managers would have to change from active management to passive portfolio management. It was also determined that certain managers needed their allocations reduced. This decision was based on a technique known as risk budgeting. It was discovered that some managers were taking on a proportionately larger amount of risk in comparison to the percentage of assets they managed. To accomplish this, a transition manager was hired to take down assets held by certain managers and manage those assets in such a way as to reduce the tracking error.

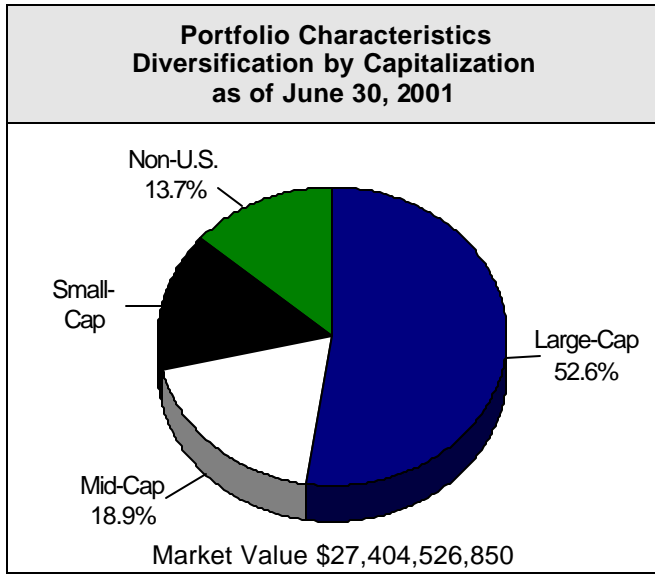
Once the assets had been transferred to the transition manager, a formalized search process was begun to identify and fund those managers who could achieve the desired return and risk profiles deemed prudent by the asset allocation optimizer. Detailed questionnaires, semi final presentations and on-site due diligence trips were held in order to determine new firms to be hired and the amount of commitment each should receive. This process is still on-going and should be completed in the next fiscal year.

PORTFOLIO CHARACTERISTICS

At June 30, 2002, the EIP held the highest concentration of its assets in domestic large-cap securities. Allocations were made to other areas of the equity markets with the intent of diversifying some of the risks associated with the large-cap sector of the market. Analysis of the correlations between different segments of the market suggests that the correlations are below 1.0, supporting the decision to allocate funds to these components.

At June 30, the EIP employed ten management firms that manage a total of 28 different portfolios. Obviously, several of these firms manage multiple portfolios.

Chart 18



The following table reflects the management firms utilized, the amount of assets, the number of portfolios, and the types of portfolios managed for the EIP.

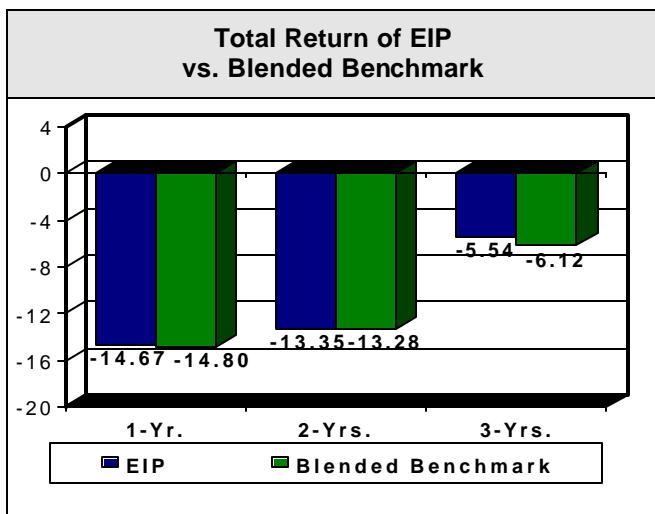
Firm	Total Assets (\$ in millions)	# of Port.	Type
Alliance Capital Management	\$9,151	7	Passive Large Passive Mid Passive Small Active Large (2) International Emerging Mkt
Banc of America Capital Management	2,407	3	Passive Large Passive Mid Passive Small
BB&T	202	1	Active Large
Evergreen	2,294	2	Passive Large Passive Mid
First Citizens	1,499	1	Passive Large
Franklin Street Partners	268	1	Opportunistic
NCM Capital Management	87	1	Active Large
Piedmont Investment Advisors	7	1	Active Large
State Street Global Advisors	2,739	2	U.S. Transition Non-US Transition
Wellington Management Company	8,374	8	Active Large (2) Biotechnology Active Mid Active Small (2) International Emerging Mkt

Chart 19

**Name and market value
of the ten largest exposures
via participation in the various trusts
as of June 30, 2002**

Microsoft Corp	\$555,218,456
General Electric Co	518,178,707
Citigroup Inc	465,045,648
Exxon Mobil Corporation	445,545,471
Pfizer Inc	431,620,805
American Intl Group	392,763,812
Walmart Stores Inc	376,512,094
Short-Term Cash	370,139,950
Johnson & Johnson	257,766,545
Bank America	244,866,802

Chart 20



PERFORMANCE SUMMARY

The EIP generated a total return of (14.67%) for fiscal year 2001. The benchmark return was (14.80%). Over a trailing three-year time period, the EIP generated a (5.54%) return versus (6.12%) for the benchmark.

Long-Term Investment Portfolio

Performance Review Fiscal Year Ended June 30, 2002

LONG-TERM INVESTMENT PORTFOLIO (LTIP)

Data as of June 30, 2002

Invested Assets:	\$25,630,038,515
Benchmark:	Merrill Lynch Blended Benchmark
Management:	Internal
Inception:	1941

PORTFOLIO DESCRIPTION

The State Treasurer sets the broad investment policy and utilizes the professional in-house staff of the Investment Management Section to manage the assets of this fixed income portfolio of securities. The holdings in the LTIP consist of fixed rate U.S. Government obligations, corporate debt, federal agency obligations, dollar-denominated sovereign debt and GNMA modified pass-through securities.

The objective of the fund is to provide diversification and positive benefits to the asset/liability mix during periods of disinflation or deflation, while maximizing returns at a risk level commensurate with the identified benchmark. The benchmark for the LTIP is a blend of established Merrill Lynch indices. The mix consists of 40% U. S. Government/agency securities, 35% corporate obligations and 25% GNMA 30-year mortgage pools.

Chart 21

Asset Allocation by Quarter-End		
Asset Allocation	LTIP	Benchmark
Governments	38.5%	40.0%
Corporates	40.3%	35.0%
Mortgages	20.5%	25.0%
Cash	0.7%	
Total	100.0%	100.0%

This portfolio represents approximately 45.5% of the assets of the various North Carolina retirement systems and approximately \$1.4 billion of other trust

funds. The retirement systems are "defined benefit plans" and as such provide retirement benefits to retirees based on a formula prescribed by law.

RISK PROFILE

The LTIP is exposed to several forms of risk. These include, but are not limited to, purchasing power, default, reinvestment and market risk. Fixed income securities are extremely sensitive to changes in market interest rates. As a means of monitoring the LTIP price sensitivity to changes in market interest rates, the staff tracks statistical data in relation to the portfolio.

PORTFOLIO CHARACTERISTICS

The LTIP continues to be a high quality fixed income portfolio with a diverse group of holdings. The portfolio, at June 30, 2001, included 40.3% corporate obligations, 38.5% U.S. Govt./Agency securities, 20.5% GNMA's. The portfolio consists of 569 different issues, with an average coupon of 6.86%.

PERFORMANCE SUMMARY

The Long Term Investment Portfolio (LTIP) turned in another strong year of performance, outpacing the benchmark by more than 30 basis points and producing close to double digit returns. The strength of the past fiscal year performance combined with strong relative performance over the past five years, left the LTIP ahead of the benchmark over every measurable period. The string of Fed rate cuts continued from the previous fiscal year, with the Fed lowering the Fed Funds rate five more times for a total of 200 basis points. The Fed moves and weakened economy left the Treasury yield curve steeper and lower than a year ago. While the corporate market suffered through several credit disasters and general spread widening, the LTIP managed to sidestep the potholes in the road well enough to out perform the investment grade corporate market by roughly 60 basis points.

The portfolio produced a total return of 9.96% for the fiscal year, beating the benchmark return of 9.63%. On a trailing three-year basis, the LTIP produced a return of 8.67% compared with 8.42% for the blended benchmark.

