

THE STATE TREASURER'S
**ANNUAL
REPORT**

TO THE PEOPLE OF
NORTH CAROLINA



North Carolina Department
of State Treasurer
FISCAL YEAR 2002-2003

325 North Salisbury Street • Raleigh, North Carolina 27603-1385

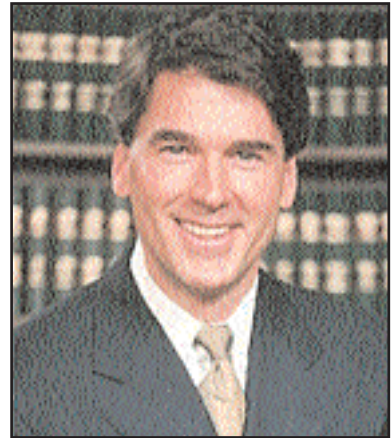


RICHARD H. MOORE
STATE TREASURER

NORTH CAROLINA

DEPARTMENT OF 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 duties and responsibilities of the Department of the State Treasurer. I hope you find this useful in developing a deeper understanding of the Department. I greatly appreciate the efforts of our staff to improve the efficiency and effectiveness of our operation on behalf of the taxpayers of North Carolina.

As the 13th popularly elected State Treasurer, it is both a great honor and challenge to follow a long line of respected public-minded occupants of this important office. While our agency'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 doing what is needed to maintain North Carolina's hard-earned reputation for credit worthiness and continuing a conservative and prudent investment strategy for the \$70 billion in public funds entrusted to us. By continuing to honor the sacred trust made with North Carolina's public employees to safeguard the long-term financial standing of their retirement system, we will continue the tradition of making sure that "good government is indeed a habit" for the Old North State.

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

Sincerely,

Richard H. Moore

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Phone: (919) 508-5176

web site: www.nctreasurer.com

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

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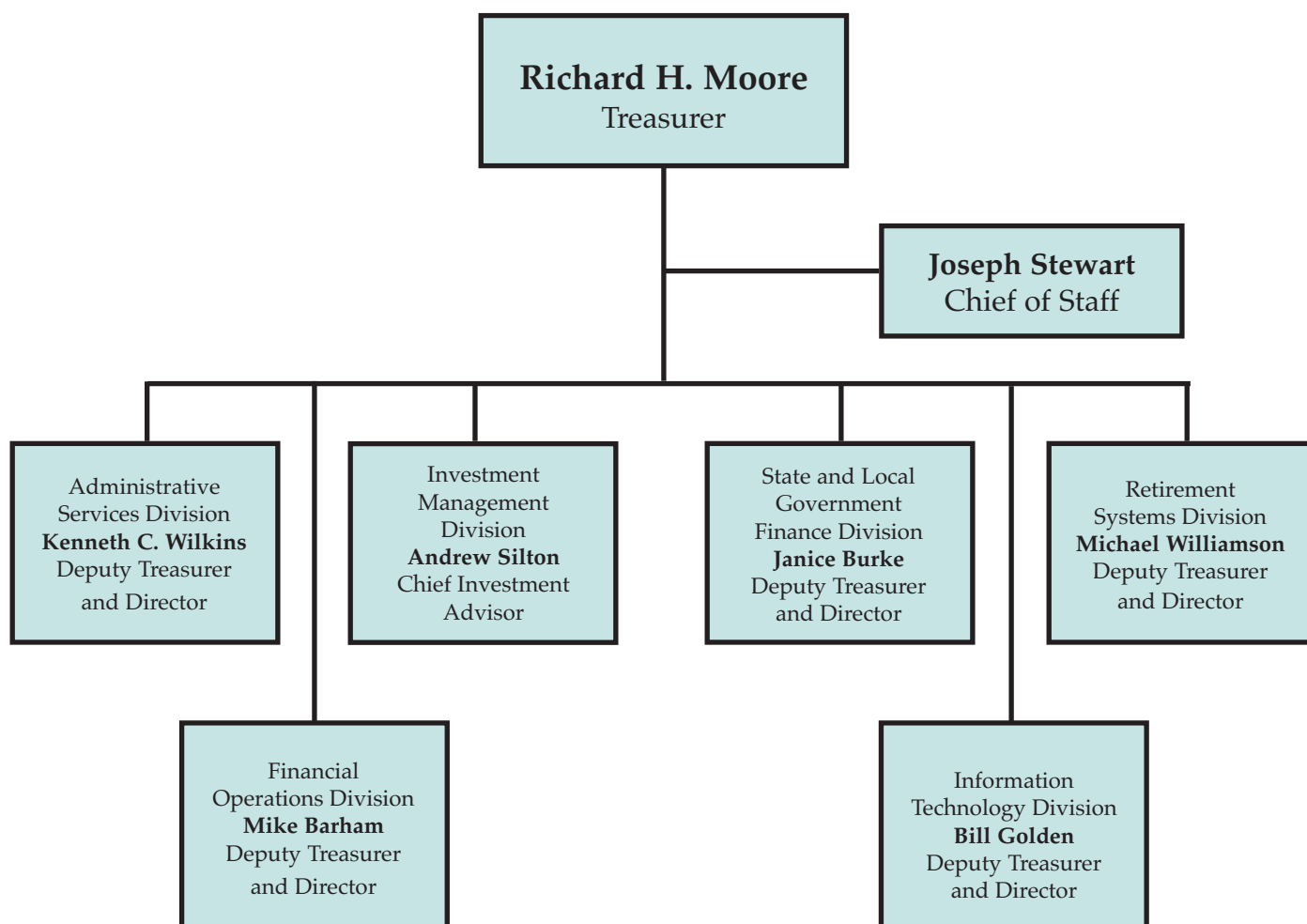
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North Carolina Department of State Treasurer

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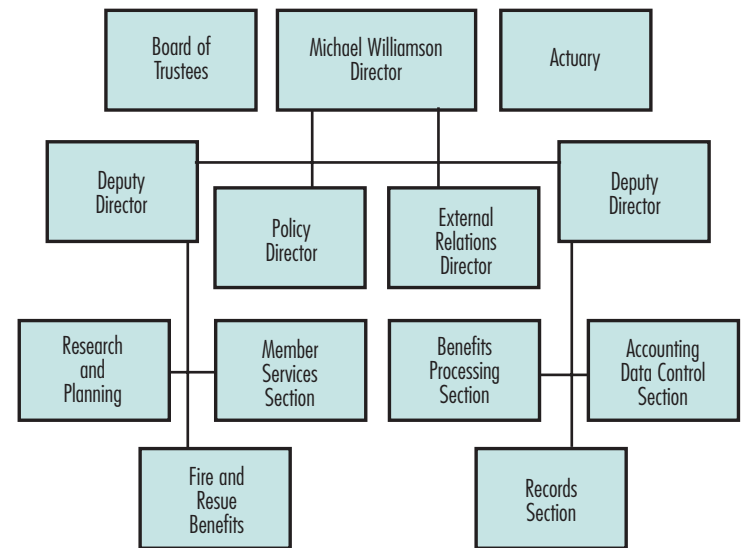


THE STATE TREASURER'S
ANNUAL REPORT

RETIREMENT
SYSTEMS
DIVISION

RETIREMENT SYSTEMS DIVISION

The Retirement Systems Division of the Department of State Treasurer administers the statutory retirement and benefit plans, as authorized by General Assembly of North Carolina, which cover public employees in North Carolina. 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 purpose of the retirement systems and benefit plans is to recruit and retain skilled 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 2003 Session of the General Assembly which resulted in the enactment of laws to:
 - provide cost-of-living adjustments equal to 1.28% to retirees of the Teachers' and State Employees' Retirement System (T.S.E.R.S.), Consolidated Judicial Retirement System (C.J.R.S.), and Legislative Retirement System (L.R.S.);
 - provide a cost-of-living adjustment equal to 2.00% to retirees of the Local Governmental Employees' Retirement System (L.G.E.R.S.); in addition, a catch up increase of 6% was approved for members who retired during or before June, 1982 and a 1.10% increase was approved for members who retired between July 1, 1982 and June 30, 1993;
 - increase the defined benefit accrual rate from 1.82% to 1.85% in the L.G.E.R.S. with a corresponding benefit adjustment to retirees equal to 1.5%;
 - allow members of the Legislative Retirement System to transfer service to the T.S.E.R.S. or C.J.R.S.
 - make technical changes to the T.S.E.R.S. and L.G.E.R.S. including clarifying the definition of "compensation" to specify what is and is not allowable as compensation for retirement purposes and clarifying guaranteed refund, military service purchase and out-of-state service purchase provisions;
 - increase the monthly benefit payment to beneficiaries of the Fireman's and Rescue Squad Workers' Pension Fund from \$156.00 to \$158.00 per month.
- Processed benefits for 11,888 new retirees.
- Processed refunds for 19,130 former public employees.
- Established approximately 47,242 new active member accounts.
- Increased utilization of direct deposit of monthly benefit payments from 147,000 to approximately 156,000 retirees.
- Continued the development and testing of the Disability Automation System. This project is ongoing.
- Updated the Retirement Systems Division Section of the State Treasurer's Web page (www.nctreasurer.com) to include the most currently revised editions of retirement forms, handbooks, and the Frequently Asked Questions.
- Developed and implemented an automated system for requesting and calculating allowable reemployment earnings.

THE BASIC FUNCTIONS

The four major 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 members of the public. 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 member of the public.

In addition to the four major 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 are paid from the retirement trust funds.

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 2002 through June 2003, 11,888 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 4,723 disability claims were reviewed by the Medical Review Board during the 2002-2003 fiscal year. Responsibilities include the calculation and payment of monthly disabili-

ty 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 1381 were issued from July 2002 through June 2003 totaling \$10,576,731.

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 6,600 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 19,130 refunds were processed for the period July 2002 through June 2003.

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 13,393 cost calculations were generated by the Benefits Processing Section for the period July 2002 through June 2003.

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 116,000 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. During 2002-2003 approximately 156,000 retirees' benefits were processed through EFT. Also, over 9,900 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 60,000 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 benefits. Accordingly, during 2002-2003 approximately 106,285 letters and other information was generated in this Section, approximately 9,593 e-mail inquiries were addressed, and approximately 349,402 telephone communications were handled by personal contact with an additional 62,370 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 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. Members nearing retirement may call to schedule an appointment with a retirement counselor.

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 transmis-

sion 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 2002-2003, 9

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 1,263,860 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 13.2 million images have been converted to the imaging system.

SIGNIFICANT ACCOMPLISHMENTS

Legislation

Prior to the convening of the 2003 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 2003 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, 54 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, 2003, in the Teachers' and State Employees' Retirement System, a 1.28% cost of living adjustment (C.O.L.A.) for beneficiaries who commenced retirement on and before July 1, 2002, and for beneficiaries who commenced retirement with effective dates of August 1, 2002 to June 1, 2003, a prorated portion of the 1.28% C.O.L.A. based on the number of months a retirement allowance was paid; (2) provide, effective July 1, 2003, in the Local Governmental Employees' Retirement

System, a 2.00% C.O.L.A. for beneficiaries in receipt of allowances on and before July 1, 2002, and for beneficiaries who commenced retirement with effective dates of August 1, 2002 to June 1, 2003, a prorated portion of the 2.00% C.O.L.A. based on the number of months a retirement allowance was paid; in addition, a catch up increase of 6% was approved for members who retired during or before June, 1982 and a 1.10% increase was approved for members who retired between July 1, 1982 and June 30, 1993; (3) provide, effective July 1, 2003, in the Consolidated Judicial Retirement System, a 1.28% C.O.L.A. for beneficiaries who commenced retirement on and before July 1, 2002, and for beneficiaries who commenced retirement with effective dates of August 1, 2002 to June 1, 2003, a prorated portion of the 1.28% post-retirement increase in their allowances based on the number of months a retirement allowance was paid; (4) provide effective July 1, 2003, in the Legislative Retirement System, a 1.28% C.O.L.A. for beneficiaries who commenced retirement on or before January 1, 2003, and for beneficiaries who commenced retirement with effective dates of February 1, 2003 to June 1, 2003, a prorated portion of the 1.28% was paid; (5) increase, effective July 1, 2003, the defined benefit formula accrual rate in the Local Governmental Employees' Retirement System from 1.82% to 1.85% 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

Local Governmental Employees' Retirement System retirement roll as of June 1, 2003, equal to 1.5% of their June allowances; (7) allow, effective Jan. 1, 2004, after five years of service in the T.S.E.R.S. or C.J.R.S., for the transfer of service from the Legislative Retirement Systems to the T.S.E.R.S. or C.J.R.S.; (8) make technical changes to the T.S.E.R.S. and L.G.E.R.S. including clarifying the definition of "compensation" to specify what is and is not

allowable as compensation for retirement purposes and clarifying guaranteed refund, military service purchase and out-of-state service purchase provisions; (9) make changes, effective July 1, 2003 to the definitions of short-term and long-term disability under the Disability Income Plan; and (10) increase, effective July 1, 2003, the monthly benefit payment to beneficiaries of the Firemen's and Rescue Squad Workers' Pension fund from \$156.00 to \$158.00 per month.

Communications

The Research and Planning Officer, in conjunction with other staff, revised forms for purposes of: 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 and Local Government Employees' Retirement System, application for refund and purchase of State and Local temporary service. An application to purchase creditable service using a rollover, which was effective January 1, 2003, was developed and added to the Web page. 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, 2003 and updated on the Web page.

In addition, Legislation Digests for the State and Local Systems were added to the Hot Topics section on the Web page, and the map and directions to the Retirement System office were updated on 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 2003, the Member Services staff conducted 13 pre-retirement meetings statewide with some 3,097 members in attendance. In addition, the staff also participated in 88 other meetings, seminars, benefit fairs, and conferences relating to retirement benefits, including Benefits and Life Planning Workshops with 10,249 attendees.

The Life Planning Workshop program was a joint venture with the State Employees' Credit Union, the Community College System, State Universities, and State agencies. This program covered legal, health, financial, housing, and family aspects of retirement.

Operational

The Division has continued to promote direct deposit of monthly benefit payments. Between July 1, 2002 and June 30, 2003, the benefit payments of 8,388 retirees were added to the direct deposit group, bringing the total number of monthly payments made by direct deposit to 156,492. This means that about 91% 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,

2003, is estimated to be approximately \$29,000.

The Firemen's and Rescue Squad Workers' Pension Fund began development of an advanced automated system which will assist in identifying delinquent accounts. This project is ongoing.

In the Local Governmental Employees' Retirement System, 9 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.