Governmental Accounting Standards Board Statement No. 31 became effective for our reporting on July 1, 1997. The Statement requires that investment assets and income be reported at fair value and therefore the fixed income assets of the Long Term Investment Portfolio are managed on a "total return" basis. Total return includes realized income and any appreciation or depreciation reflected in the fair market value from an independent pricing source.

Chart 22

Top Five Corporate & Govt. Holdings in LTIP as of June 30, 2002	
Issuer	Market Value (in millions)
Verizon (incl. subs)	\$480
GE	441
SBC (incl. subs)	418
Bristol-Myers	340
Bank of America	337
UST 8.125 8/15/19	\$774
UST 7.875 2/15/21	771
UST 8.50 2/15/20	761
UST 7.25 8/15/22	739
UST 7.50 11/15/16	598

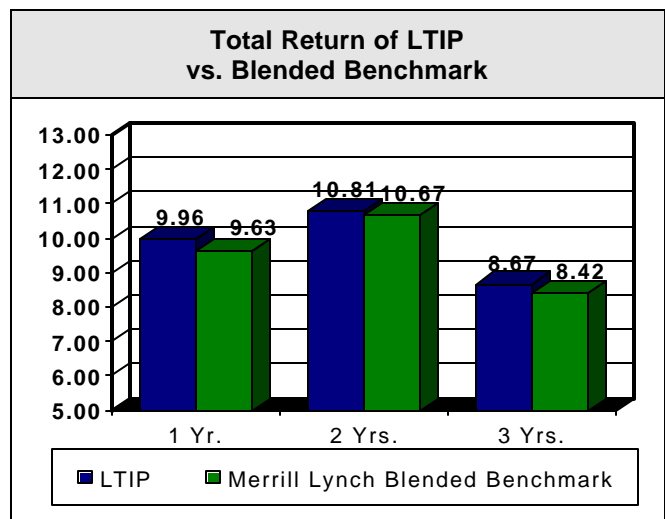
Chart 24

Maturity Range Distribution as of June 30, 2002	
0 — 5 years	2%
5 — 10 years	27%
10 — 20 years	23%
20 — 30 years	45%
30 + years	3%

Chart 23

Distribution by Quality Rating as of June 30, 2002	
AAA	13.2%
AA	36.1%
A	46.6%
BBB	4.1%

Chart 25



Real Estate Investment Portfolio

Performance Review Fiscal Year Ended June 30, 2002

Data as of June 30, 2002

Invested Assets:	\$1,601,305,363
Benchmark:	National Council of Real Estate Investment Fiduciaries (NCREIF)
Management:	Nine investment firms managing 18 separate trusts
Inception:	1984

PORTFOLIO DESCRIPTION

The objective of the Real Estate Investment Portfolio (REIP) is to provide long-term growth of capital while observing the requirements of applicable State law and the principles of prudent investment management. The REIP is expected to generate a "total return" which will equal or exceed that of NCREIF over a trailing 36-month time period. This portfolio represents approximately 3.0% of the assets of the various North Carolina Retirement Systems. Growth of capital will be accomplished by investing and reinvesting a stable flow of current income into the real estate asset class. Positive real rates of return during periods of rising or high inflation, along with a degree of additional diversification, are the goals of this portfolio.

The REIP is constructed to offer both high current income and price appreciation. The portfolio has a varied mix of funds that it utilizes to accomplish this objective. Core portfolios are utilized to provide the base returns for the REIP. It is expected that these portfolios will generate income levels that will grow as property rents are increased and offer the opportunity for price appreciation as well. The REIP also utilizes opportunistic funds which take advantage of pricing anomalies in the market place. These portfolios typically hold their investments for shorter periods of time and incorporate the use of moderate leverage to achieve higher rates of return.

RISK PROFILE

The REIP is utilized as a means of offering solid returns while possessing a lower correlation to the fixed income and equity assets found in the total pension portfolio. Within the REIP, the portfolio is

balanced between core holdings and opportunistic funds.

The core positions offer a stable cash flow component while the opportunistic portfolios attempt to capture significant price appreciation through financial leverage, capital improvements, and other forms of very active management.

PORTFOLIO CHARACTERISTICS

At June 30, 2002, the REIP held the highest concentration of its assets in core real estate. The portfolio held the next highest concentration in opportunistic real estate.

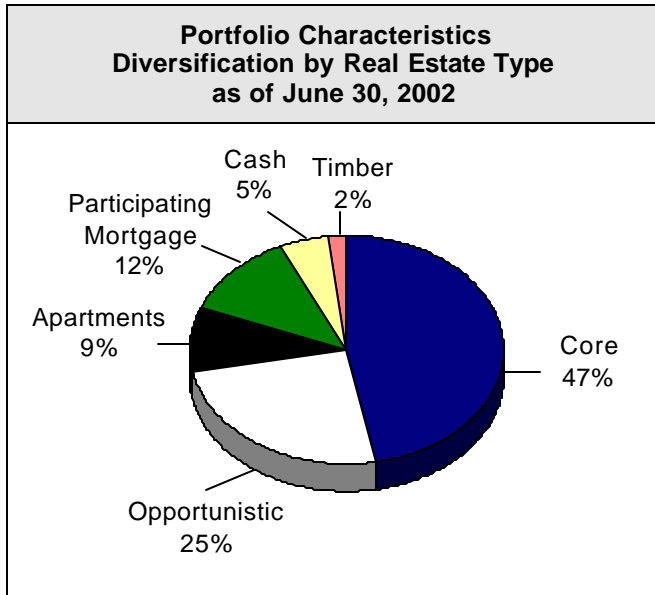
The State Treasurer sets the broad real estate policy and utilizes professional external managers to carry out the mandates. At June 30, the REIP employed nine management firms that currently manage 18 different portfolios. Obviously, some of these firms manage multiple portfolios for the REIP.

The following table reflects the management firms utilized, the amount of assets, the number of portfolios and the types of portfolios managed for the REIP.

As of June 30, 2002

<u>Firm</u>	<u>Total Assets (\$ in 000's)</u>	<u># of Port.</u>	<u>Type</u>
DLJ	\$ 23,561	2	Opportunistic
DRA	17,370	1	Opportunistic
Lend Lease	171,952	4	Opportunistic
J.P. Morgan	220,623	1	Core
Sentinel	197,930	2	Multi-Family Opportunistic
Times Square	299,434	1	Core
UBS Brinson	443,883	2	Participating-Mortgage Core
Wachovia	24,484	1	Timber
Westbrook	116,980	4	Opportunistic

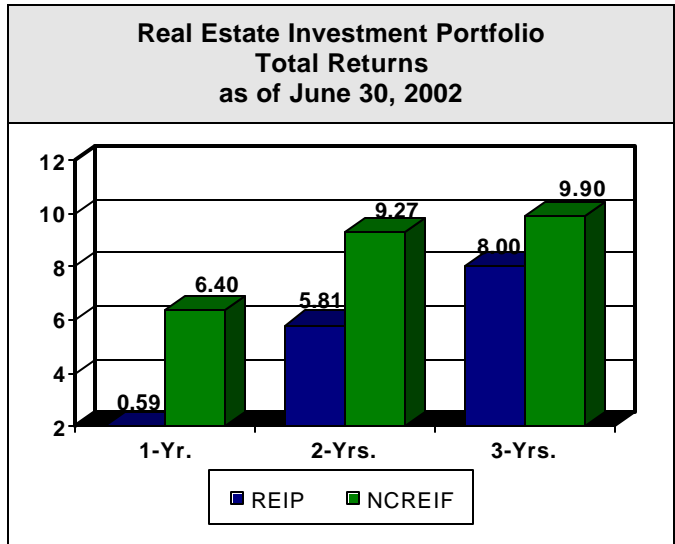
Chart 26



PERFORMANCE SUMMARY

The REIP underperformed the National Council of Real Estate Fiduciaries (NCREIF) benchmark for Fiscal Year 2002, posting a .59% total return versus a 6.40% return for the benchmark. On a trailing three-year time period, the REIP has underperformed the NCREIF by generating a 8.00% total return versus 9.9% for the benchmark.