Effective October 14, 2002, the member services section converted to an appointment only policy for members visiting the Retirement System's office. This action has resulted in greatly reduced waiting times for members.

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.
- Continued converting Excel spreadsheets that were serving as databases to actual databases, thereby providing for multiple simultaneous updates and user access. This project is ongoing.
- Developed and implemented an automated system for requesting and calculating allowable reemployment earnings.

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 implementation of the new imaging system in June, 2002 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 continues to provide 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 to determine the contribution rates necessary to sustain 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 what contribution rate is needed 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 that follow.

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 experienced 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.

Funding 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 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		Local Governmental Employees' Retirement System		Consolidated Judicial Retirement System	
1998	99.4%	1998	99.2%	1998	100.3%
1999	106.4%	1999	99.2%	1999	107.6%
2000	112.8%	2000	99.3%	2000	108.4%
2001	111.6%	2001	99.3%	2001	108.9%
2002	108.4%	2002	99.4%	2002	107.4%

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

Chart 2

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, 2002 was 351,276, and in addition there were 118,129 retired members and beneficiaries of deceased retired members. Invested assets at market value amounted to about \$40.5 billion.

The distribution of the investments of the assets of the State System as of December 31, 2002 was:

Long-Term Fixed Income Investment Fund	\$ 19,167,283,380
Short-Term Fixed Income Investment Fund	57,286,252
Real Estate Investment Fund	1,260,255,647
Equity Investment Fund	19,781,914,626
Venture Capital	277,287,301
Total	\$ 40,544,027,206

Operations of the State System during the calendar year 2002 resulted in total receipts of \$(1,488,239,409) and total expenditures of \$2,009,782,240. 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, 2002, is shown in Table 10. Based on the latest actuary's report, the General Assembly set the employer contribution rate at .00% of covered payroll, effective July 1, 2002, and at .22% of covered payroll, effective July 1, 2003. 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, 2003, the remaining accrued liability for past service.

Teachers' and State Employees' Retirement System of North Carolina Year Ended December 31, 2002

SOURCES OF FUNDS

Employee Contributions	\$ 667,464,920
Employer Contributions	\$ 108,932,000
Other Income	\$ 1,425,662
Investment Income	\$(2,266,061,992)

APPLICATIONS OF FUNDS

Retirement Benefits	\$ 1,933,197,292
Refunds	\$ 69,400,385
Administrative Expenses	\$ 7,140,831
Other Expenses	\$ 43,730
Addition to Reserves For Future Benefits	\$(3,498,021,649)

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, 2002, a total of 856 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, 2002 was 135,948; in addition there were 32,951 retired members and beneficiaries of deceased members. Invested assets at market value amounted to about \$10.9 billion.

The distribution of investments of the assets of the Local System as of December 31, 2002 was:

Long-Term Fixed Income Investment Fund	\$ 5,467,370,989
Short-Term Fixed Income Investment Fund	18,326,396
Real Estate Investment Fund	333,626,844
Equity Investment Fund	4,986,504,208
Venture Capital	74,559,339
Total	\$ 10,880,387,776

Operations of the Local System during the calendar year 2002 resulted in total receipts of \$(72,901,134) and total expenditures of \$464,744,887. 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, 2002, is shown in Table 11.

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, 2003. 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, 2002

SOURCES OF FUNDS	
Employee Contributions	\$ 234,971,389
Employer Contributions	\$ 200,178,952
Other Income	\$ 47,014
Investment Income	\$(508,098,492)

APPLICATIONS OF FUNDS	
Retirement Benefits	\$ 416,228,264
Refunds	\$ 45,927,359
Administrative Expenses	\$ 2,578,354
Other Expenses	\$ 10,910
Addition to Reserves For Future Benefits	\$(537,646,021)

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, 2002, there were 489 active members and 401 retired members and beneficiaries of deceased retired members. The invested assets at market value were about \$308.9 million.

The distribution of the investments of the Judicial System as of December 31, 2002, was:

Long-Term Fixed Income Investment Fund	\$149,859,162
Short-Term Fixed Investment Fund	525,050
Real Estate Investment Fund	9,557,873
Equity Investment Fund	146,810,819
Venture Capital	2,118,158
Total	<u><u>\$308,871,062</u></u>

Operations of the Judicial System during the calendar year 2002 resulted in total receipts of \$(5,588,689) and total expenditures of \$17,051,858. 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, 2002, is shown in Table 12. Based on the actuary's latest report, the General Assembly set the employer contribution rate at 11.92% of covered members' payroll, effective July 1, 2003. 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, 2002

SOURCES OF FUNDS	
Employee Contributions	\$ 3,485,036
Employer Contributions	\$ 6,849,226
Investment Income	\$(15,922,952)

APPLICATIONS OF FUNDS	
Retirement Benefits	\$ 16,897,877
Refunds	\$ 117,004
Administrative Expenses	\$ 36,977
Addition to Reserves For Future Benefits	\$(22,640,548)

Teachers' and State Employees' Benefit Trust (Benefit Trust)

N.C.G.S. 135-5(1) ; 128-27(1); 143-166.20; And 143-166.60

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 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 2002 were:

Life Insurance Payments Calendar Year 2002

Retirement System Membership	Number of Payments	Payment Amount
Teachers' and State Employees'	443	\$14,740,282
Local Governmental Employees'	131	2,504,369

Chart 5

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

SOURCES OF FUNDS

Local Governmental Employees' Retirement System	\$3,469,862	6.0%
Separate Benefits Fund	\$1,171,045	2.0%
Legislative Retirement System	\$0	0%
Retirees' Death Benefit	\$8,114,635	13.9%
Teachers' and State Employees' Retirement System	\$16,158,869	27.7%
Investment Income	\$29,331,741	50.4%

APPLICATIONS OF FUNDS

Local Death Benefits Paid	\$2,504,369	4.3%
Death Benefits and Insurance Paid SIF	\$877,555	1.5%
Administrative Expenses	\$164,166	.3%
Retirees' Death Benefits Paid	\$5,591,183	9.6%
State Death Benefits Paid	\$14,740,282	25.3%
Legislative Death Benefit	\$15,000	0.0%
Addition to Reserves for Future Benefits	\$34,353,599	59.0%

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, 2003, the active membership of the fund was 32,435 while the number of retired members was 8,882. Invested assets at book value amounted to about \$253.5 million.

The distribution of the investments of the assets as of June 30, 2003, was:

Long-Term Fixed Income	
Investment Fund	\$ 114,492,116
Short-Term Fixed Income	
Investment Fund	464,530
Real Estate Investment Fund	7,410,156
Equity Investment Fund	128,977,384
Venture Capital	2,200,147
Total	\$ 253,544,333

Operations of the Pension Fund during the 2003 fiscal year resulted in total receipts of \$28,180,182 and total expenditures of \$17,492,681. Chart 6 presents the distribution of revenues by source and expenditures by purpose.

The latest Actuary's Valuation Balance Sheet, as of June 30, 2002, is shown in Table 13. Based on the latest actuary's report, the General Assembly appropriated

\$6,856,179 for the 2002-03 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, 2002, the remaining accrued liabilities for past service.

Chart 6

Firemen's and Rescue Squad Workers' Pension Fund Year Ended June 30, 2003

SOURCES OF FUNDS	
Appropriation	\$ 6,856,179
Member Contributions	\$ 2,632,278
Investment Income	\$18,690,867
Other Income	\$ 857

APPLICATIONS OF FUNDS	
Pension Benefits	\$16,427,417
Refunds	\$ 474,212
Administrative Expenses	\$ 591,052
Addition to Reserves For Future Benefits	\$10,687,500

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 2002

Beginning Fund Balance		\$ 59,131,336
Additions:		
Employer Contributions	\$ 260,184,190	
Investment Income	<u>0</u>	<u>260,184,190</u>
Deductions:		
Health Premiums Paid	\$ 274,411,011	
Administrative Expense	<u>112,032</u>	<u>274,523,043</u>
Ending Fund Balance		<u>\$ 44,792,483</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 28 former members and officers of the General Assembly in receipt of allowances, with a cost in the year ended December 31, 2002, of some \$40,900. 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 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, 2002, the System had 169 active members, 81 inactive members, and 205 retired members.

Assets on that date totaled \$24,847,952. Operations of the System during calendar year 2002 resulted in total receipts of \$(364,357) and disbursements of \$1,232,345.

Based on the latest actuarial report, the employer contribution rate was set by the General Assembly at .00% of covered payroll, effective July 1, 2003. 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, and at .00% of covered payroll effective July 1, 2003.

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 2001 and 2002.

	<u>2001</u>	<u>2002</u>
Number of Disabled Members	4,490	4,767
New Claims During the Year	838	1,016
Employer Contributions	\$55,638,722	\$56,515,520
Investment Income	\$18,465,752	\$35,509,142
Amount of Benefit Payments	\$40,311,759	\$44,013,882

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 National Guard Pension 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, 2002, there were 2,170 beneficiaries in receipt of

monthly allowances from the Guard Plan at a cost that calendar year of \$2,047,283.

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 2002-03 was \$1,132,455.

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 through September 2003, 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 monitoring investment products.

During the 2002-2003 fiscal year, the Department

began the competitive procurement process and issued a Request for Proposals for the third party administration and investments of the Supplemental Retirement Income plan. After an extensive and thorough review of the proposals, the Board of Trustees awarded the contract for the third-party administration and investments to Prudential Retirement to be effective in September, 2003.

The Plan's number of participating members rose from 178,058 as of July 1, 2002, to 181,084 members as of June 30, 2003, for an increase of over 1.7%. Contributions by employers during this fiscal year totaled \$106,164,027 while salary deferred contributions by members were over \$170,598,892. The total assets at market value of the Plan increased by 8.46% to \$2,387,425,175.

Under the current contract, members may select from a bank investment contract, a money market account, and 16 mutual funds. As of June 30, 2003, 16.06% of the assets were invested in the bank investment con-

tract, 66.40% were invested in the mutual funds, and 12.11% were invested in the money market account. In addition, 5.01% of the assets were loans receivable and 0.41% 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, 2003,

court cost receipts of \$1,768,600 were transferred and credited to the State and local law enforcement officers' accounts.

The Supplemental Retirement Income Plan of North Carolina is 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, 2002, the Fund had total assets in the amount of \$17,322,556.

Benefits from the Fund became payable beginning July 1, 1988. For the year ending December 31, 2002, the Fund paid total benefits in the amount of \$736,706 to 67 retired Registers of Deeds.



THE STATE TREASURER'S
ANNUAL REPORT

INVESTMENT
MANAGEMENT
DIVISION

INVESTMENT MANAGEMENT DIVISION

Structure

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:

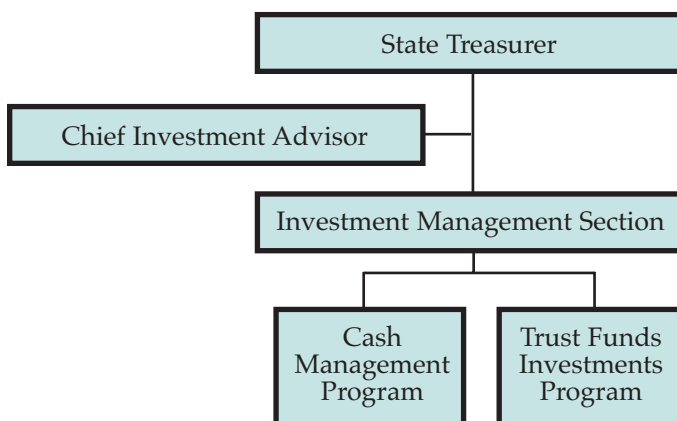
1. Management of the combined assets of the North Carolina Retirement Systems. This is referred to as the Trust Funds Investment Program.
2. Management of the assets of the Cash Management Program.

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.

The State Treasurer administers both the Cash Management and Trust Funds Investment Program. 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 doing so, 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."

As of June 30, 2003, total assets under management were nearly \$63 billion. Of this amount, 12% was assets

of the Cash Management Program and 88% was assets of the Trust Funds Investment Program. This total represents the aggregate assets of 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.



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 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 system assets (the dominant 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 owners of the trusts' assets.

The Investment Pool

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

- A short-term fixed income portfolio that invests in highly liquid money market instruments such as treasuries, agencies and some liquid short-term corporate issues.
- A long-term fixed income portfolio that invests in longer term investment grade corporate securities as well as treasuries, agencies and GNMA's.
- 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. The portfolio also invests in hedge fund of funds.

In addition, there is a bond proceeds pool of approximately \$667 million within the Cash Management Program to hold and invest moneys subject to federal arbitrage regulations.

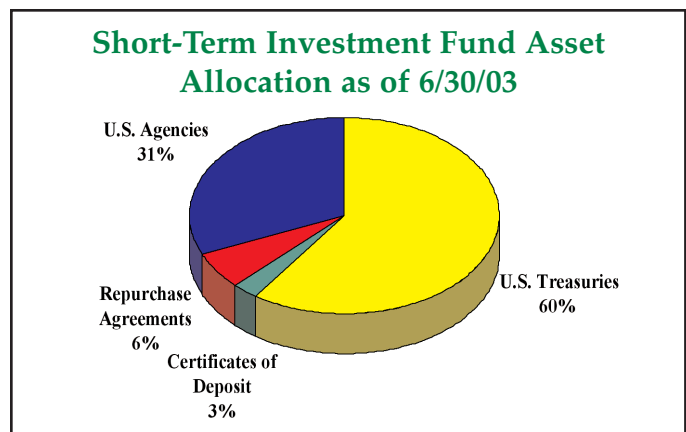
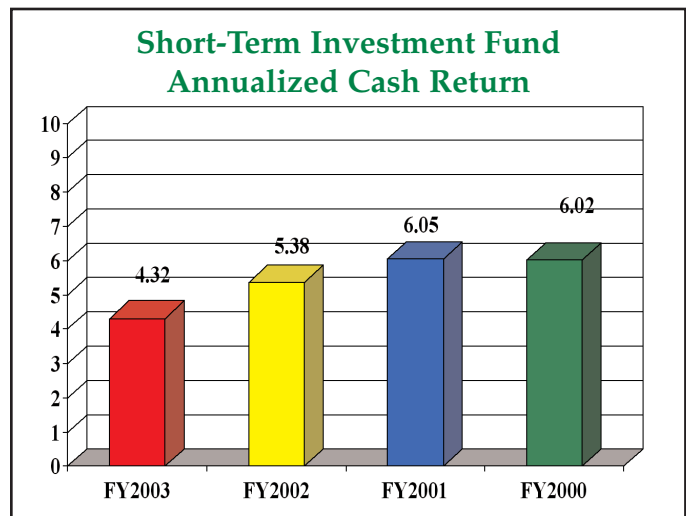
CASH MANAGEMENT REVIEW

Short-Term Investment Fund

The Short-Term Investment Fund (STIF) is an internally managed portfolio of highly liquid fixed income securities. These securities are primarily money market instruments and short to intermediate treasuries and agencies. All bank accounts of the State Treasurer are included in portfolios of the Cash Management Program. 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.