Chart 27



Alternative Investment Portfolio

Performance Review Fiscal Year Ended June 30, 2002

Data of June 30, 2002

Invested Assets:	\$81,403,545
Benchmark:	The S&P 500 Index is the benchmark used for <u>comparison purposes</u>
Management:	Fourteen firms utilized for the management of 17 venture capital and buyout portfolios plus internal management of cash position and the in-kind stock distributions
Inception:	1988

PORTFOLIO DESCRIPTION

The objective of the Alternative Investment Portfolio (AIP) is to provide, over a period of time (seven-to-ten years), a source of potentially high realized income for the retirement system assets. (The 1990 Short Session of the General Assembly changed the governing statutes, which had restricted these investments to the General and Highway Funds, on a retroactive basis.) This portfolio represents approximately .15% of the assets of the various North Carolina Retirement Systems. The partnership risk is controlled by diversification in industry type, stage of corporate development and geographic location.

The AIP's objective of generating high amounts of realized income over a seven-to-ten year period requires that the partnership portfolio be constructed so that a balance between stage of company development and industry type is maintained. The partnership portfolio uses a combination of early stage, later stage and buyout funds. The early stage funds take a longer period of time to produce returns, but normally provide very strong returns as a result of investments being made in companies very early in their corporate life. To provide returns in the interim, this portfolio invests in later stage and buyout funds that will generally contribute returns sooner than the early stage funds. It is anticipated that these later stage funds will sacrifice some long-term potential in return for quicker recognition of gains. The portfolio also seeks to diversify across industry sectors.

Given the long-term time horizon of these investments, sectors can fall in and out of favor during an investment cycle, so diversification is important. Finally, the portfolio seeks to diversify as to geographic location and the portfolio has some exposure to international venture capital and buyout activity. With markets becoming more and more global, opportunities

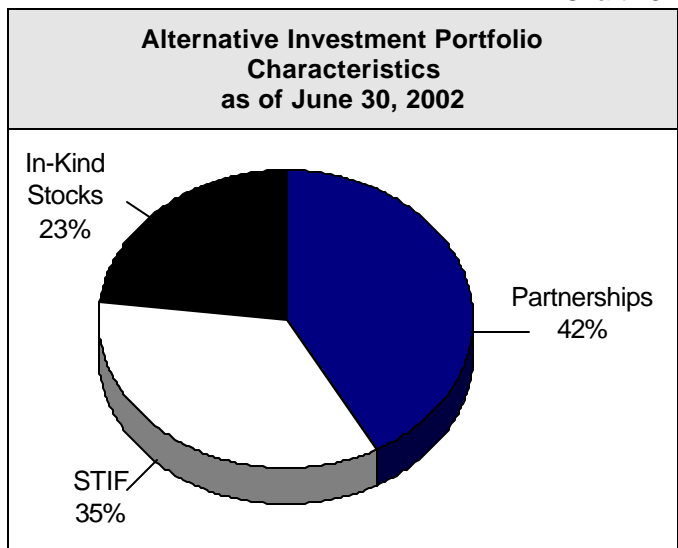
exist to reap substantial returns from overseas investments.

The portfolio also holds stock and cash positions that are the result of partnership distributions. The stock positions are monitored daily and the cash positions are invested in both the LTIP and STIP.

OVERALL PORTFOLIO CHARACTERISTICS

At June 30, 2002, the AIP held 58% of its assets in either in-kind stocks distributions or fixed income investments. The partnership component of the AIP amounted to 42%.

Chart 28



At June 30, 2002, there were 6 different in-kind stock positions held in the AIP. These stocks could be used as a source of capital for future venture commitments. Most of these positions represent either technology or telecommunications companies.

The 35% of the AIP that is held in STIP is the result of cash distributions received from the partnerships.

RISK PROFILE

Venture capital investing is by its nature a higher risk asset class. Investing in new companies or new technologies can pose the risk of losing all of the principal investment, yet at the same time the potential for returns substantially higher than those of other asset classes justifies exposure in the asset class.

With the risk of the asset class acknowledged, the partnership portfolio is structured with certain risk controls utilized. For example, efforts are made not to overweight any one particular industry sector or geographic location. Professional managers utilized for this program are scrutinized to determine that capabilities are in place to identify good investments leading to strong returns. Finally, partnership investments are balanced between stage of development in order to achieve a consistent realized

income stream, rather than sporadic periods of high-income generation.

PARTNERSHIP PORTFOLIO CHARACTERISTICS

As June 30, 2002, the AIP held most of its partnership assets in vintage 1989 portfolios. Nineteen eighty nine marked the first full year that the pension funds began making venture capital investments. As time has progressed, the portfolio continues to add new vintage year portfolios in order to replace those partnerships which will soon terminate as provided in the original contracts. The portfolio also holds the highest percentage of its partnership assets in early stage partnerships. In theory, these partnerships should produce the highest returns. The portfolio has balanced the early stage program with investments in later stage and buyout funds.

The State Treasurer sets the broad venture capital policy and utilizes external professional managers to carry out the mandates. At June 30, the AIP employed fourteen management firms that manage a total of 17 different portfolios. Obviously, several of these firms manage multiple portfolios for the AIP.

The following table reflects the management firms utilized, the market value of the investment, the number of partnerships, and the types of partnerships managed for the AIP.

Chart 29

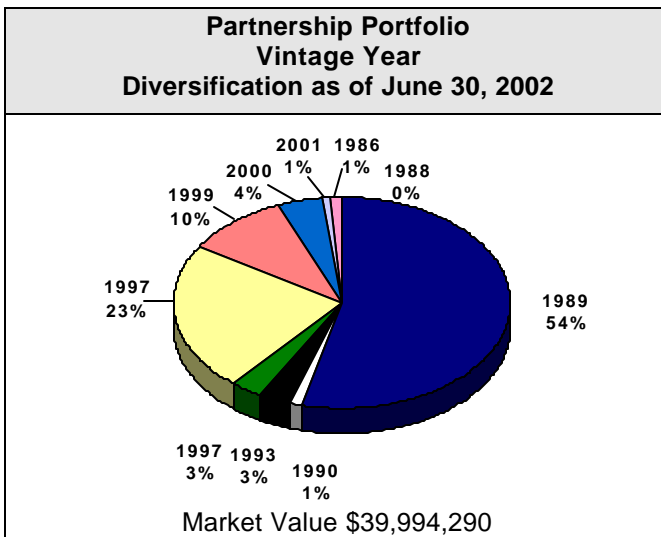
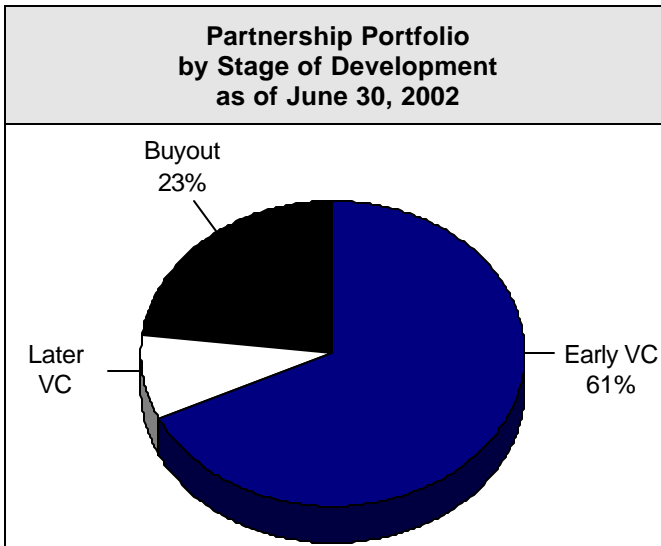


Chart 30



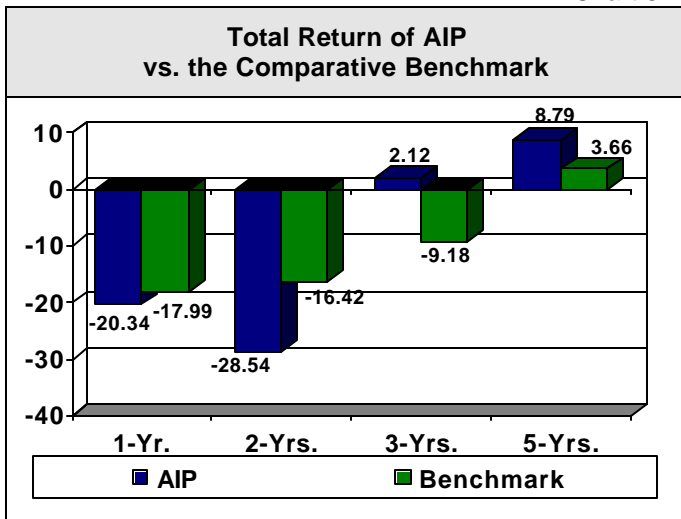
Firm	Total Market Value (\$ in millions)	# of Partnerships	Type
Academy	\$ 3.4	1	Early Stage
A.M. Pappas	1.5	1	Later Stage
Aurora	1.0	1	Early Stage
Carolinas Capital	.1	1	Early Stage
DLJ Merchant	5.04	1	Buyout
Franklin-Fairview	2.73	1	Buyout
HarbourVest	.69	1	Later Stage
Highland	.3	1	Early Stage
InterSouth	.62	2	Early Stage
Kitty Hawk	.4	1	Early Stage
KRG	2.20	1	Buyout
Sprout Capital	1.62	2	Early Stage Later Stage
The N.C. Enterprise Corp.	17.3	2	Early Stage
Venture First	.3	1	Early Stage

PERFORMANCE SUMMARY

The AIP recorded a total return of (18.22%) for Fiscal Year 2002. This compares with (17.99%) for the S&P 500.