For the fiscal year 2003, the STIF generated a cash return of 4.32%. The benchmark for this portfolio is the U.S. Treasury Two-Year Constant Maturity Notes yield. This benchmark generated a return of 1.81% for the fiscal year.

During the fiscal year, the portfolio continued to fight the downward shift in fixed income yields. As securities matured, the reinvestment rate typically proved to be much lower than the yield generated on the maturing security. Also, interest rates on overnight repurchase agreements moved constantly lower during the year. At the beginning of the fiscal year, the repo rate was hovering somewhere in the 1.7% range and by June 30th, rates had declined to approximately 1.0%. This interest rate environment has made it extremely tough to maintain the historical yields produced by this portfolio and the yields generated by STIF will probably move lower in fiscal year 2004.



The Bond Proceeds Investment Pool was established in 1987 as a separate portfolio in order to comply with Internal Revenue Service 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 this portfolio is to provide maximum income within the parameters of the IRS regulations on bond arbitrage.

SUMMARY OF BROKERS USED DURING FY 2003

Bank of America	Legg Mason
Bear Stearns	Lehman Brothers
Bank of New York	McDonald Investments
Citigroup	Merrill Lynch
Deutsche Bank	Mizuho
A.G. Edwards	Morgan Keegan
First Boston	Morgan Stanley
First Tennessee	Southtrust
Goldman Sachs	UBS Warburg
HSBC Securities	Wachovia

TOP 10 POSITIONS IN STIF AS OF JUNE 30, 2003

ISSUER	COUPON	MATURITY DATE	PAR VALUE
FHLB DISC NT		7/23/2003	250,000,000
FHLB DISC NT		7/25/2003	250,000,000
FHLMC	5.000	1/15/2004	250,000,000
FNMA	5.125	2/13/2004	250,000,000
FNMA	5.625	5/14/2004	250,000,000
US TREAS NOTE	5.750	8/15/2003	250,000,000
US TREAS NOTE	4.250	11/15/2003	250,000,000
US TREAS NOTE	4.750	2/15/2004	250,000,000
US TREAS NOTE	5.875	2/15/2004	250,000,000
US TREAS NOTE	5.875	11/15/2004	250,000,000
US TREAS NOTE	1.625	1/31/2005	250,000,000

PENSION FUND REVIEW

FY 2003 provided welcome relief to the assets managed by the Investment Management Division. The pension fund assets generated a total return of 7.56% for the fiscal year, beating the actuarial assumption of 7.25%. What this means to members of the various retirement systems is that the pension fund achieved a return higher than the required actuarial rate and this allowed the pension fund to retain its fully funded status.

Various studies ranked the performance of the pension plan at or near the top of all public pension funds in the country. This is due to our focus on quality and risk control. Our mission is to maintain the fully funded status of the pension plan. In turbulent markets our portfolios are structured to perform very well. In times of high returns, our portfolio should provide median results, but we are willing to accept this tradeoff for protecting assets in down markets.

Looking back over the past year, the decision to maintain a significant allocation to fixed income provided outstanding benefits to the performance of the overall pension portfolio. Our fixed income portfolio generated a total return of 15.65% for the fiscal year. Over the last three years, the allocation to fixed income has not only produced strong results but has been a key reason that the pension fund has retained its fully funded status.

In FY 2003, the staff continued to restructure the equity portfolio in an attempt to provide more diversifi-

cation across the various equity sub-classes, reduce business risk with certain investment firms managing equity assets for us and find managers who can consistently generate alpha for the portfolio. During the year, we increased our allocation to the mid and small cap areas of the domestic equity market and increased our non-U.S. allocation.

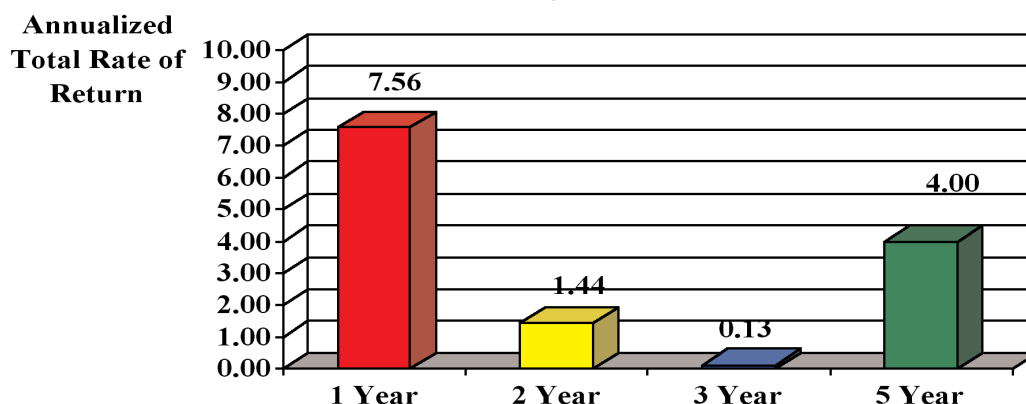
In real estate and alternatives, the staff continued to build up these programs. In July of 2001, the State Treasurer received authority to invest up to 5% of the pension assets in alternative investments. Our due diligence process, which is very vigorous, takes approximately 6-9 months to complete before an investment is made. The staff will continue to work diligently over the next year to continue increasing these assets.

Looking ahead to FY 2004, we feel very comfortable with our overall asset allocation. While there are a variety of risks that we must manage, we feel confident that our investment strategy will produce results that ensure the pension fund maintains its fully funded status. Our staff takes its fiduciary obligations very seriously and will continue to invest the pension assets in a prudent fashion.

Pension Investment Summary as of June 30, 2003

Portfolio Type	Market Value (\$ in 000's)	% of Market Value
US Equities	\$24,505,464	43.96%
Non-US Equities	3,899,488	7.00%
Fixed Income	25,221,062	45.25%
Real Estate	1,632,569	2.93%
Alternatives	484,705	.87%
Total Market Value	\$55,743,288	100.00%

Pension Investment Total Returns as of June 30, 2003



Investment Policy

The Investment Management Division conducts its activities in accordance with the Investment Policy approved by the State Treasurer. This policy covers fiduciary standards of care, asset allocation ranges, rebalanc-

ing requirements and other issues that are important to the management of pension assets. During fiscal year 2003, there were no material changes to the Investment Policy.

Investment Objective

The primary objective of the Investment Division is to generate an annualized return that equals or exceeds the actuarial assumption, which is currently 7.25%.

In order to meet this actuarial requirement, the Investment Division models a policy portfolio that should over time produce a return that exceeds the actuarial requirement with prudent risk guidelines.

On June 30, 2003, the composition of the policy portfolio and its corresponding benchmark ranges were as follows:

- 32% US Large Cap Equity - S&P 500
- 6% US Mid Cap Equity - S&P 400
- 6% US Small Cap Equity -Russell 2000
- 7% Non-US Equity-MSCI AC ex US
- 40% Fixed Income – Merrill Lynch Custom
- 3% Real Estate – NCREIF
- 1% Alternatives – 50% T-bills plus 300 basis points;
50% Venture Economics

During the year, the ranges served the pension funds well as equities fell during the year to 45% in March. This prompted a rebalancing, in which fixed income exposure was reduced and equities were increased.

The Investment Division is constantly monitoring the overall pension fund in an effort to control risk. This is accomplished through the utilization of two tools; an

optimizer and a risk budget. By simulating different market conditions, the staff can better understand how certain market movements can impact the portfolio both in terms of risk and return. During fiscal year 2003, these simulations did not indicate a need to change the policy portfolio or adjust the ranges stipulated by the asset allocation model.

Investment Performance

It has been a difficult environment to produce long-term returns that exceed the actuarial assumption. Because the size of the plan exceeds \$55 billion, the plan will always be subject to the absolute returns generated by the various markets that the plan invests. However, while the Investment Division cannot control the absolute returns of certain markets, what it can do is strive to obtain relative performance that exceeds the market return. This is exactly what occurred in fiscal year 2003. In addition to the strong relative performance recorded in the past year, it is noteworthy that the absolute returns for the pension fund are positive for all time periods measured.

Fiscal Year 2003 Results

For the fiscal year ending June 30, 2003, the pension plan generated a total return of 7.56%. This exceeded the actuarial assumption of 7.25% and also was higher than the policy portfolio's return of 6.68%. The returns generated by the fixed income component of the overall portfolio drove the returns. The equity returns, while slightly negative, outperformed the policy returns by a substantial margin.

Total Pension Plan Performance as of 6/30/03

Asset Class	Portfolio Weight	1 Year	2 Year	3 Year	5 Year
Equity	50.96%	.51%	-7.39%	-8.96%	.28%
Fixed	45.25%	15.65%	12.77%	12.40%	8.45%
Real Estate	2.93%	1.97%	1.28%	4.52%	7.71%
Alternatives	.87%	-5.83%	-13.39%	-21.65%	4.93%
Total Portfolio	100.0%	7.56%	1.44%	.13%	4.0%

*All returns are net of all fees

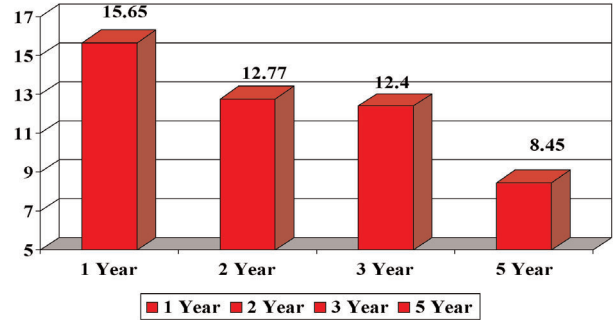
Fixed Income

The fixed income allocation of the pension plan is actively managed through the Long Term Investment Fund (LTIF). For the fiscal year 2003, the LTIF generated a total return of 15.65% compared to a return of 15.02% for the Merrill Lynch Custom Benchmark.

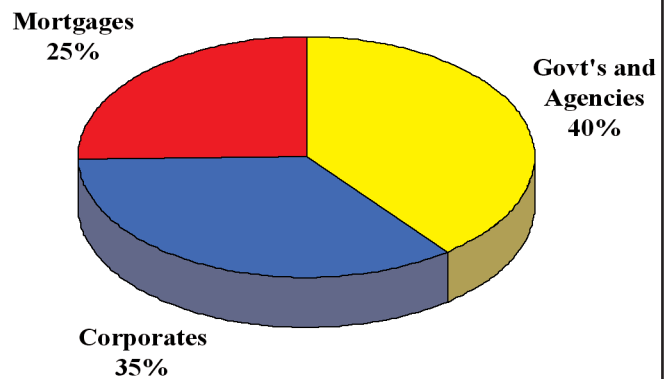
The Investment Division utilizes the LTIF to help match the liabilities of the overall pension plan. Because of this approach, the duration of the portfolio tends to be very long. This certainly helped for fiscal year 2003 as yields declined and spreads tightened. The LTIF continued to build up its BBB exposure during the year, investing in names that were on the higher quality end of the BBB universe. Because spread products produced high returns, this increased allocation worked exceptionally well for the portfolio during the year.

Because of the large move downward in yields and spread compression, fixed income returns are expected to return to more traditional levels. Fiscal year 2004 will be challenging, yet the active management of this portfolio should deliver strong relative performance. Fixed income is not charged a management fee.

Long Term Investment Fund Performance as of 6/30/03



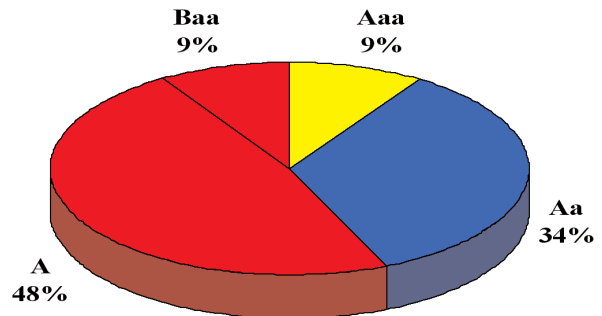
Fixed Income Allocation



TOP 10 CORPORATE POSITIONS BY ISSUER (6/30/03)

Issuer	Market Value (\$mm)
General Electric	455
Bank Of America	367
HSBC	339
Verizon	316
Ford	312
Citigroup	292
J.P. Morgan	292
Wal-Mart	289
SBC	288
Target	243

Corporate Sector Ratings Exposure



Summary Schedule of Fixed Income Brokers Utilized by the Long-Term Investment Fund for Fiscal Year 2003

Broker

Advest	Deutsche Banc	Goldman Sachs	Mellon Investor	UBS Warburg
Banc One	A.G. Edwards	HSBC Securities	Merrill Lynch	Wachovia
Bank of America	Credit Suisse First	JP Morgan Chase	Morgan Keegan	
Bear Stearns Citigroup	Boston	Lehman Brothers	Morgan Stanley	
Countrywide	First Tennessee Bank	McDonald Investment Inc	Raymond James	

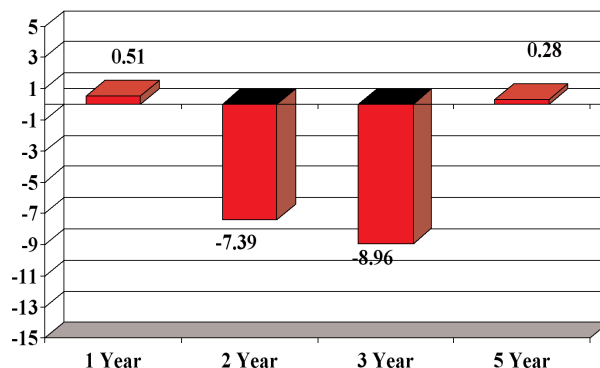
Equities

The equity allocation of the pension fund is actively managed through the Equity Investment Fund (EIF). The State Treasurer and the Investment Division determine the overall asset allocation and select managers to implement those decisions. The Investment Division is charged with monitoring those managers to ensure compliance with the overall objectives of the EIF.