It is also important to note that the returns for the AIP include not only investments made in 1988, but investments made in 2002. Historically, it takes about six years to begin to see solid performance of a venture capital partnership. By combining partnerships that are relatively new (i.e. going through the “J curve” effect) with those that have been in existence for some time, the returns are somewhat diluted.

Chart 31



Financial Operations Division

The Financial Operations Division was created effective July 1, 2001, to ensure that efficient banking services are provided to all State agencies and institutions, and to ensure that all funds deposited, invested and disbursed through the State Treasurer are properly accounted for and reported. The division is also responsible for managing the fiscal responsibilities of the Department such as budget preparation and control, cash management, payroll, purchasing, and accounts payable. The newly created division is comprised of four sections: Banking Operations, Bank Reconciliation Unit, Statewide Operations and Departmental Operations.



Operational Highlights

- Transitioned all equity assets from multiple trusts and custodian relationships to one trust with one master custodian relationship. This transition to one master custodian allowed for a more efficient securities lending program for equities that is projected to generate annually an additional \$10 million in earnings to the Retirement Trust Funds.
- Negotiated a new master record keeping agreement that provides for a new investment accounting system that ensures more timely reporting and strengthens accounting control over investment transactions.
- Issued an RFP and selected the vendor for the State Treasurer's new core banking system to be developed and implemented by June 30, 2003.
- Initiated a new method of compensating banks for depository services that generated approximately \$3 million in additional investment earnings for the Short-term Investment Portfolio.
- Approximately 225,000 bank deposits, made by 775 different depositing agency locations were processed.
- Some 5,000 electronic warrants totaling \$18.8 billion, to fund vendor payments, payroll, and governmental transfers, were processed.
- Over 24 million State warrants totaling \$24 billion presented through the Federal Reserve Bank were processed against agencies' disbursing accounts.
- On average, over 1,000 images of paid State warrants were viewed by agencies through the Warrant Image Retrieval System each business day.
- Some 1,500 forged and counterfeited State warrants were experienced and handled.
- The value of securities pledged to the State Treasurer to secure public deposits in financial institutions totaled over \$3.7 billion.

Banking Operations

The General Assembly of North Carolina has authorized a centralized system for managing the flow of moneys collected and disbursed by all State departments, agencies, institutions, and universities. Rather than each of these entities having an account with a commercial bank, they maintain accounts with the State Treasurer. The State Treasurer in turn provides each entity the same service that a commercial bank would normally provide. This system assures that the State is the prime beneficiary of the flow of its funds through the commercial banking system in the course of conducting State business. The Banking Operations Section performs the State Treasurer's role of serving as the State's Banker.

Receiving State Moneys

All revenues collected by a State entity on behalf of the State must be deposited with the State Treasurer. To facilitate this requirement, the section has established correspondent depository relationships with various banks and savings institutions in order for those entities to have a convenient location to make their deposits. Relationships are maintained with the seven major banking institutions having a statewide branch network, as well as 65 community banks across the state. Moneys deposited into these depository accounts are concentrated daily in order to fund the State's daily disbursement requirements, with any

excess being made available to the Investment Management Division for investment purposes.

Disbursing State Moneys

State entities disburse funds from their disbursing accounts maintained with the State Treasurer either electronically or by the issuance of warrants (State checks). For funds disbursed electronically, the section facilitates the funding of the electronic files submitted to the originating depository financial institutions. For funds disbursed by warrants, the section has an established arrangement with the Federal Reserve Bank in Charlotte for processing of items presented for payment. The warrants, which bear the State Treasurer's unique ABA transit-routing number, are processed and imaged, with the financial data and images being transmitted to the section for further

validation processing. During fiscal year 2001-2002, over 24 million warrants were processed.

Specialized Banking Functions

Other functions performed by the section are securities processing related. As such, the section is involved in and monitors the activities of the Division's custodian banks, including securities delivery instructions, collection of income and maturities, and the securities lending program. Additionally, the section performs the accounting and monitoring process for the collateralization of public deposits program, which provides for the securing of funds deposited by the State and local units of government with financial institutions, where the funds on deposit exceed the FDIC insurance coverage.

Bank Reconciliation Unit

The Bank Reconciliation Unit reports directly to the Director of the Financial Operations Division for internal control purposes. This unit is responsible for reconciling all of the State Treasurer's bank accounts. The central depository accounts, the Federal Reserve clearing account and cash concentration accounts located in Raleigh are reconciled daily. Other out of

town community bank depository accounts are reconciled monthly. This unit also performs a monthly reconciliation of the State Treasurer's budgetary control records with those of the State Controller to ensure that an accurate system of checks and balances is maintained.

Statewide Operations

The Statewide Operations Section provides the accounting functions for the State Treasurer's investment programs, the retirement trust funds, and the Escheats Trust Fund.

investment fund, market valuations, participant units of ownership and earnings distributions.

Investment Accounting

This section manages the accounting for the State Treasurer's \$62 billion investment pool. The accounting and reporting for the investment pool is very similar to the accounting for mutual funds. The section maintains an accounting system that accounts for the principal and income transactions of each

Retirement and Escheat Fund Accounting

This section maintains the general ledgers for each pension fund, employee benefit trust funds and the Escheat Fund administered by the State Treasurer. All pension payments are processed in the Retirement Systems Division, with oversight by this section. This section reviews the transactions, posts entries to the general ledger and the North Carolina Accounting System (NCAS).

Departmental Operations

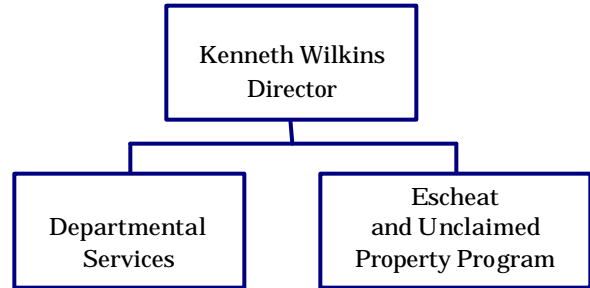
The Departmental Operations section manages all fiscal duties that relate to the administration of the programs of the Department of State Treasurer. These duties include developing and monitoring the operating budget for the department, preparing the payroll for our nearly 300 employees, depositing funds received by the department for various activities, cash management, managing our accounts payable,

accounting for fixed assets, and maintaining the general ledger for the department. In addition, this fiscal year all purchasing responsibility has been added to the duties of this section.

This section works closely with the Office of State Budget and Management and the Office of the State Controller to ensure that we are reporting accurately and timely.

Administrative Services Division

The Administrative Services Division is organized to provide support services to the State Treasurer and the program divisions within the Department. In addition, the Administrative Services Division is also responsible for the administration of the State's Escheat and Unclaimed Property Program.



Operational Highlights

- **\$18,644,820 in net investment income from earnings of the Escheat and Unclaimed Property Fund was submitted to the State Education Assistance Authority to provide 5,500 loans to North Carolina students in State-supported schools of higher education.**
- **\$64,833,337 in escheated and unclaimed property (cash and securities) was received from 5,421 reports submitted.**
- **\$9,607,419 in cash and securities was refunded to 5,701 rightful owners.**

Departmental Services

Departmental Services provides general support to the Department in areas of departmental accounting, personnel management, information systems, and mail and supply room/purchasing functions.