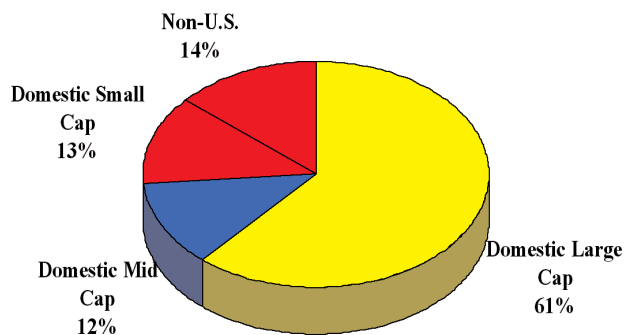
For the fiscal year ended June 30, 2003, the EIF produced a total return of .51% versus a (.14)% for the policy portfolio. This strong relative performance was due to the decision to increase the exposure to mid and small cap stocks in the U.S. and substantial increases in our international exposure.

During the fiscal year, the Investment Division continued to restructure the EIF in order to provide greater diversification, reduce business risk and enhance the probability of generating alpha. The end of calendar year 2003 should complete this restructuring process, which began in 2001. The cost of the program was \$33.1 million.

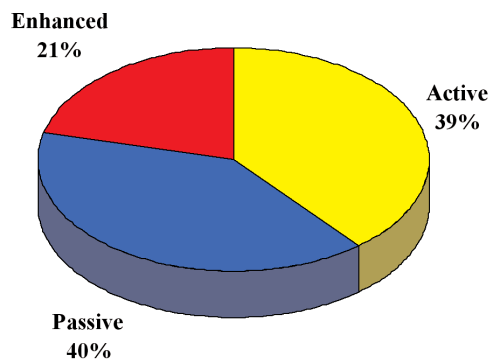
Equity Investment Fund Performance as of 6/30/03



Equity Allocation



Management Style Allocation



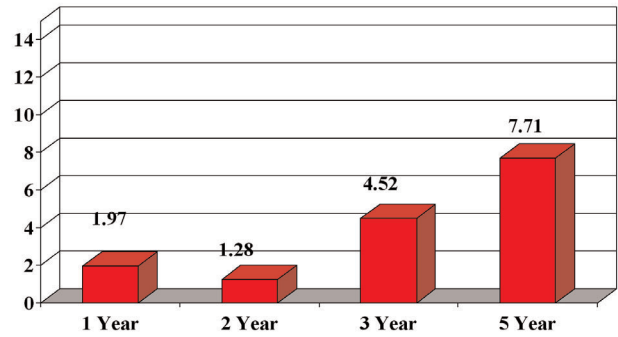
Real Estate

The real estate allocation of the pension fund is actively managed through the Real Estate Investment Fund (REIF). The State Treasurer and the Investment Division determine the overall asset allocation and select managers to implement those decisions. The Investment Division is charged with monitoring those managers to ensure compliance with the overall objectives of the REIF.

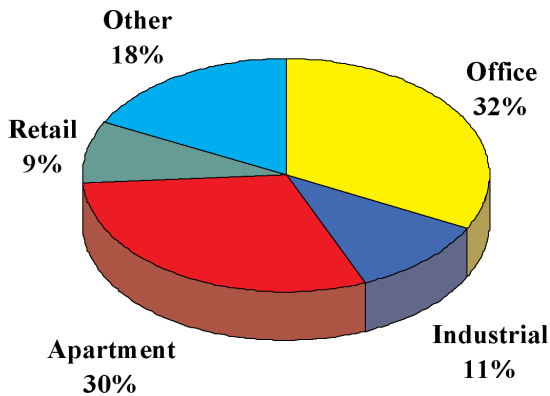
For the fiscal year ended June 30, 2003 the REIF generated a total return of 1.97% versus 7.13% for the National Council for Real Estate Investment Fiduciary (our benchmark). The poor relative return was due to two investments held by the REIF, which did not perform well during the last year. Also, the REIF had a lower allocation to retail properties than the benchmark and this impacted performance given retail's strong returns over that time period.

Despite the poor relative performance, the pension plan has always owned real estate in order to provide diversification and produce returns that are between fixed income and equity. These objectives were met in 2003. There is considerable restructuring that needs to occur in this portfolio and the Investment Division will be devoting a considerable amount of their time to this project in the next fiscal year. The cost of the program was \$17.12 million.

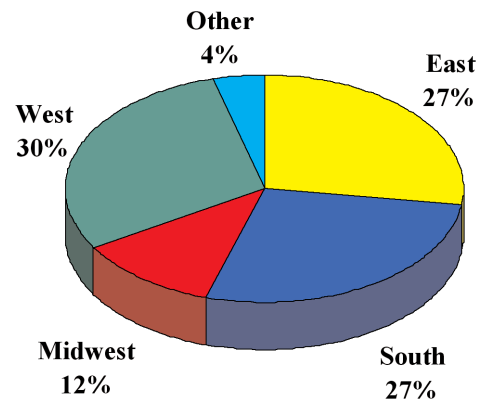
Real Estate Investment Fund Performance as of 6/30/03



Real Estate Property Allocation



Real Estate Geographic Allocation



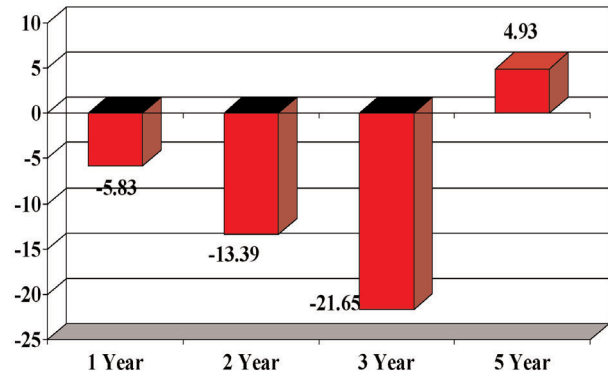
Alternatives

The alternative allocation of the pension fund is actively managed through the Alternative Investment Fund (AIF). Alternatives include private equity and hedge funds. The State Treasurer and the Investment Division determine the overall asset allocation and select managers to implement those decisions. The Investment Division is charged with monitoring those managers to ensure compliance with the overall objectives of the AIF.

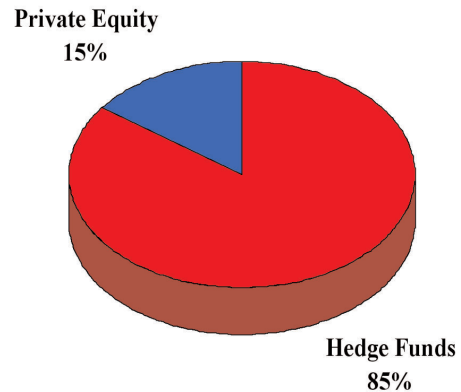
For fiscal year 2003, the AIF generated a total return of (5.83)%. This return was as expected given the fact that new commitments are being made in the private equity space. As these investments are made, it takes several years for results to be generated. While the private equity allocation did not show positive results, what did perform well was the hedge fund allocation.

The Treasurer and Investment Division invest in hedge funds through fund of funds. These hedge fund managers determine the amount that is allocated to various strategies. For the fiscal year, the hedge fund allocation generated a total return of 7.7%. The hedge fund program also produced a standard deviation of only 1.97%. The net result of the hedge fund program has been high returns, diversification and low levels of risk. The cost of the program was \$9.41 million.

Alternative Investment Fund Performance as of 6/30/03



Alternative Allocation



North Carolina Retirement Systems'
Equity Investment Portfolio
Variable Period Returns

(as of June 30, 2003)

Description	Ending Market Value (\$ in 000s)	1 YR Return	3 YR Return	5 YR Return
Equity Investments by Portfolio				
Alliance ACWI-ex US	694,461.00	(4.32)	(13.69)	(2.45)
Alliance Disciplined Growth	623,843.00	(2.03)	(21.12)	(5.67)
Alliance Emerging Markets	161,568.00	8.30	(7.98)	6.19
Alliance Large Cap Passive	1,907,814.00	0.45	(11.06)	(1.50)
Alliance Mid Cap Passive	1,399,116.00	(0.71)	1.29	7.36
Alliance Relative Value	1,275,158.00	4.19	(0.95)	3.88
Alliance Small Cap Passive	371,083.00	(3.45)	2.58	3.81
Ariel Capital Small Cap *	80,828.00	-	-	-
Bank of America Large Cap Passive	1,445,677.00	0.22	(11.28)	(2.54)
Bank of America Mid Cap Passive *	338,483.00	(0.75)	-	-
Bank of America Small Cap Passive *	601,519.00	(3.63)	-	-
BB&T	193,481.00	(4.32)	(0.47)	0.76
BGI Russell 2000 Alpha Tilts *	572,401.00	-	-	-
BGI S&P 500 Alpha Tilts *	1,159,236.00	-	-	-
Capital Guardian International *	646,032.00	-	-	-
Capital Guardian Large Cap *	907,911.00	-	-	-
Earnest Partners Small Cap *	117,938.00	-	-	-
Evergreen Large Cap Passive *	2,292,594.00	0.22	-	-
Evergreen Mid Cap Passive *	788,562.00	(0.78)	-	-
First Citizens Large Cap Passive *	1,830,126.00	0.22	-	-
Fuller and Thaler Small Cap *	98,491.00	-	-	-
GE Asset Management International *	516,581.00	-	-	-
GE Asset Management Large Cap *	680,308.00	-	-	-
Grantham Mayo Van Otterloo International *	533,334.00	-	-	-
Jarislowsky Fraser International *	163,573.00	-	-	-
NCM Focused Equity *	81,242.00	(7.00)	(17.09)	-
Piedmont Strategic Core *	60,364.00	6.27	-	-
SSGA S&P 600 Index *	401,302.00	-	-	-
Sterling Capital Small Cap *	109,740.00	-	-	-
Walter Scott International *	202,108.00	-	-	-
Wellington Biotech *	366,783.00	26.82	1.85	-
Wellington International	981,369.00	(4.42)	(10.91)	(1.86)
Wellington Large Cap	4,158,550.00	0.30	(10.59)	(1.14)
Wellington Mid Cap	895,704.00	(0.26)	1.44	6.26
Wellington Opportunistic Growth *	823,676.00	7.81	(14.99)	-
Wellington S&P 600 Intersection *	454,738.00	(0.80)	3.28	-
Wellington Small Cap 2000	450,962.00	(0.34)	(0.24)	6.26
Total	28,386,656.00	0.51	(8.96)	0.28

* Denotes those investments who did not have either a 1 year, 3 year or 5 year performance record at June 30, 2003

Long-Term Investment Fund Top 100 (as of June 30, 2003)

Security	Coupon	Maturity Date	Security	Coupon	Maturity Date
US TREAS BOND	8.125	8/15/19	GNMA I	6.5	7/15/32
US TREAS BOND	8.5	2/15/20	GNMA I	5.5	5/15/33
US TREAS BOND	7.5	11/15/16	AMOCO CANADA PETE	6.75	9/1/23
US TREAS BOND	8.125	5/15/21	MCDONALDS CORP	7.375	7/15/33
US TREAS BOND	7.25	5/15/16	PACIFIC BELL	6.625	10/15/34
US TREAS BOND	8.125	8/15/21	GNMA I	6	10/15/32
US TREAS BOND	7.875	2/15/21	CHES POT TEL VA	7	7/15/25
US TREAS BOND	7.25	8/15/22	GNMA I	6	1/15/29
GNMA I	5	6/15/33	GEN ELEC CAP	7.5	6/15/09
US TREAS NOTE	5.5	2/15/08	WACHOVIA CORP	6.375	2/1/09
US TREAS BOND	6.25	8/15/23	NATIONSBANK CORP	7.8	9/15/16
FNMA	5.75	2/15/08	US TREAS BOND	7.5	11/15/24
US TREAS BOND	7.125	2/15/23	GNMA I	6	10/15/32
US TREAS BOND	5.375	2/15/31	WAL MART STORES	6.75	10/15/23
FHLMC	5.125	10/15/08	GE INSURANCE	6.45	3/1/19
FNMA	7.125	1/15/30	TARGET CORP	6.35	1/15/11
US TREAS NOTE	5	8/15/11	CITIGROUP INC	6	2/21/12
US TREAS NOTE	6.125	8/15/07	PEPSI BOTTLING HLDS INC	5.625	2/17/09
US TREAS NOTE	4.75	11/15/08	GNMA I	6	1/15/32
GNMA I	6	12/15/32	GNMA I	5	4/15/33
UPS	8.375	4/1/20	FNMA	6.625	9/15/09
US TREAS BOND	9.125	5/15/09	US TREAS BOND	8.75	11/15/08
US TREAS BOND	5.25	11/15/28	FNMA	4.75	2/21/13
FHLMC	6	6/15/11	WAL MART STORES	6.875	8/10/09
GNMA I	6	10/15/32	BANKAMERICA CORP	4.875	1/15/13
US TREAS BOND	8	11/15/21	GEN ELEC CAP	6.125	2/22/11
GNMA I	6	12/15/32	BANKAMERICA CORP	5.125	11/15/14
US TREAS BOND	5.25	2/15/29	HFC	6.75	5/15/11
GNMA I	5	4/15/33	CHUBB CORP	6	11/15/11
FNMA	6	5/15/08	MERCK & CO INC	6.4	3/1/28
US BANK NA	6.3	2/4/14	TARGET CORP	7	7/15/31
US TREAS BOND	6.375	8/15/27	HFC	6.45	2/1/09
FHLMC	4.5	1/15/13	Atlantic Richfield	5.9	4/15/09
GNMA I	6.5	9/15/31	BAYER CORP	7.125	10/1/15
MORGAN JP & CO	6.25	1/15/09	FHLB	4.5	11/15/12
GNMA I	6.5	8/15/31	ARCHER DANIELS	7.125	3/1/13
IBM CORP	6.5	1/15/28	GNMA I	6	1/15/33
GEN ELEC CAP	6.75	3/15/32	ONTARIO-PROV	5.5	10/1/08
WYETH	7.25	3/1/23	GNMA I	5.5	5/15/33
GNMA I	6	12/15/32	UNITED TECH CORP	6.7	8/1/28
FNMA	5.25	1/15/09	GNMA I	5.5	2/15/33
GNMA I	6	2/15/32	SOUTHRN NE TEL	7.25	12/15/33
FNMA	4.375	9/15/12	NORWEST FINL INC	5.625	2/3/09
HYDRO QUEBEC	8.5	12/1/29	GOLDMAN SACHS	6.125	2/15/33
Comcast/AT&T Broadband	9.455	11/15/22	ONTARIO HYDRO	7.45	3/31/13
GNMA I	5.5	5/15/33	FORD MOTOR CRED	7.375	2/1/11
WAL MART STORES	7.25	6/1/13	AOL TIME WARNER	6.875	5/1/12
WISC BELL INC	6.75	8/15/24	METLIFE INC	6.125	12/1/11