Personnel Management

As of June 30, 2002, the Department of State Treasurer had 292 positions which were assigned as follows:

Personnel Recapitulation	
Administrative Services Division	36
Financial Operations	35
Health and Wellness Trust Fund	5
Information Technology Division	38
Investment and Banking Division	12
State and Local Government	
Finance Division	36
Retirement Systems Division	<u>130</u>
	292

During the past fiscal year, 12 employees were promoted to higher level positions and 32 new employees were hired. In addition, there were 42 employees who separated from employment (nine retired) in the Department.

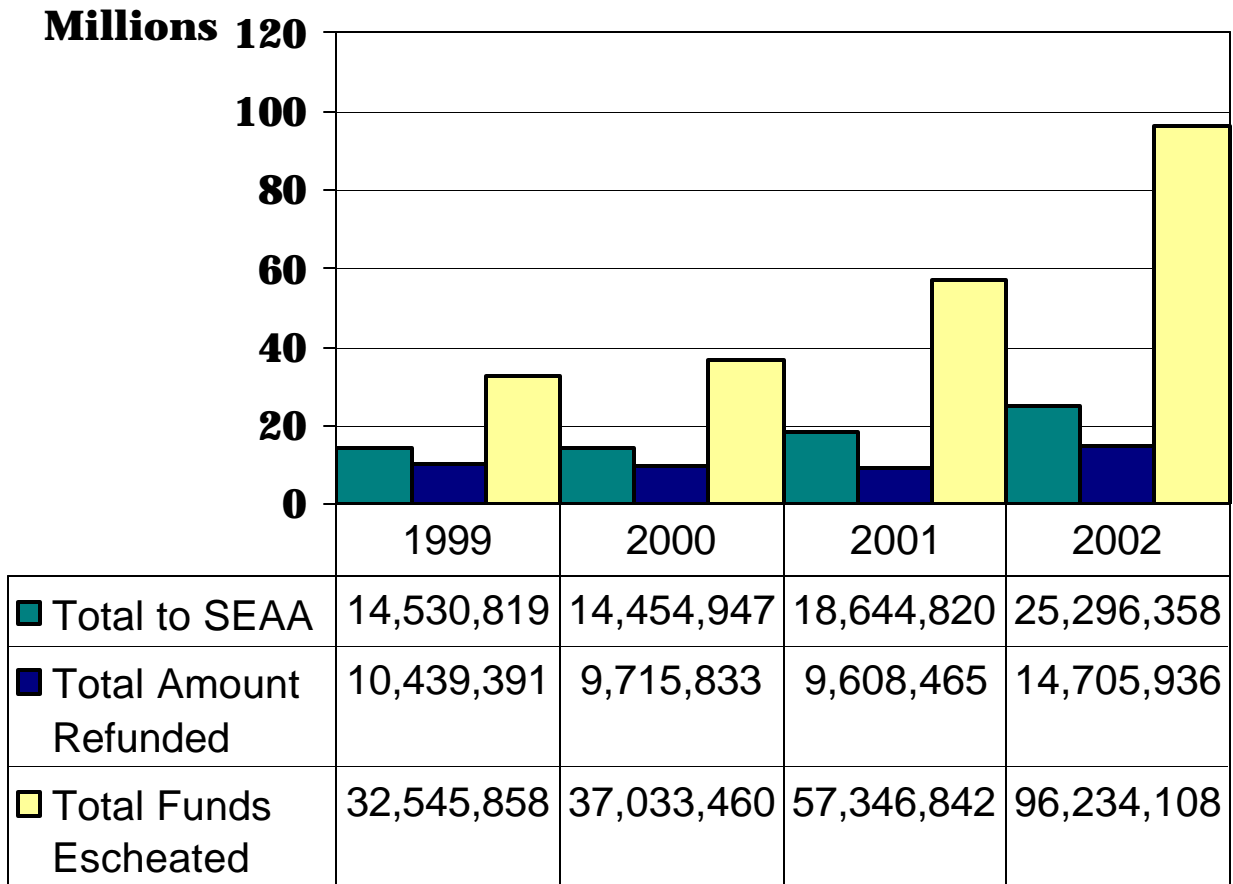
Also this past fiscal year, the following personnel actions were approved by the Office of State Personnel: one position was reallocated up to higher classifications; while zero positions was reallocated down.

Unclaimed Property Program

The State Treasurer’s Office maintains a database of the names and addresses of owners of unclaimed property, and is responsible for recovering and returning such property to all rightful owners. These funds are invested while being held in trust until the owners are located. Interest earnings on those investments are given to the State Education Assistance Authority (SEAA) for student loans and grants. In fiscal year 2002, SEAA received more than \$25 million, which helped 15,000 needy students with loans and grants to North Carolina State-supported schools.

Property is considered unclaimed when the apparent owner fails to communicate interest in it for a period of time, called the dormancy holding period.

Once property has met its dormancy period and the holder has exhausted his resources in locating the owner, the names, addresses and any funds they are holding are escheated to the State Treasurer’s Office, where staffers attempt to locate the owner by various means, including listing names on the website; media coverage through television and newspapers; mailing lists to Clerks of Court; and attending outreach events whereby they perform owner look-up at civic groups and other events that bring together a large crowd, such as the North Carolina State Fair and the Mountain State Fair. We have worked with AARP, state agencies and legislators, providing them listings for their districts.



Statistical Tables

Table of Contents

Table 1	Summary of Investments by Participants.....	A-2
Table 2	Treasurer's Cash Balances	A-3
Table 3	Statement of Departmental Revenues and Expenditures	A-4
Table 4	General Obligation Bonds – Referenda and Authorizations	A-5
Table 5	Installment Purchase Agreements Approved by Purchase.....	A-6
Table 6	Installment And Lease Agreements Approved by the Local Government Commission	A-7
Table 7	Summary of State and Local Government Debt and Authorizations	A-8
Table 8	Annual Debt Requirements for State Bonds — Issued and Outstanding.....	A-9
Table 9	Revenue Bonds and Other Indebtedness of State Authorities and Institutions	A-10
Table 10	Valuation Balance Sheet Showing the Assets and Liabilities of the North Carolina Teachers' and State Employees' Retirement System	A-11
Table 11	Valuation Balance Sheet Showing the Assets and Liabilities of the North Carolina Local Governmental Employees' Retirement System	A-12
Table 12	Valuation Balance Sheet Showing the Assets and Liabilities of the North Carolina Consolidated Judicial Retirement System.....	A-13
Table 13	Valuation Balance Sheet Showing the Assets and Liabilities of the Firemen's and Rescue Squad Workers' Pension Fund.....	A-14

**Summary of Investments by Participants
For the Periods Ended June 30, 2002 and June 30, 2001 (in thousands)**

	June 30, 2002	June 30, 2001
Retirement Trust Funds:		
Teachers' and State Employees' Retirement System	\$41,751,489	\$44,659,909
Local Governmental Employees' Retirement System	10,989,184	11,458,233
North Carolina Firemen's Pension Fund	218,182	229,541
Rescue Squad Workers' Pension Fund	24,697	25,849
Consolidated Judicial Retirement System	315,578	334,591
North Carolina National Guard Pension Fund	45,161	48,017
Legislative Retirement System	25,366	26,330
Total Retirement Trust Funds:	53,369,657	56,782,470
Other Funds:		
General Fund	1,331,519	1,758,994
Other Funds Which Earn Interest for the General Fund	1,011,184	1,139,338
Highway Fund	558,153	394,679
Highway Trust Fund	497,325	782,425
University Funds	1,222,393	1,263,047
Other Independent Trust Funds	3,070,181	2,817,191
Local Political Subdivisions	439,048	395,010
Licensing Boards	5,999	4,526
Total Other Funds	8,135,802	8,555,210
Grand Total All Funds	\$61,505,459	\$65,337,680

Treasurer's Cash Balances
As of June 30, 2002

CONCENTRATION ACCOUNTS

Raleigh, Bank of America of North Carolina	\$10,833,912.68	Lumberton, Lumbee Guaranty Bank	43,375.80
Unemployment Clearing Account	65,114.00	Manteo, The East Carolina Bank	130,985.54
Raleigh, Branch Banking & Trust Co.	1,699,524.29	Moyock, Bank of Currituck	43,503.37
Raleigh, Central Carolina Bank & Trust Co.	967,749.97	Mt Airy, The Community Bank	33,220.85
Raleigh, Centura Bank	504,593.25	Murphy, Carolina Community Bank	93,547.63
Raleigh, First Citizens Bank & Trust Co.	1,581,376.13	Murphy, Macon Savings Bank	67,213.11
Raleigh, First Union National Bank of N.C.	7,737,486.27	Nags Head, The East Carolina Bank	55,361.74
Raleigh, Wachovia Bank of N.C.	7,011,548.77	Newland, Avery County Bank	55,683.74
Total Concentration Accounts	<u>\$30,401,305.36</u>	Newton, Peoples Bank	33,807.82
		North Wilkesboro, Yadkin Valley Bank & Trust Co.	32,596.64

COMMUNITY BANK ACCOUNTS

Aberdeen, First Bank	\$ 70,522.71	Ocracoke, The East Carolina Bank	96,184.19
Ahoskie, Southern Bank & Trust Co.	34,456.39	Pembroke, Lumbee Guaranty Bank	96,751.89
Asheboro, First Nat'l Bank & Trust Co.	45,625.06	Plymouth, Southern Bank & Trust Co.	32,321.32
Bath, Southern Bank & Trust Co.	9,117.10	Polkton, First Bank	31,873.20
Bryson City, Carolina Community Bank	33,744.17	Raleigh, Mechanics & Farmers	6,470.36
Burnsville, First Western Bank	32,158.72	Reidsville, First National Bank of Reidsville	33,421.16
Camden, Bank of Currituck	31,029.09	Robbins, First Bank	44,166.70
Cary, The Fidelity Bank	32,814.32	Robbinsville, Carolina Community Bank	32,732.41
Columbia, The East Carolina Bank	85,587.59	Salemburg, Southern Bank & Trust Co.	68,253.29
Creedmoor, Fidelity Bank	62,519.61	Seven Springs, Southern Bank & Trust Co.	16,533.66
Creswell, The East Carolina Bank	21,532.02	Shelby, Fidelity Bank	33,981.97
Danbury, Old North State Bank	19,920.41	Spruce Pines, First Western Bank	33,231.71
Durham, Mechanics & Farmers Bank	75,765.11	St Pauls, First Bank	33,444.24
Durham, SouthBank, FSB	52,040.97	Swan Quarter, The East Carolina Bank	88,738.11
Edenton, Southern Bank & Trust Co.	18,784.58	Troy, The Fidelity Bank	32,014.33
Englehard, The East Carolina Bank	33,709.48	Troy, First Bank	96,401.69
Fayetteville, United National Bank	96,429.51	W Jefferson, 1st Charter Bank	127,855.49
Franklin, Macon Savings Bank	32,507.42	Walnut Cove, The Community Bank	58,250.61
Gastonia, Fidelity Bank	32,918.13	Wanchese, The East Carolina Bank	58,846.28
Gatesville, Southern Bank & Trust Co.	32,683.81	Waynesville, Carolina Community Bank	32,421.21
Greensboro, Mutual Community Savings Bank	133,833.32	Wentworth, Fidelity Bank	32,582.98
Hampstead, Anchor Bank	33,324.18	West End, First Bank	19,234.32
Harrisburg, First Charter National	53,122.93	Windsor, Southern Bank & Trust Co.	32,877.86
High Point, High Point Bank & Trust Co.	36,347.66	Winton, Southern Bank & Trust Co.	32,113.17
Kernersville, Independence Bank	70,005.04	Yanceyville, Fidelity Bank	72,440.18
Kings Mountain, Fidelity Bank	13,076.29	Total Community Banks Accounts	<u>\$3,190,736.99</u>
Laurinburg, First Scotland Bank	32,482.15	Treasurer's Cash Balance before Adjustments	\$33,592,042.35
Lenoir, Bank of Granite	53,225.18	Transactions in Process	47,319,272.09
Lewiston, Southern Bank & Trust Co.	13,791.72	Treasurer's Adjusted Cash Balances	<u>\$80,911,314.44</u>
Lexington, Lexington State Bank	65,223.75		

**Statement of Departmental Revenues and Expenditures
Budget and Actual (Budgetary Basis)
General Fund (Departmental Activities Only)
For the Fiscal Year Ended June 30, 2002**

	<u>Budget</u>	<u>Actual</u>	Variance Favorable (Unfavorable)
Departmental Expenditures			
General Administration	\$ 997,387	\$ 930,928	\$ 66,459
Escheat Operations	2,173,243	2,144,463	28,780
Investment Management Operations	2,200,801	2,160,333	40,468
Local Government Operations	3,519,717	3,436,682	83,035
State Bond Issuance cost	406,255	406,254	1
Retirement Operations	14,035,744	13,829,441	206,303
Financial Operations:			
Banking	2,423,944	2,408,854	15,090
Accounting	1,383,504	1,354,551	28,953
Total Expenditures	\$ 27,140,595	\$ 26,671,506	\$ 469,089
Departmental Receipts			
General Administration	\$ 997,387	\$ 930,928	\$ (66,459)
Escheat Operations	2,180,243	2,144,463	(35,780)
Investment Management Operations	100	33	(67)
Local Government Operations	714,886	896,878	181,992
State Bond Issuance cost	406,255	406,254	(1)
Retirement Operations	14,035,744	13,829,441	(206,303)
Financial Operations:			
Banking	232,118	233,136	1,018
Accounting	1,359,694	1,354,551	(5,143)
Total Receipts	19,926,427	19,795,684	(130,743)
Appropriation	\$ 7,214,168	\$ 6,875,822	\$ 338,346

**GENERAL OBLIGATION BONDS
LOCAL GOVERNMENT
REFERENDA AND AUTHORIZATIONS
FISCAL YEAR JULY 1, 2001 THROUGH JUNE, 30, 2002**

	Propositions			Bonds	
	# Proposed	# Approved	% Approved	\$ Proposed	\$ Approved
COUNTIES:					
Voted Propositions:					
Schools	10	7	70.00%	\$ 522,300,000	\$ 461,800,000
Community College	2	2	100.00%	\$ 9,000,000	\$ 9,000,000
Library	2	2	100.00%	\$ 15,570,000	\$ 15,570,000
Museum	1	1	100.00%	\$ 5,840,000	\$ 5,840,000
Recreation	1	1	100.00%	\$ 5,550,000	\$ 5,550,000
Co. Bldg-EMS, Sr. Ctr.	2	2	100.00%	\$ 5,200,000	\$ 5,200,000
Parks & Open Space	2	2	100.00%	\$ 20,000,000	\$ 20,000,000
Housing	1	1	100.00%	\$ 4,000,000	\$ 4,000,000
Total	21	18	85.71%	\$ 587,460,000	\$ 526,960,000
Nonvoted Propositions:					
Refunding	9	9	100.00%	166,855,000	166,855,000
2/3rd issues	6	6	100.00%	34,405,000	34,405,000
Total	15	15	100.00%	\$ 201,260,000	\$ 201,260,000
DISTRICTS:					
Voted Propositions:					
Water	3	3	100.00%	\$ 14,115,000	\$ 14,115,000
Total	3	3	100.00%	\$ 14,115,000	\$ 14,115,000
MUNICIPALITIES:					
Voted Propositions:					
Sewer	3	3	100.00%	2,662,000	2,662,000
Water	2	2	100.00%	4,250,000	4,250,000
Beach Renourishment	1	1	100.00%	17,000,000	17,000,000
Total	6	6	100.00%	\$ 23,912,000	\$ 23,912,000
Nonvoted Propositions:					
Refunding	9	9	100.00%	50,500,000	50,500,000
2/3rd issues	4	4	100.00%	58,350,000	58,350,000
Total	13	13	100.00%	\$ 108,850,000	\$ 108,850,000
TOTAL VOTED	30	27	90.00%	\$ 625,487,000	\$ 564,987,000
TOTAL NONVOTED	13	13	100.00%	108,850,000	108,850,000
GRAND TOTALS	43	40	93.02%	\$ 734,337,000	\$ 673,837,000