Short-Term Holdings by Maturity (as of June 30, 2003)

Security Name	Interest Rate	Maturity Date	Par Value
BANK OF AMERICA NA REPO	0.88	7/1/03	120,000,000.00
WACHOVIA BANK	0.98	7/1/03	50,000,000.00
WACHOVIA BANK	1	7/1/03	100,000,000.00
WACHOVIA BANK	1.05	7/1/03	100,000,000.00
HSBC REPO	1.09	7/1/03	100,000,000.00
FEDERAL HOME LN BK CONS DSC NT	0	7/2/03	100,000,000.00
UNITED STATES TREAS BILLS	0	7/3/03	200,000,000.00
CENTRAL CAROLINA BANK DURHAM	1.375	7/3/03	5,000,000.00
FIRST CHARTER NTL BK CONCORD	1.375	7/3/03	100,000.00
PARKWAY BANK	1.375	7/3/03	1,000,000.00
STERLING SOUTH BANK	1.375	7/3/03	1,700,000.00
FEDERAL HOME LN BK CONS DSC NT	0	7/7/03	100,000,000.00
FEDERAL HOME LN BK CONS DSC NT	0	7/9/03	100,000,000.00
CENTRAL CAROLINA BANK DURHAM	1.375	7/10/03	5,000,000.00
FIRST NATIONAL BANK + TRUST CO	1.375	7/10/03	7,000,000.00
FOUR OAKS BK + TR	1.375	7/10/03	500,000.00
MUTUAL COMMUNITY SAVINGS BANK	1.375	7/10/03	100,000.00
FARMERS + MERC BK GRANITE QUAR	1.375	7/10/03	1,300,000.00
FIRST CHARTER NTL BK CONCORD	1.375	7/10/03	5,000,000.00
FEDERAL HOME LN BK CONS DSC NT	0	7/11/03	100,000,000.00
BANK OF ASHEVILLE	1.375	7/17/03	1,000,000.00
BANK OF GRANITE GRANITE FALLS	1.375	7/17/03	2,500,000.00
FIRST GASTON BANK GASTONIA	1.375	7/17/03	450,000.00
LEXINGTON STATE BANK LEXINGTON	1.375	7/17/03	5,000,000.00
FIRST TRUST BANK CHARLOTTE	1.375	7/17/03	2,000,000.00
THE SCOTTISH BANK	1.375	7/17/03	1,000,000.00
K S BANK	1.375	7/17/03	1,000,000.00
FEDERAL HOME LN BK CONS DSC NT	0	7/23/03	250,000,000.00
BANK OF GRANITE GRANITE FALLS	1.375	7/24/03	3,100,000.00
LEXINGTON STATE BANK LEXINGTON	1.375	7/24/03	5,000,000.00
CENTRAL CAROLINA BANK DURHAM	1.375	7/24/03	5,000,000.00
LUMBEE BANK PEMBROKE	1.375	7/24/03	500,000.00
FEDERAL HOME LN BK CONS DSC NT	0	7/25/03	250,000,000.00
CENTRAL CAROLINA BANK DURHAM	1.375	7/31/03	5,000,000.00
CATAWBA VALLEY BANK	1.375	7/31/03	6,000,000.00
BANK OF GRANITE GRANITE FALLS	1.375	8/7/03	5,000,000.00
PEOPLES BANK NEWTON	1.375	8/7/03	2,000,000.00
MUTUAL COMMUNITY SAVINGS BANK	1.375	8/7/03	100,000.00
FEDERAL HOME LN BK CONS DSC NT	0	8/12/03	50,000,000.00
UNITED COMMUNITY BANK	1.375	8/14/03	500,000.00
UNITED STATES TREAS NTS	5.25	8/15/03	175,000,000.00
UNITED STATES TREAS NTS	5.75	8/15/03	250,000,000.00
BANK OF THE CAROLINAS	1.375	8/21/03	1,000,000.00
FIRST CHARTER NTL BK CONCORD	1.375	8/21/03	10,000,000.00
CENTRAL CAROLINA BANK DURHAM	1.375	8/21/03	100,000.00

Short-Term Holdings by Maturity (as of June 30, 2003)—Continued

Security Name	Interest Rate	Maturity Date	Par Value
TRINITY BANK	1.375	8/28/03	500,000.00
NORTHWESTERN NATIONAL BANK	1.375	8/28/03	500,000.00
BANK OF GRANITE GRANITE FALLS	1.375	9/4/03	2,000,000.00
FIRST CHARTER NTL BK CONCORD	1.375	9/4/03	5,000,000.00
FIDELITY BANK FUQUAY VARINA	1.375	9/4/03	796,000.00
COMMUNITY SAV BK BURLINGTON	1.375	9/4/03	2,000,000.00
SOUTHTRUST BANK NA	1.25	9/11/03	2,000,000.00
FIRST CHARTER NTL BK CONCORD	1.25	9/11/03	10,000,000.00
FEDERAL HOME LN BKS	5.125	9/15/03	100,000,000.00
FIRST CHARTER NTL BK CONCORD	1.25	9/18/03	10,000,000.00
THE SCOTTISH BANK	1.25	9/18/03	1,000,000.00
CENTRAL CAROLINA BANK DURHAM	1.25	9/18/03	500,000.00
TRINITY BANK	1.25	9/25/03	700,000.00
SOUTHTRUST BANK NA	1.25	9/25/03	700,000.00
CATAWBA VALLEY BANK	1.25	9/25/03	1,000,000.00
CAROLINA BANK	1.25	9/25/03	3,000,000.00
BANK OF GRANITE GRANITE FALLS	1.25	9/25/03	600,000.00
MOORESVILLE SAVINGS BANK SSB	1.25	10/2/03	100,000.00
CENTRAL CAROLINA BANK DURHAM	1.25	10/2/03	500,000.00
LUMBEE BANK PEMBROKE	1.25	10/9/03	500,000.00
CENTRAL CAROLINA BANK DURHAM	1.25	10/9/03	5,000,000.00
FIRST GASTON BANK GASTONIA	1.25	10/9/03	100,000.00
SOUTHTRUST BANK NA	1.25	10/9/03	1,300,000.00
THE BANK OF NORTH CAROLINA	1.25	10/9/03	500,000.00
BANK OF GRANITE GRANITE FALLS	1.25	10/9/03	2,200,000.00
UNITED COMMUNITY BANK	1.25	10/16/03	500,000.00
CATAWBA VALLEY BANK	1.25	10/16/03	1,000,000.00
FNB SOUTHEAST	1.25	10/16/03	500,000.00
CENTRAL CAROLINA BANK DURHAM	1.25	10/23/03	5,000,000.00
BANK OF GRANITE GRANITE FALLS	1.25	10/23/03	350,000.00
CAROLINA BANK	1.25	10/23/03	1,000,000.00
CATAWBA VALLEY BANK	1.25	10/23/03	1,500,000.00
UNITED COMMUNITY BANK	1.25	10/23/03	2,500,000.00
COASTAL FEDERAL BANK CD	1.25	10/30/03	3,000,000.00
BANK OF THE CAROLINAS	1.25	10/30/03	1,500,000.00
UNITED COMMUNITY BANK	1.25	10/30/03	500,000.00
HIGHPOINT BANK + TRUST	1.25	10/30/03	10,000,000.00
PEOPLES BANK NEWTON	1.25	11/6/03	2,000,000.00
FIRST TRUST BANK CHARLOTTE	1.25	11/6/03	1,300,000.00
FIRST CHARTER NTL BK CONCORD	1.25	11/6/03	5,000,000.00
FIRST CHARTER NTL BK CONCORD	1.25	11/13/03	5,000,000.00
PEOPLES BANK NEWTON	1.25	11/13/03	3,000,000.00
FIRST GASTON BANK GASTONIA	1.25	11/13/03	500,000.00
CENTRAL CAROLINA BANK DURHAM	1.25	11/13/03	5,000,000.00
BANK OF GRANITE GRANITE FALLS	1.25	11/13/03	3,200,000.00
UNITED STATES TREAS NTS	4.25	11/15/03	250,000,000.00

Short-Term Holdings by Maturity (as of June 30, 2003)—Continued

Security Name	Interest Rate	Maturity Date	Par Value
INDUSTRIAL FED SAV BANK LEXING	1.25	11/20/03	100,000.00
FIRST CHARTER NTL BK CONCORD	1.25	11/20/03	100,000.00
CENTRAL CAROLINA BANK DURHAM	1.25	11/20/03	2,000,000.00
BLUE RIDGE SAVINGS BANK	1.25	11/20/03	100,000.00
HOME SAV SSB INC THOMASVILLE	1.25	12/4/03	700,000.00
CAROLINA BANK	1.25	12/4/03	1,000,000.00
BANK OF GRANITE GRANITE FALLS	1.25	12/4/03	4,300,000.00
BANK OF GRANITE GRANITE FALLS	1.125	12/11/03	1,000,000.00
NORTHWESTERN NATIONAL BANK	1.125	12/11/03	1,000,000.00
WAKE FOREST S + L ASSOC	1.125	12/11/03	100,000.00
CENTRAL CAROLINA BANK DURHAM	1.125	12/11/03	500,000.00
BANK OF WILMINGTON	1.125	12/11/03	100,000.00
BANK OF GRANITE GRANITE FALLS	1.125	12/18/03	250,000.00
PEOPLES BANK NEWTON	1.125	12/18/03	1,000,000.00
NORTHWESTERN NATIONAL BANK	1.125	12/18/03	500,000.00
THE SCOTTISH BANK	1.125	12/18/03	500,000.00
FIRST CHARTER NTL BK CONCORD	1	12/23/03	100,000.00
BANK OF GRANITE GRANITE FALLS	1	12/23/03	1,000,000.00
FIRST FEDERAL S + L LINCOLNTON	1	12/23/03	100,000.00
PEOPLES BANK NEWTON	1	12/23/03	5,000,000.00
FEDERAL HOME LN MTG CORP	5	1/15/04	250,000,000.00
FEDERAL NATL MTG ASSN	5.125	2/13/04	250,000,000.00
UNITED STATES TREAS NTS	4.75	2/15/04	250,000,000.00
UNITED STATES TREAS NTS	5.875	2/15/04	250,000,000.00
FEDERAL NATL MTG ASSN	5.625	5/14/04	250,000,000.00
UNITED STATES TREAS NTS	5.25	5/15/04	100,000,000.00
FEDERAL HOME LN MTG CORP	6.25	7/15/04	200,000,000.00
UNITED STATES TREAS NTS	2.25	7/31/04	100,000,000.00
FEDERAL HOME LN MTG CORP	4.5	8/15/04	200,000,000.00
UNITED STATES TREAS NTS	2.125	8/31/04	200,000,000.00
UNITED STATES TREAS NTS	5.875	11/15/04	250,000,000.00
UNITED STATES TREAS NTS 1	1.625	1/31/05	250,000,000.00
UNITED STATES TREAS NTS	1.5	2/28/05	250,000,000.00
UNITED STATES TREAS NTS	1.625	3/31/05	250,000,000.00
UNITED STATES TREAS NTS	1.625	4/30/05	250,000,000.00
UNITED STATES TREAS NTS	1.25	5/31/05	250,000,000.00
FEDERAL NATL MTG ASSN	5.75	6/15/05	200,000,000.00
UNITED STATES TREAS NTS	1.125	6/30/05	250,000,000.00
UNITED STATES TREAS NTS	5.875	11/15/05	250,000,000.00
UNITED STATES TREAS NTS	5.625	2/15/06	250,000,000.00
UNITED STATES TREAS NTS	2	5/15/06	250,000,000.00
UNITED STATES TREAS NTS	3.5	11/15/06	250,000,000.00
UNITED STATES TREAS NTS	3.25	8/15/07	50,000,000.00

North Carolina Retirement Systems'
Equity Investment Portfolio Top 100 Positions
As of June 30, 2003

Security Description	# of Shares Beneficially Owned	Ending Market Value	Security Description	# of Shares Beneficially Owned	Ending Market Value
PFIZER INC	16,424,987	\$ 560,913,306	UNION PAC CORP	1,280,844	\$ 74,314,569
MICROSOFT CORP	20,815,375	\$ 533,081,754	3M CO	566,632	\$ 73,084,195
CITIGROUP INC	11,250,372	\$ 481,515,922	CARDINAL HEALTH INC	1,131,133	\$ 72,731,852
GENERAL ELEC CO	16,615,184	\$ 476,523,477	SLM CORP	1,850,924	\$ 72,500,693
EXXON MOBIL CORP	10,601,353	\$ 380,694,586	WASHINGTON MUT INC	1,743,888	\$ 72,022,574
WAL MART STORES INC	6,413,262	\$ 344,199,772	TYCO INTL LTD	3,769,953	\$ 71,553,708
AMERICAN INTL GROUP INC	5,530,511	\$ 305,173,597	OMNICOM GROUP	977,602	\$ 70,094,063
BANK AMER CORP	3,241,175	\$ 256,150,060	UNITEDHEALTH GROUP INC	1,391,247	\$ 69,910,162
INTERNATIONAL BUSINESS MACHS	2,962,169	\$ 244,378,943	INTERACTIVECORP	1,740,400	\$ 68,867,628
PROCTER + GAMBLE CO	2,662,879	\$ 237,475,549	UNITED PARCEL SVC INC	1,071,070	\$ 68,227,159
INTEL CORP	11,261,534	\$ 234,059,723	BELLSOUTH CORP	2,546,176	\$ 67,804,667
MERCK + CO INC	3,864,279	\$ 233,982,093	COMCAST CORP NEW	2,335,344	\$ 67,527,968
JOHNSON + JOHNSON	4,473,201	\$ 231,264,492	TEXAS INSTRS INC	3,779,299	\$ 66,515,662
CISCO SYS INC	12,087,184	\$ 201,735,101	MEDTRONIC INC	1,385,160	\$ 66,446,125
VERIZON COMMUNICATIONS	5,010,869	\$ 197,678,782	ASTRAZENECA PLC	1,600,700	\$ 65,260,539
ALTRIA GROUP INC	4,133,211	\$ 187,813,108	FEDERAL HOME LN MTG CORP	1,262,982	\$ 64,121,596
PEPSICO INC	4,171,547	\$ 185,633,842	TOTAL SA	413,696	\$ 62,622,379
DELL COMPUTER CORP	5,657,140	\$ 180,802,194	GILEAD SCIENCES INC	1,109,396	\$ 61,660,230
J P MORGAN CHASE + CO	5,056,087	\$ 172,817,054	TARGET CORP	1,603,604	\$ 60,680,375
FEDERAL NATL MTG ASSN	2,533,458	\$ 170,856,408	ACE LTD	1,752,603	\$ 60,096,757
VIACOM INC	3,754,191	\$ 163,907,979	FEDEX CORP	965,416	\$ 59,884,754
BANK ONE CORP	4,391,547	\$ 163,277,717	GILLETTE CO	1,879,239	\$ 59,872,555
FIRST DATA CORP	3,795,296	\$ 157,277,066	DU PONT E I DE NEMOURS + CO	1,435,669	\$ 59,781,257
LILLY ELI + CO	2,044,293	\$ 140,994,888	EXELON CORP	992,297	\$ 59,349,284
SBC COMMUNICATIONS INC	5,433,068	\$ 138,814,887	AVON PRODS INC	922,949	\$ 57,407,428
CHEVRONTXACO CORP	1,859,613	\$ 134,264,059	BNP PARIBAS	1,116,381	\$ 56,822,203
AMGEN INC	2,011,604	\$ 133,650,970	US BANCORP DEL	2,241,348	\$ 54,913,026
MORGAN STANLEY	3,111,111	\$ 132,999,995	CANON INC	1,190,415	\$ 54,726,016
COCA COLA CO	2,860,270	\$ 132,745,131	AMERICAN EXPRESS CO	1,293,121	\$ 54,065,389
WYETH	2,821,232	\$ 128,507,118	APPLIED MATERIALS INC	3,378,440	\$ 53,582,058
WELLS FARGO + CO NEW	2,525,624	\$ 127,291,450	GANNETT INC	691,086	\$ 53,082,316
HOME DEPOT INC	3,645,398	\$ 120,735,582	BURLINGTON NORTHN SANTA FE	1,846,118	\$ 52,503,596
ABBOTT LABS	2,743,615	\$ 120,060,592	DISNEY WALT CO	2,631,635	\$ 51,974,791
AOL TIME WARNER INC	7,361,927	\$ 118,453,405	EBAY INC	497,644	\$ 51,844,552
CONOCOPHILLIPS	2,090,345	\$ 114,550,906	GENERAL DYNAMICS CORP	706,036	\$ 51,187,610
MERRILL LYNCH + CO INC	2,451,546	\$ 114,438,167	GENZYME CORP GENL DIVISION	1,221,532	\$ 51,060,038
COMCAST CORP NEW	3,281,311	\$ 99,029,966	ANALOG DEVICES INC	1,466,222	\$ 51,053,850
HEWLETT PACKARD CO	4,540,351	\$ 96,709,476	GOLDMAN SACHS GROUP INC	609,286	\$ 51,027,703
UNITED TECHNOLOGIES CORP	1,344,942	\$ 95,262,242	HCA INC	1,581,472	\$ 50,670,363
VODAFONE GROUP	48,043,034	\$ 94,101,285	COLGATE PALMOLIVE CO	873,612	\$ 50,625,815
WELLPOINT HEALTH NETWORKS INC	1,111,989	\$ 93,740,673	COUNTRYWIDE FINL CORP	720,543	\$ 50,128,177
ROYAL BK SCOT GRP	3,308,423	\$ 92,964,413	NOVARTIS AG	1,258,510	\$ 49,908,358
ORACLE CORP	7,729,773	\$ 92,911,871	BRISTOL MYERS SQUIBB CO	1,789,238	\$ 48,577,812
SCHERING PLOUGH CORP	4,823,103	\$ 89,709,716	VERITAS SOFTWARE CORP	1,666,321	\$ 47,773,423
GUIDANT CORP	1,935,218	\$ 85,904,327	MARSH + MCLENNAN COS INC	924,021	\$ 47,189,752
ANHEUSER BUSCH COS INC	1,629,308	\$ 83,176,173	APOLLO GROUP INC	762,292	\$ 47,079,154
WACHOVIA CORP 2ND NEW	2,024,619	\$ 80,903,775	SPRINT CORP	3,189,864	\$ 45,934,042
FOREST LABS INC	1,471,435	\$ 80,561,066	YAHOO INC	1,397,828	\$ 45,792,845
MBNA CORP	3,862,597	\$ 80,496,521	NATIONAL CITY CORP	1,382,752	\$ 45,229,818
LOWES COS INC	1,744,061	\$ 74,907,420	EMC CORP	4,315,149	\$ 45,179,610



THE STATE TREASURER'S ANNUAL REPORT

STATE AND LOCAL GOVERNMENT

STATE AND LOCAL GOVERNMENT FINANCE DIVISION

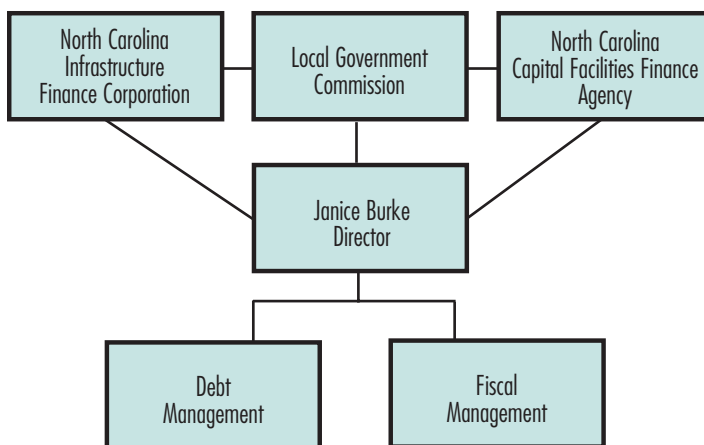
The State and Local Government Finance Division is organized to provide the State Treasurer, the Local Government Commission, the North Carolina Infrastructure Finance Corporation, and the North Carolina Capital Facilities Finance Agency with staff assistance in fulfilling their respective statutory 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 those 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 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. 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 North Carolina Infrastructure Finance Corporation (Corporation) was created by the General Assembly and organized as a separate not-for-profit corporation. It is managed by a three-member board appointed by the State Treasurer. The Corporation is authorized to issue tax-exempt debt to finance the acquisition, construction, repair and renovation of State facilities and related infrastructure. The debt obligations are secured by lease agreements with the State, which constitute the imposition of a financial burden on the State. The administrative staff for the Corporation is also provided by the Department of State Treasurer.

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



OPERATIONAL HIGHLIGHTS

- During fiscal year 2002-03, the State sold general obligation bonds totaling \$1.268 billion. Those sales included over \$500 million in variable rate refunding bonds that reduced the State's debt service for fiscal year 2002-03 by approximately \$43 million. It also included over \$600 million in clean water and higher education bonds sold at interest rates that resulted in interest savings of more than \$35 million over the life of the bonds when compared to the national Bond Buyer's Index. Simultaneously with this transaction, the State synthetically fixed the interest rates on these bonds by entering into swap agreements.
- As an additional means of lowering its borrowing costs, the State entered into an interest rate swap agreement in connection with the \$355 million variable rate bonds issued by the State in May, 2002. The swap agreement allowed the State to synthetically fix the interest rate on these bonds at 1.06% for a term of two years.

- During the 2002-03 fiscal year, the State issued \$17.5 million in Certificates of Participation for the first time through the North Carolina Infrastructure Finance Corporation to provide funds for the acquisition, construction and equipping of two centers for the Wildlife Resources Commission.
- 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 all 100 counties and 401 municipalities.
- The State continued to retain its excellent bond rating of "Triple-A" from two of the three national rating agencies.
- General obligation bonds sold for local governments in 2002-03 totaled \$1.7 billion. These included \$0.9 billion sold competitively with rates averaging 96 basis points under the national Bond Buyer's Index resulting in savings of more than \$67 million over the life of these bonds, and \$0.5 billion in refunding bonds sold competitively resulting in savings of \$41 million when compared to the Bond Buyer's Index.
- Twenty-six revenue bonds for over \$850 million were also sold for local governments, mainly for hospitals, airports, water and sewer and housing projects. In addition, two swaptions were approved and executed involving approximately \$166 million as an alternative to an advanced refunding, producing over \$10 million in net present value savings.
- Other bond issues in 2002-03 included over \$58 million approved and sold for the North Carolina Housing Finance Agency increasing the supply of affordable housing for North Carolinians of moderate and low income; \$27.8 million in industrial revenue and pollution control bonds to finance or refinance six projects creating about 500 new jobs; \$883 million in installment purchase contracts typically for smaller projects; \$769 million in hospital revenue bonds through eleven bond issues for the North Carolina Medical Care Commission; and over \$193 million for capital projects for private schools, colleges and other nonprofit corporations through 7 bond issues by the North Carolina Capital Facilities Finance Agency.
- Members of the staff worked with the University of North Carolina at Chapel Hill School of Government to present the Second 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, acceleration of the additional half cent local option sales tax, revised GAO Independence Standards, and single audit and financial reporting issues.
- The staff has updated the County and Municipal Information Website (<http://www.treasurer.state.nc.us/lgc/units/unitlistjs.htm>) which displays detailed financial, population and property tax data for the latest six-year period for all North Carolina counties and municipalities.
- The staff reviewed the financial statements of 1,175 local governments and public authorities.
- 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.
- The fourteenth 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. For the second year, State Treasurer's Awards were also presented to nonprofit organizations that provide valuable services to the citizens of the State.
- In March the Local Government Commission voted to return control of the fiscal affairs of the Town of East Spencer to the Town's locally elected officials.

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 continued to be favorable for the issuance of tax-exempt debt during the fiscal year and the international pressures in the Middle East did not have an adverse effect in the market place. Issuers of new and re-funded debt enabled governmental units to receive historically low interest rates for their bonds. During this period, The Bond Buyer's Index of 20 General Obligation Bonds ranged from a high of 5.12% in October 2002 to a low of 4.21% in June, 2003.

The Basic Functions Debt Management

The Division issues and monitors all State debt, including debt secured by a pledge of the taxing power of the State and debt for which repayment is subject to appropriation. 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, 2003, the State had general obligation bonds outstanding of \$4.059 billion and Certificates of Participation outstanding of \$17.5 million. (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 Ratings, Inc., the three national bond rating agencies used by the State and local governmental units in North Carolina. At June 30, 2003, the State had a "Triple-A" rating, the highest rating attainable, from two of the three national rating agencies. These favorable ratings have 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 distributed electronically 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, 2003, authorized and unissued general obligation bonds for local governments amounted to \$1.9 billion; and general obligation debt outstanding amounted to over \$8.2 billion. (Table 8) Of the \$1.7 billion in general obligation bonds marketed for local units, over \$1.2 billion were sold competitively for new money at tax-exempt rates averaging approximately 96 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 \$67 million in interest costs. Over \$0.5 billion in refundings were sold competitively, achieving savings in excess of \$41 million over the life of these bonds. Such savings are a result, in part, of the Division's successful efforts in maintaining and/or 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, public authorities, 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.

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, 2003, the Local Government Commission approved contracts or other agreements totaling \$883.1 million. (Tables 6 and 7)

Fiscal Management

The Division monitors 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

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.)

The Division also serves as staff to the North Carolina Infrastructure Corporation created by General Assembly to issue tax-exempt debt to finance the acquisition, construction, repair and renovation of State facilities and related infrastructure.

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 UNC-Chapel Hill School of Government; the North Carolina Association of School Business Officials, the North Carolina American Water Works Association, 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 UNC-Chapel Hill School of Government to present the

Second 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 School 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 General Statutes. In addition, 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 2002-03 the State sold general obligation bonds totaling \$1.268 billion. On December 4, 2002, the State sold competitively \$125.28 million of general obligation bonds consisting of \$18.8 million clean water bonds, \$50 million federally taxable natural gas bonds, and \$56.48 million refunding bonds. The \$18.8 million clean water bonds were sold at a true interest cost of 4.4516%; the \$50 million federally taxable natural gas bonds were sold at a true interest cost of 3.3733%; and the \$56.48 million refunding bonds were sold at a true interest cost of 3.246%. On December 11, 2002, the State sold \$499.870 million of variable rate refunding bonds, which together with the \$56.48 million refunding bonds sold on December 4, 2002 reduced the State's debt service for fiscal year 2002-03 by approximately \$43 million. Simultaneously with the closing of this variable rate refunding transaction, the State synthetically fixed the interest rates on these bonds at 3.089% and 3.283% by entering into two swap agreements.

On January 6, 2003, the State sold \$2.9 million clean water bonds at a net interest cost of 2.7516%. On February 26, 2003, \$320 million clean water and higher education bonds were sold competitively at a true interest cost of 4.3415%. When compared to the national Bond Buyer's Index (the "BBI"), this resulted in savings over the life of these bonds of over \$20.4 million. On March 26, 2003, \$283.255 million clean water and higher education bonds were sold competitively at a true interest cost of

4.3094%, resulting in interest savings of approximately \$14.7 million over the life of the bonds. Natural gas bonds of \$33 million were also sold on March 26, 2003 at a true interest cost of 2.8471% and a \$3.645 clean water bond issue was sold on May 19, 2003 at a net interest cost of 2.8190%.

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.

As an additional means to lower its borrowing costs, the State entered in to an interest rate swap agreement on June 24, 2003 (effective July 1, 2003), in connection with the \$355 million variable rate bonds issued by the State in May 2002. The swap agreement allowed the State to synthetically fix the interest rate on these bonds at 1.06% for a term of two years ending on July 1, 2005 (and extendable for one additional year at the option of the counterparty).

North Carolina Infrastructure Finance Corporation — In 2002-03 the State issued certificates of participation for the first time. On April 10, 2003, the State through the North Carolina Infrastructure Finance Corporation issued \$17.5 million certificates of participation to provide funds for the acquisition, construction and equipping two centers for the Wildlife Resources Commission. The State is required to make the installment payments subject to its right of nonappropriation. No deficiency judgment may be rendered against the

State and the taxing power of the State or any agency, department or commission of the State is not pledged directly or indirectly to secure the certificates of participation.

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 increased from 96 to 118 and the dollar volume approved increased from \$493.9 million in FY 2001-2002 to \$883.1 million in FY 2002-03. (Tables 6 and 7)

Revenue Bonds — Interest in revenue bond financing and related derivative products (swaps, swaptions — especially in refunding opportunities) continued. Over \$21,000,000 in net present value savings were achieved as a result of 12 refundings and an additional \$10.7 million as a result of executing swaptions (selling an option to enter into a swap in the future). While these synthetic products provide enhanced benefits, they also involve risks that need to be addressed for each issue individually. Revenue 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 2002-2003 the Local Government Commission sold over \$850 million in revenue bonds in 26 issues for local governments (not including two swaptions entered into for over \$166 million). Economic growth, synthetic alternatives to traditional refundings, viable enterprise activities, legislative changes involving housing approval and the continued presence of extremely low market rates 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. Water and sewer and hospital issues continued to represent the majority of the revenue bond purposes.

North Carolina Medical Care Commission Bonds

— During 2002-2003 the Local Government Commission approved and sold eleven separate issues of bonds and notes for the North Carolina Medical Care Commission totaling over \$769 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 Wake Forest University Health Sciences System for \$198 million to provide for construction refinancing other indebtedness. In attempting to meet the needs of our aging population, two revenue bond issues providing for the acquisition or financing of two separate independent living/assisted care facilities

were successfully completed during 2002-2003 and hospital construction and/or refinancings comprised seven other issues. 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 financings 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) that 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 \$6 billion in tax-exempt bonds and tax credits to produce and provide housing for over 157,000 households. In FY 2002-2003, financing and tax credits were provided to support total development of \$84.2 million. The agency also provided funding to The Masonic Home for Children through the issuance of \$8 million special facilities bonds. These bonds provided funding for the renovation and expansion of current facilities, construction of seven single story cottages and preparation of the sites and infrastructure for eighteen additional cottages. The Masonic Home for Children offers an alternative family environment for about 120 children between the ages of three and sixteen.

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 1,103 issues totaling over \$6.159 billion. These 1,103 issues have created over 98,400 jobs and saved over 39,200 jobs. In the fiscal year ended June 30, 2003, six issues of Industrial Revenue and Pollution Control Facilities Bonds were issued for a total of \$27,850,000. This resulted in the creation of 499 jobs. Additionally, \$14 million 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 2003, the State was allotted \$624 million to use for private activity bonds.

Triple A General Obligation Bond Ratings — At June 30, 2003, the State had a "Triple A" bond rating from two of the three rating agencies. The rating from the third rating agency is Aa1, which is one grade below "Triple A."

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 the 1998 session of the General Assembly to broaden its powers to permit financing facilities of kindergarten, elementary and secondary nonprofit private schools and again in the 1999-2000 session and to change its name to its present name and to allow it to finance additional types of capital projects, including student-housing facilities owned or operated by an institution other than an institution of higher education or elementary or secondary education. 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 \$1.8 billion in tax-exempt capital financing through 120 issues. This

amount includes \$23.6 million in tax-exempt financing originally issued by the North Carolina Industrial Facilities and Pollution Control Facilities Financing Authority in three issues on behalf of 13 corporations. There have been no defaults. At June 30, 2003, there were \$1.3 billion 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, 2003, the NCCFFA issued \$193 million for 7 institutions. The Annual Report of the NCCFFA 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 2002-2003, a total of 12 units were selected to receive revolving loans ranging from \$900,000 to \$17,442,000. Additionally, one State bond loan was approved in the amount of \$800,000.

Fiscal Management

The Town of East Spencer — Under the authority of G.S. 159—181(c) the Local Government Commission voted to assume control of the fiscal affairs of the Town of East Spencer in October, 2001. The Town was in violation of General Statutes, had no financial management system in place and could not provide services to its citizens. Control of the financial affairs of the Town was returned to locally elected officials in March, 2003. The staff 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. The Town hired an administrator and finance director. A financial management system was put into place that produces reliable accounting records and controls expenditures. The staff worked with vendors and the Town to settle all debts of the Town. The Town is currently working to catch up on past due audits and obtain financing to repair its water system.

The North Carolina Capital Management Trust — The balance of the cash portfolio in the North Carolina Capital Management Trust (NCCMT) increased approximately 2.6% from June 30, 2002 to June 30, 2003. This increase occurred because some units had additional funds available for investment. At fiscal year-end, the cash portfolio totaled \$4.0 billion, while the term portfolio had a year-end balance of \$73.5 million. The North Carolina Capital Management Trust (NCCMT) is an 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 of the trust. There were 579 participants in the cash portfolio at June 30, 2003 compared to 562 at June 30, 2002. The number of participants in the term portfolio was 43 at June 30, 2003, which was unchanged from the prior fiscal period. 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, 2003, and December 31, 2002, 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 44 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 of 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.

Analysis of Official Pronouncements — Each year the staff analyzes proposed changes or additions to accounting standards that will 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 impairment of assets and other post employment benefits.

State Treasurer's Conference on Local Government Accounting, Auditing and Financial Management, and Other Continuing Education Courses and Conferences. — Staff members worked with the UNC-Chapel Hill School of Government to present the second annual conference. The conference was intended for both local government auditors and officials. It was conducted on two sites, and drew more than 100 participants at each site. Topics covered included GASB Statement No. 34, amended Governmental Auditing Standards for independence, debt management, cash and investments reporting, and audit issues.

Staff members spoke at approximately 25 continuing education courses and conferences sponsored by organizations such as the UNC-Chapel Hill School of Government, various North Carolina Government Finance Officers Associations, and the North Carolina Association of Certified Public Accountants.

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. External quality review reports have been received from 345 offices of CPA firms.

Audit Manual for Governmental Auditors — The audit manual available to CPAs performing governmental audits in North Carolina is updated annually. 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. 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. The illustrative financial statements also were revised this year based on experience and information from those units implementing GASB Statement 34 in Phase I.

Audit Review Process — The staff of the Division annually reviews the audit reports of approximately 1,175 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 300 of these letters were sent to units of local government during the 2002-2003 fiscal year.

As a part of the audit review process, the Division's staff reviewed approximately 663 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.

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 210 "Yellow Book" audits.

Memoranda and Other Publications — A signifi-

cant 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, acceleration of the additional half cent local option sales tax, revised GAO independence standards 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.

State Treasurer's Governmental Accounting/Financial Management Awards Program — The Department sponsored the fourteenth 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.

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.

State Treasurer's Accounting/Financial Management Awards Program for Nonprofit Organizations — The Department sponsored the second annual 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 are evaluated by the Health Care Industry Committee and the Not-for-Profit Committee of the NCACPA. For the year ended December 31, 2002, entries were received from private schools, private colleges nonprofit hospitals and other non-profit organizations.

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 penal-

ties 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.

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 that required 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 fre-

quently, 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, 2002, 213 units were required to make annual information filings by January 31, 2003.

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.nctreasurer.com).

County and Municipal Information Website — The staff has developed the County and Municipal Information website (www.nctreasurer.com). 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, 1998, through June 30, 2003, 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 infor-

mation 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 or fax of new memoranda 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.

Monitoring the Impact of Drought Conditions and Plant Closings on North Carolina Cities and Counties — During the 2002-2003 fiscal year certain areas of the State experienced severe drought conditions, resulting in lower water sales as citizens reduced water usage. Other areas experienced plant closings that will reduce utility and sales tax revenues, and may slow property tax collections. From the database of financial information, the staff developed several specialized reports to identify those cities, counties, and water and sewer districts that appeared to be more vulnerable to financial problems as a result of an extended drought or a major plant closing. Staff members contacted those units to discuss the current situation and the units' plans to deal with their difficulties, including use of financial reserves, transfers from other funds, and necessary budget amendments. This monitoring will continue as audits are received and the financial trends of the water and sewer systems are reviewed.

Policies Manual Update — The staff continues to update 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. The updated sections published on the web site incorporate "hot links" so that readers may access web pages providing more detail on specific items of interest.

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.

Most counties and school boards have implemented the reporting model during Phase 2. Most cities and public authorities will implement the model during Phase 3 and will not be subject to retroactive infrastructure requirements. Phase 1 units submitted their reports for the fiscal year ended June 30, 2002. The staff reviewed the draft reports and worked with units and auditors to correct any reporting problems referred. Common problems were brought to units' and auditors' attention in memorandums and at classes and conferences.

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

The staff also has worked with units and auditors to implement reporting standards to check comparability between financial statements. Memoranda have been issued on GASB Statements No. 37, No. 38 and Interpretation 6 which will be implemented with Statement No. 34. Guidance has been 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 help 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 for 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 continues to develop checklists, applications and other guidance regarding these transactions.

Revised OMB Circular A-133 — In April 2003 the Office of Budget and Management (OMB) revised Circular A-133, Compliance Supplements for Audits of State and Local Governments and Non-Profit Organizations. These changes were effective for the fiscal year ending June 30, 2003. The supplements placed greater responsibility upon the Office of State Auditor for testing eligibility determinations while performing compliance audits of major programs. The State relies upon local governments to make eligibility determinations for many major programs. Those eligibility determinations must be tested as part of the single audit of the State. Local governments in North Carolina are subject to the State Single Audit Implementation Act, which is intended to limit the number of auditor organizations that will audit a local government. Staff members met with representatives of the Office of State Auditor, the North Carolina Association of County Commissioners, the North Carolina Association of Certified Public Accountants and several county finance officers to determine the most appropriate way to implement the revisions to Circular A-133. All parties agreed that the best solution is for local auditors to test eligibility of units. Auditors will provide additional documentation of their testing and their findings to the Office of State Auditor. In addition, the Office of State Auditor will coordinate the selection of major programs with local units and their auditors. This is necessary to be certain all major programs will receive adequate testing for the State's single audit.

Staff members will receive and review the additional documentation from local units and pass it on to the Office of State Auditor. The staff will be working with the Office of State Auditor to communicate with

local units about major programs to be tested and any changes in documentation submitted. In addition, staff will determine if any adjustments to the criteria for selecting major programs are necessary.

Revised GAO Standards — The Governmental Accounting Office (GAO) has amended the Governmental Auditing Standards concerning independence of local government auditors. The amendment addresses the nonaudit services that can be provided to a unit by an auditor without impairing the auditor's independence. The amended standards will not permit auditors to perform bookkeeping services for a unit. The standards limit the extent of services an auditor can provide in preparing payroll and taxes, appraising assets, selecting and installing data processing systems and advising clients in filling key positions. The amended standards will permit the auditor to prepare draft financial statements from the accounting records of the unit if the unit can evaluate the work and take responsibility for the statements. The amendments become effective for the fiscal year ending June 30, 2004.

Staff members have analyzed the amended standards and discussed its application to North Carolina local governments with GAO in addition to working with local units and the North Carolina Association of Certified Public Accountants to see that the amendment is correctly and consistently applied in North Carolina. The staff also has issued memoranda and spoken at courses to make units and auditors aware of the amended standard. The staff is maintaining a list of audit firms willing to provide nonaudit services to units that they do not audit.

PURPOSES FOR WHICH LOCAL GOVERNMENTS
SOLD BONDS AND NOTES
FISCAL YEAR 2002-03

	School	Utilities	Refunding	Other	No.	Total Amount
G.O. Bonds						
Counties	\$ 597,355,000	\$ 16,025,000	\$ 249,435,000	\$ 262,065,000	37	\$ 1,124,880,000
Municipalities	-	\$ 21,808,000	\$ 249,065,500	\$ 264,065,000	32	\$ 535,378,500
Districts and Authorities	-	\$ 20,687,000	\$ 17,965,305	\$ 13,000,000	9	\$ 51,652,305
Total G.O. Bonds	\$ 597,355,000	\$ 58,520,000	\$ 516,465,805	\$ 539,570,000	78	\$ 1,711,910,805
Revenue Bonds						
Counties	-	\$ -	\$ 22,585,000	\$ 67,035,000	5	\$ 89,620,000
Municipalities	-	\$ -	\$ 258,150,000	\$ 185,719,000	9	\$ 443,869,000
Districts and Authorities	-	\$ 18,319,000	\$ 26,970,000	\$ 277,445,000	12	\$ 322,734,000
Total Revenue Bonds	-	\$ 18,319,000	\$ 307,705,000	\$ 530,199,000	26	\$ 856,223,000
Special Obligation Bonds						
Solid Waste	-	-	-	\$ 14,355,000	1	\$ 14,355,000
Total Special Obligation Bonds	-	\$ -	\$ -	\$ 14,355,000	1	\$ 14,355,000
State Bond and Revolving Loans						
Counties	-	\$ -	\$ -	\$ 10,411,657	3	\$ 10,411,657
Municipalities	-	\$ -	\$ -	\$ 24,360,161	7	\$ 24,360,161
Districts	-	\$ -	\$ -	\$ 15,834,112	2	\$ 15,834,112
Total State Bond and Revolving Loans	-	\$ -	\$ -	\$ 50,605,930	12	\$ 50,605,930
Notes						
G.O. Bond Anticipation Notes	-	\$ 50,898,000	\$ -	\$ 21,525,000	21	\$ 72,423,000
Revenue Notes	-	\$ -	-	\$ -	-	\$ -
Total	-	\$ 50,898,000	\$ -	\$ 21,525,000	21	\$ 72,423,000
Total Bonds and Notes	\$ 597,355,000	\$ 127,737,000	\$ 824,170,805	\$ 1,156,254,930	138	\$ 2,705,517,735

Debt Management Activities – State and Local (In Millions)

	FY	2002-03	FY	2001-02	FY	2000-01
	No.	Amt.	No.	Amt.	No.	Amt.
Bonds Sold for State						
G.O. Bonds (General Fund)	7	\$ 1,268.0	4	\$ 605.0	2	\$ 680.0
G.O. Bonds (Highway Fund)	0	-	0	-	0	-
Total	7	\$ 1,268.0	4	\$ 605.0	2	\$ 680.0
Bonds and Notes Sold for Local Government Units:						
G.O. Bonds	78	1,711.9	60	1,040.2	42	1,290.5
Revenue Bonds	26	856.2	23	611.8	26	786.8
State Bond and Revolving Loans	12	50.6	16	39.4	13	17.6
Special Obligation Bonds - Solid Waste	1	14.4	0	-	0	-
G.O. Notes	21	72.4	28	86.4	33	82.1
Revenue Notes	0	-	0	-	0	-
Total	138	\$ 2,705.5	127	\$ 1,777.8	114	\$ 2,177.0
Installment/Lease Contracts Sold for Local Units:	68	\$ 656.7	70	\$ 461.9	104	\$ 627.2
Revenue Bonds Sold for:						
Medical Care Commission	12	769.0	13	497.1	12	435.1
Housing Finance Agency	2	58.1	3	302.8	4	152.2
Power Agencies	4	1,517.5	0	-	0	-
Industrial Facilities and Pollution Control						
Financing Authorities	8	41.9	15	122.9	26	578.9
Capital Facilities Finance Agency	7	193.0	19	455.9	16	196.1
Total	33	\$ 2,579.5	50	\$ 1,378.7	58	\$ 1,362.3
Grand Total	246	\$ 7,209.7	251	\$ 4,223.4	278	\$ 4,846.5



THE STATE TREASURER'S ANNUAL REPORT

FINANCIAL OPERATIONS DIVISION

FINANCIAL OPERATIONS DIVISION

The Financial Operations Division is responsible for ensuring that efficient banking services are provided to all State agencies and institutions, and ensuring that all funds deposited, invested, and disbursed through the State Treasurer are properly accounted for and reported. The accounting functions include accounting for investments, pension funds, trust funds, and State debt. Departmental support functions include budget prepara-

tion and control, cash management, payroll, purchasing, and accounts payable for the various divisions. Reconciliation functions include reconciling depository bank account statements and reconciling budgetary accounts with the Office of State Controller. The division is comprised of four sections: Banking Operations, Bank Reconciliation Unit, Statewide Operations, and Departmental Operations.