**Installment Purchase Agreements Approved by Purchase
Fiscal Year July 1, 2001 through June 30, 2002**

MUNICIPALITIES:	Amount
Utilities	
Sanitary Sewer	\$ 9,511,664
Water	<u>\$ 20,698,939</u>
	\$ 30,210,603
Public Buildings	
Convention Center	\$ 1,000,000
Fire Station	\$ 9,707,862
City, Town or Village Hall	\$ 1,800,000
Public Safety	\$ 6,395,434
Public Works	<u>\$ 1,842,624</u>
	\$ 20,745,920
Refunding	\$ 20,964,982
Land Acquisition	\$ 10,903,729
Recreation	\$ 19,752,314
Streets & Sidewalks	\$ 2,376,091
Other	\$ 7,987,300
Equipment	<u>\$ 62,430,997</u>
	<u>\$ 175,371,936</u>
 COUNTIES:	
Schools	\$ 138,506,687
Public Buildings	
Emergency Medical Services	\$ 275,000
Health & Social Services	<u>\$ 3,000,000</u>
	\$ 3,275,000
Courthouse/Law Enforcement/Jail	\$ 52,530,257
Hospital	\$ 6,000,000
Refunding	\$ 51,453,550
Utilities	
Water	\$ 13,805,973
Sanitary Sewer	\$ 8,330,440
Solid Waste	<u>\$ 4,000,000</u>
	\$ 26,136,413
Other	\$ 4,431,159
Community College	\$ 2,200,000
Recreation	\$ 4,750,000
Industrial Development	\$ 2,324,136
Parking	\$ 10,157,177
Library	<u>\$ 4,738,773</u>
	<u>\$ 306,503,152</u>
 COMMUNITY COLLEGES:	
Guaranteed Energy Savings Contracts	<u>\$ 9,715,464</u>
 AUTHORITIES:	
Adult Day/Mental Health Center	\$ 300,000
Energy Conservation	<u>\$ 1,994,586</u>
	<u>\$ 2,294,586</u>
 GRAND TOTAL	 <u>\$ 493,885,138</u>

Installment and Lease Agreements
Approved by the Local Government Commission
Fiscal Years ended June 30, 2000, 2001 and 2002

	<u>FY</u>	<u>2001-02</u>	<u>FY</u>	<u>2000-01</u>	<u>FY</u>	<u>1999-00</u>
	<u>No.</u>	<u>Amt.</u>	<u>No.</u>	<u>Amt.</u>	<u>No.</u>	<u>Amt.</u>
Counties	37	\$ 304.3	51	\$433.8	40	\$405.5
Municipalities	46	175.4	49	270.3	60	160.0
Authorities/Districts	2	2.3	0	-	4	77.5
Boards of Education	3	5.8	0	-	2	1.5
Community Colleges	4	6.1	2	2.8	0	-
TOTAL	<u>92</u>	<u>\$ 493.9</u>	<u>102</u>	<u>\$706.9</u>	<u>106</u>	<u>\$644.5</u>

**SUMMARY OF STATE AND LOCAL GOVERNMENT
DEBT AND AUTHORIZATION
AT JUNE 30, 2002**

	General Obligations			Non-General Obligations Bonds	Industrial Revenue Bonds	Total Indebtedness	General Obligation Authorized and Unissued Bonds
	Bonds	Other	Total				
State	\$ 3,458,244,986	\$ -	\$ 3,458,244,986	\$ -	\$ -	\$ 3,458,244,986	\$ 3,765,000,000
State Authorities and Institutions	\$ -	\$ -	\$ -	\$ 14,208,612,487	\$ 4,300,000	\$ 14,212,912,487	\$ -
Totals	\$ 3,458,244,986	\$ -	\$ 3,458,244,986	\$ 14,208,612,487	\$ 4,300,000	\$ 17,671,157,473	\$ 3,765,000,000
Counties	\$ 4,806,267,931	\$ 3,185,000	\$ 4,809,452,931	\$ 2,290,417,898	\$ -	\$ 7,099,870,829	\$ 1,698,229,000
Municipalities	\$ 2,435,847,336	\$ 34,046,000	\$ 2,469,893,336	\$ 3,428,853,612	\$ -	\$ 5,898,746,948	\$ 846,160,100
Districts	\$ 292,238,130	\$ 26,570,000	\$ 318,808,130	\$ 159,032,783	\$ -	\$ 477,840,913	\$ 153,912,500
Authorities	\$ -	\$ -	\$ -	\$ 1,230,043,334	\$ 2,009,654,796	\$ 3,239,698,130	\$ -
Total	\$ 7,534,353,397	\$ 63,801,000	\$ 7,598,154,397	\$ 7,108,347,627	\$ 2,009,654,796	\$ 16,716,156,820	\$ 2,698,301,600
Grand Total	\$ 10,992,598,383	\$ 63,801,000	\$ 11,056,399,383	\$ 21,316,960,114	\$ 2,013,954,796	\$ 34,387,314,293	\$ 6,463,301,600

¹Outstanding bonded indebtedness above does not include the bonded indebtedness for which funds have been escrowed from advance refunding proceeds or other sources to cover the debt.

²Other General Obligations above includes Literary Fund Loans and Bond Anticipation Notes.

ANNUAL DEBT SERVICE REQUIREMENTS FOR STATE BONDS ISSUED AND OUTSTANDING AT JUNE 30, 2002

Fiscal Year	General		Highway		Total	
	Existing Debt		Existing Debt		Existing Debt	
	Principal	Principal & Interest	Principal	Principal & Interest	Principal	Principal & Interest ¹
2002-03	\$ 187,447,158.00	\$ 345,036,318.17	\$ 16,675,000.00	\$ 25,356,425.00	\$ 204,122,158.00	\$ 370,392,743.17
2003-04	187,293,448.80	336,256,064.84	16,675,000.00	24,606,050.00	\$ 203,968,448.80	\$ 360,862,114.84
2004-05	187,652,952.60	327,833,419.84	16,675,000.00	23,855,675.00	\$ 204,327,952.60	\$ 351,689,094.84
2005-06	187,465,431.80	318,648,819.84	16,675,000.00	23,105,300.00	\$ 204,140,431.80	\$ 341,754,119.84
2006-07	187,310,722.90	309,483,509.84	16,675,000.00	22,354,925.00	\$ 203,985,722.90	\$ 331,838,434.84
2007-08	187,580,014.55	300,734,954.84	16,675,000.00	21,604,550.00	\$ 204,255,014.55	\$ 322,339,504.84
2008-09	187,395,257.30	291,376,044.84	16,675,000.00	20,837,500.00	\$ 204,070,257.30	\$ 312,213,544.84
2009-10	187,550,000.00	280,858,574.84	16,675,000.00	20,003,750.00	\$ 204,225,000.00	\$ 300,862,324.84
2010-11	187,525,000.00	271,551,424.84	16,675,000.00	19,170,000.00	\$ 204,200,000.00	\$ 290,721,424.84
2011-12	187,500,000.00	262,205,349.84	16,675,000.00	18,336,250.00	\$ 204,175,000.00	\$ 280,541,599.84
2012-13	187,480,000.00	252,754,016.52	16,550,000.00	17,377,500.00	\$ 204,030,000.00	\$ 270,131,516.52
2013-14	187,465,000.00	243,767,016.68			\$ 187,465,000.00	\$ 243,767,016.68
2014-15	187,450,000.00	234,780,766.80			\$ 187,450,000.00	\$ 234,780,766.80
2015-16	187,430,000.00	225,790,266.52			\$ 187,430,000.00	\$ 225,790,266.52
2016-17	187,500,000.00	216,073,516.68			\$ 187,500,000.00	\$ 216,073,516.68
2017-18	187,500,000.00	207,175,266.80			\$ 187,500,000.00	\$ 207,175,266.80
2018-19	181,400,000.00	192,467,599.84			\$ 181,400,000.00	\$ 192,467,599.84
2019-20	75,000,000.00	78,509,999.84			\$ 75,000,000.00	\$ 78,509,999.84
2020-21	19,000,000.00	19,696,666.52			\$ 19,000,000.00	\$ 19,696,666.52
	<u>\$ 3,274,944,985.95</u>	<u>\$ 4,714,999,597.93</u>	<u>\$ 183,300,000</u>	<u>\$ 236,607,925</u>	<u>\$ 3,458,244,985.95</u>	<u>\$ 4,951,607,522.93</u>

**REVENUE BONDS AND OTHER INDEBTEDNESS OF STATE
AUTHORITIES AND INSTITUTIONS
AT JUNE 30, 2002**

Appalachian State University	\$ 83,144,000
East Carolina University	59,905,000
Elizabeth City State University	4,905,000
Fayetteville State University	3,765,000
North Carolina A & T State University	17,280,000
North Carolina Central University	11,050,000
North Carolina School of the Arts	4,910,000
North Carolina State University at Raleigh	87,092,000
University of North Carolina at Asheville	19,730,000
University of North Carolina at Chapel Hill	382,247,579
University of North Carolina at Charlotte	69,820,000
University of North Carolina at Greensboro	76,497,000
University of North Carolina at Pembroke	4,625,000
University of North Carolina at Wilmington	39,035,000
Western Carolina University	8,113,000
Winston-Salem State University	11,660,000
North Carolina Capital Facilities Finance Agency	1,257,164,275
North Carolina Eastern Municipal Power Agency	3,144,767,000
North Carolina Housing Finance Agency	1,348,072,000
North Carolina Medical Care Commission	4,302,858,578
North Carolina Municipal Power Agency No. 1	2,152,928,000
North Carolina State Education Assistance Authority	1,103,406,000
North Carolina State Ports Authority	<u>19,938,055</u>
Total	<u>\$ 14,212,912,487</u>

Source: Chief fiscal officer of each authority or institution.