OPERATIONS HIGHLIGHTS

- ▣ Selected a vendor, i-flex Solutions, to install a new Core Banking System (CB\$), an off-the-shelf banking product used by commercial banks. The system replaced the outdated legacy systems used by the State Treasurer's Office for the past 25 years. The implementation process took ten months, with the old system being converted to the new system on June 28, in time for the CB\$ to become the official system beginning July 1, 2003.
- ▣ Expanded the positive pay program by enrolling a number of the larger agency accounts. More than 500 counterfeit warrants were detected during the year. In addition, some 1,500 forged warrants were discovered and resolved.
- ▣ Modified the securities lending program administered by The Bank of New York to allow Government National Mortgage Association securities (GNMAs) to participate in the program, increasing the lending earnings by approximately \$5 million. The securities lending programs administered by the two custodians, The Bank of New York and State Street Bank, reached an all time high of \$43 million.
- ▣ Approximately 225,000 bank deposits, made by 775 different depositing agency locations were processed.
- ▣ Some 5,000 electronic warrants totaling \$17.9 billion to fund vendor payments, payroll, and governmental transfers were processed.
- ▣ Over 23 million State warrants totaling \$23.5 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.
- ▣ The value of securities pledged to the State Treasurer to secure public deposits in financial institutions totaled over \$4.2 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 bank-

ing 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 2002-2003, over 23 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 bank, 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 governments 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 investments programs, the retirement trust funds, and the Escheats Trust Fund.

Investment Accounting

The section manages the accounting for the State Treasurer's \$65 billion investment programs. The accounting and reporting for the investment program 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 investment fund, market valuations, participant units of ownership, and earnings distributions.

Retirement and Escheat Fund Accounting

The 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 handled in the Retirement Systems Division, with oversight by this section. The 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, managing accounts payables,

accounting for fixed assets, maintaining the general ledger for the Department, and centralized purchasing.

This section works closely with the Office of State Budget and Management and the Office of the State Controller to ensure that the Department is reporting accurately and timely according to all State requirements.

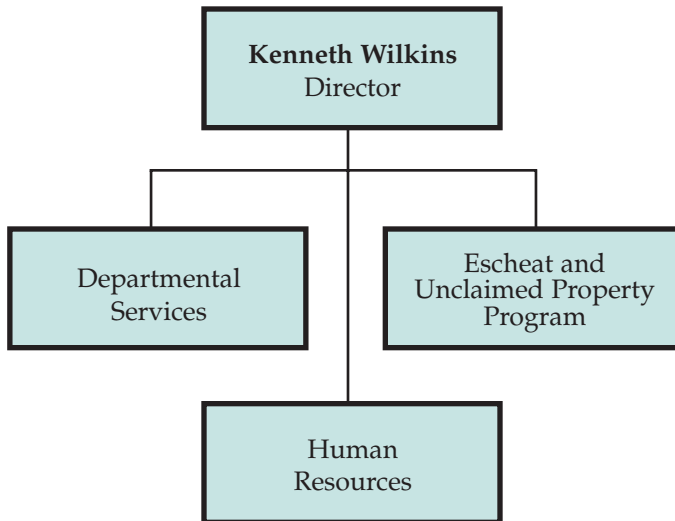


THE STATE TREASURER'S ANNUAL REPORT

ADMINISTRATIVE SERVICES DIVISION

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.

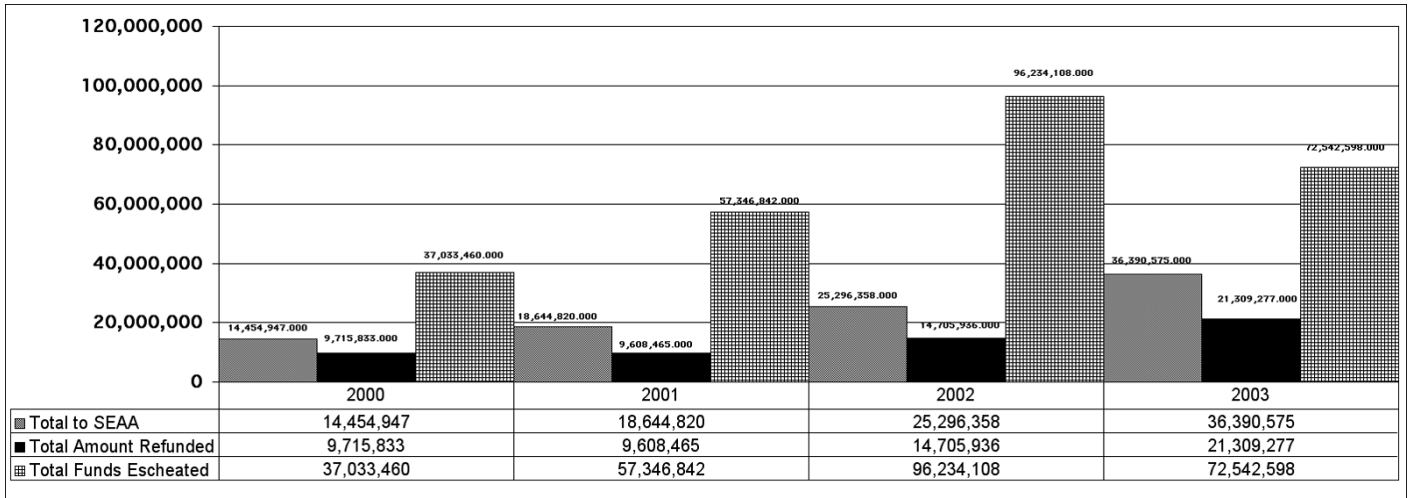


Escheat and Unclaimed Property Program

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. For fiscal year ending 2003, \$36 million in interest was earned and given to SEAA to aid approximately 16,000 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 their resources in locating the owner, the names, addresses and any funds they are holding are escheated to the State Treasurer's Office. Upon receipt of this information efforts are made to locate the owners 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, such as the North Carolina State Fair and the Mountain State Fair. We also worked with AARP, other state agencies, and legislators to return funds.

Escheat Unclaimed Property Program Facts



Fiscal Year	2000	2001	2002	2003
Total Funds Escheated	37,033,460	57,346,842	96,234,108	72,542,598
Total Amount Refunded	9,715,833	9,608,465	14,705,936	21,309,277
Total to SEAA	14,454,947	18,644,820	25,296,358	36,390,575



THE STATE TREASURER'S ANNUAL REPORT

STATISTICAL TABLES

Treasurer's Cash Balances As of June 30, 2003

CONCENTRATION ACCOUNTS

Raleigh, Bank of America of North Carolina	\$ 1,256,200.29
Unemployment Clearing Account	42,446.71
Raleigh, Branch Banking & Trust Co.	2,195,400.94
Raleigh, Central Carolina Bank & Trust Co.	1,461,366.02
Raleigh, RBC Centura Bank	1,027,817.55
Raleigh, First Citizens Bank & Trust Co.	1,318,530.31
Raleigh, Wachovia Bank of N.C.	5,381,669.04
Total Concentration Accounts	\$ 12,683,430.86

COMMUNITY BANK ACCOUNTS

Aberdeen, First Bank	\$ 138,000.04
Ahoskie, Southern Bank & Trust Co.	72,000.12
Albemarle, First National Bank & Trust	30,000.23
Asheboro, First Natl Bank & Trust Co.	93,999.81
Bath, Southern Bank & Trust Co.	12,861.60
Bryson City, Carolina Community Bank	69,999.79
Burnsville, First Western Bank	34,999.63
Camden, Bank of Currituck	34,999.51
Cary, The Fidelity Bank	50,000.13
Columbia, The East Carolina Bank	123,000.37
Columbus, Tryon Federal Savings	35,000.38
Creedmoor, Fidelity Bank	99,999.86
Creswell, The East Carolina Bank	24,552.38
Danbury, Old North State Bank	31,000.07
Durham, Mechanics & Farmers Bank	135,999.97
Durham, SouthBank, FSB	102,999.77
Edenton, Southern Bank & Trust Co.	27,966.25
Englehard, The East Carolina Bank	72,000.14
Fayetteville, United National Bank	120,000.15
Franklin, Macon Savings Bank	35,000.06
Gastonia, Fidelity Bank	34,999.62
Gatesville, Southern Bank & Trust Co.	35,000.25
Greensboro, Mutual Community Savings Bank	132,999.90
Hampstead, Anchor Bank	71,999.50
Harrisburg, First Charter National	103,000.40
High Point, High Point Bank & Trust Co.	74,999.82
Kernersville, Independence Bank	74,999.68
Kings Mountain, Fidelity Bank	20,751.75
Laurinburg, First Scotland Bank	68,999.67
Lenoir, Bank of Granite	81,999.70
Lewiston, Southern Bank & Trust Co.	18,290.62

Lexington, Lexington State Bank	103,000.34
Lumberton, Lumbee Guaranty Bank	34,999.66
Manteo, The East Carolina Bank	165,999.74
Moyock, Bank of Currituck	36,999.70
Mt Airy, The Community Bank	69,999.59
Murphy, Carolina Community Bank	35,000.48
Murphy, Macon Savings Bank	211,000.19
Nags Head, The East Carolina Bank	63,774.75
Newland, Avery County Bank	92,000.26
Newton, Peoples Bank	70,000.28
North Wilkesboro, Yadkin Valley Bank & Trust Co.	70,000.16
Ocracoke, The East Carolina Bank	213,302.34
Pembroke, Lumbee Guaranty Bank	151,999.75
Plymouth, Southern Bank & Trust Co.	71,999.73
Polkton, First Bank	49,999.95
Raleigh, Mechanics & Farmers	5,999.73
Reidsville, First National Bank of Reidsville	71,999.78
Robbins, First Bank	70,000.28
Robbinsville, Carolina Community Bank	34,000.44
Salemburg, Southern Bank & Trust Co.	119,000.17
Seven Springs, Southern Bank & Trust Co.	24,000.37
Shelby, Fidelity Bank	71,999.69
Shelby, First National Bank	30,000.33
Spruce Pines, First Western Bank	72,999.70
St Pauls, First Bank	69,999.79
Swan Quarter, The East Carolina Bank	113,186.14
Tarboro, The Heritage Bank	34,999.53
Troy, The Fidelity Bank	69,999.90
Troy, First Bank	92,999.56
W Jefferson, 1st Charter Bank	156,000.11
Walnut Cove, The Community Bank	76,999.80
Wanchese, The East Carolina Bank	85,000.46
Waynesville, Carolina Community Bank	33,999.93
Wentworth, Fidelity Bank	35,000.22
West End, First Bank	21,875.12
Windsor, Southern Bank & Trust Co.	35,000.33
Winton, Southern Bank & Trust Co.	34,999.87
Yanceyville, Fideiliy Bank	102,000.05

Total Community Banks Accounts	\$ 4,964,559.39
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Treasurer's Cash Balance before Adjustments	\$ 17,647,990.25
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Table 2

**Summary of Investment by Participants
For the Periods Ended
June 30, 2003 and June 30, 2002 (in thousands)**

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Retirement Trust Funds:		
Teachers' and State Employees' Retirement System	\$ 43,258,594	\$ 41,751,489
Local Governmental Employees' Retirement System	11,887,613	10,989,184
North Carolina Firemen's Pension Fund	227,721	218,182
Rescue Squad Workers' Pension Fund	25,899	24,697
Consolidated Judicial Retirement System	330,862	315,578
North Carolina National Guard Pension Fund	46,502	45,161
Legislative Retirement System	26,401	25,366
Total Retirement Trust Funds:	<u>55,803,592</u>	<u>53,369,657</u>
Other Funds:		
General Fund	1,470,880	1,331,519
Other Funds Which Earn Interest for the General Fund	1,083,475	1,011,184
Highway Fund	430,248	558,153
Highway Trust Fund	188,940	497,325
University Funds	1,493,248	1,222,393
Other Independent Trust Funds	3,162,507	3,070,181
Local Political Subdivisions	463,214	439,048
Licensing Boards	5,926	5,999
Total Other Funds	<u>8,298,438</u>	<u>8,135,802</u>
Grand Total All Funds	<u>\$ 64,102,030</u>	<u>\$ 61,505,459</u>

Statement of Departmental Revenues and Expenditures
Budget and Actual (Budgetary Basis)
General Fund (Departmental Activities Only)
For the Fiscal year Ended June 30, 2003

	<u>Budget</u>	<u>Actual</u>	<u>Variance Favorable (Unfavorable)</u>
Departmental Expenditures			
General Administration	\$ 978,050	\$ 920,055	\$ 57,995
Escheat Operations	1,943,491	1,942,247	1,244
Investment Management Operations	2,090,453	1,816,128	274,325
Local Government Operations	3,285,008	2,940,835	344,173
State Bond Issuance cost	1,163,365	1,163,365	-
Retirement Operations	13,462,507	13,213,132	249,375
Financial Operations:			
Banking	3,283,379	2,900,229	383,150
Accounting	1,203,784	1,073,971	129,813
Total Expenditures	\$ 27,410,037	\$ 25,969,962	\$