Table 10

Valuation Balance Sheet
Showing the Assets and Liabilities
of the North Carolina
Teachers' and State Employees' Retirement System

ASSETS	<u>December 31, 2001</u>	<u>December 31, 2000</u>
Current Assets:		
Annuity Savings Fund	\$ 6,421,852,841	\$ 6,078,884,844
Pension Accumulation Fund	35,682,233,185	33,694,862,321
Total Current Assets	<u>42,104,086,026</u>	<u>39,773,747,165</u>
Future Member Contributions to Annuity Savings Fund	<u>5,527,713,120</u>	<u>5,256,054,210</u>
Prospective Contributions to Pension Accumulation Fund		
Normal Contributions	6,144,974,418	5,781,659,631
Accrued liability contributions	(4,390,422,826)	(4,524,977,179)
Undistributed gain contributions	98,550,093	1,056,814,998
Total Prospective Contributions	<u>1,853,101,685</u>	<u>2,313,497,450</u>
Total Assets	<u>\$ 49,484,900,831</u>	<u>\$ 47,343,298,825</u>
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 6,421,852,841	\$ 6,078,884,844
Future member contributions	5,527,713,120	5,256,054,210
Total Contributions to Annuity Savings Fund	<u>11,949,565,961</u>	<u>11,334,939,054</u>
Pension Accumulation Fund:		
Benefits currently in payment	16,308,089,907	14,943,297,371
Benefits to be paid to current active members	20,792,144,356	19,696,610,432
Reserve for increases in retirement allowances effective July 1, 2002 (July 1, 2000 for December 31, 2000 figures)	336,550,514	311,636,970
Reserve from undistributed gains	98,550,093	1,056,814,998
Total Benefits Payable from Pension Accumulation Fund	<u>37,535,334,870</u>	<u>36,008,359,771</u>
Total Liabilities	<u>\$ 49,484,900,831</u>	<u>\$ 47,343,298,825</u>

Table 11

Valuation Balance Sheet
Showing the Assets and Liabilities
of the North Carolina
Local Governmental Employees' Retirement System

ASSETS	December 31, 2001	December 31, 2000
Current Assets:		
Annuity Savings Fund	\$ 2,094,105,014	\$ 1,927,995,942
Pension Accumulation Fund	8,669,927,020	7,964,808,639
Total Current Assets	10,764,032,034	9,892,804,581
Future Member Contributions to Annuity Savings Fund	2,134,912,134	2,001,310,620
Prospective Contributions to Pension Accumulation Fund		
Normal Contributions	1,274,570,909	1,094,939,937
Accrued liability contributions	72,427,629	74,743,188
Undistributed gain contributions	408,247,921	482,338,338
Total Prospective Contributions	1,755,246,459	1,652,021,463
Total Assets	\$ 14,654,190,627	\$ 13,546,136,664
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 2,094,105,014	\$ 1,927,995,942
Future member contributions	2,134,912,134	2,001,310,620
Total Contributions to Annuity Savings Fund	4,229,017,148	3,929,306,562
Pension Accumulation Fund:		
Benefits currently in payment	3,549,931,729	3,222,660,002
Benefits to be paid to current active members	6,392,657,970	5,788,831,040
Reserve for increases in retirement allowances effective July 1, 2002 (July 1, 2001 for December 31, 2000 figures)	74,335,859	123,000,722
Reserve from undistributed gains	408,247,921	482,338,338
Total Benefits Payable from Pension Accumulation Fund	10,425,173,479	9,616,830,102
Total Liabilities	\$ 14,654,190,627	\$ 13,546,136,664

Table 12

Valuation Balance Sheet
Showing the Assets and Liabilities
of the North Carolina
Consolidated Judicial Retirement System

ASSETS	<u>December 31, 2001</u>	<u>December 31, 2000</u>
Current Assets:		
Annuity Savings Fund	\$ 31,154,848	\$ 30,073,458
Pension Accumulation Fund	280,066,096	261,733,340
Total Current Assets	<u>311,220,944</u>	<u>291,806,798</u>
Future Member Contributions to Annuity Savings Fund	<u>36,997,536</u>	<u>33,535,767</u>
Prospective Contributions to Pension Accumulation Fund		
Normal Contributions	103,050,681	92,428,675
Accrued liability contributions	(25,528,777)	(22,625,393)
Undistributed gain contributions	5,381,386	6,907,032
Total Prospective Contributions	<u>82,903,290</u>	<u>76,710,314</u>
Total Assets	<u>\$ 431,121,770</u>	<u>\$ 402,052,879</u>
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 31,154,848	\$ 30,073,458
Future member contributions	36,997,536	33,535,767
Total Contributions to Annuity Savings Fund	<u>68,152,384</u>	<u>63,609,225</u>
Pension Accumulation Fund:		
Benefits currently in payment	146,821,585	128,416,867
Benefits to be paid to current active members	208,705,495	200,436,517
Reserve for increases in retirement allowances effective July 1, 2002 (July 1, 2001 for December 31, 2000 figures)	2,060,920	2,683,238
Reserve from undistributed gains	5,381,386	6,907,032
Total Benefits Payable from Pension Accumulation Fund	<u>362,969,386</u>	<u>338,443,654</u>
Total Liabilities	<u>\$ 431,121,770</u>	<u>\$ 402,052,879</u>

Valuation Balance Sheet
Showing the Assets and Liabilities
of the North Carolina
Firemen's And Rescue Squad Workers' Pension Fund

ASSETS	<u>June 30, 2001</u>	<u>June 30, 2000</u>
Current Assets:		
Annuity Savings Fund	\$ 27,021,271	\$ 23,651,274
Pension Accumulation Fund	198,254,967	179,099,524
Total Current Assets	<u>225,276,238</u>	<u>202,750,798</u>
Future Member Contributions to Annuity Savings Fund	<u>20,114,028</u>	<u>19,393,301</u>
Prospective Contributions to Pension Accumulation Fund		
Normal Contributions	29,830,069	28,690,924
Accrued liability contributions	5,519,663	37,584,202
Total Prospective Contributions	<u>35,349,732</u>	<u>66,275,126</u>
Total Assets	<u>\$ 280,739,998</u>	<u>\$ 288,419,225</u>
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 27,021,271	\$ 23,651,274
Future member contributions	20,114,028	19,393,301
Total Contributions to Annuity Savings Fund	<u>47,135,299</u>	<u>43,044,575</u>
Pension Accumulation Fund:		
Benefits currently in payment	119,688,831	110,109,857
Benefits to be paid to current active members	113,915,868	135,264,793
Total Benefits Payable from Pension Accumulation Fund	<u>233,604,699</u>	<u>245,374,650</u>
Total Liabilities	<u>\$ 280,739,998</u>	<u>\$ 288,419,225</u>

If you do not wish to remain on the mailing list to receive this publication, please complete the section below and mail it immediately to:

Richard H. Moore
Treasurer, State of North Carolina
325 North Salisbury Street
Raleigh, North Carolina 27603-1385

TEAR HERE

Please discontinue sending the Annual Report of the State Treasurer of North Carolina to: (Please print or type name and address)

NAME _____ ID# (found on mailing label) _____

ADDRESS _____

CITY _____ STATE _____ ZIP _____

SIGNATURE _____

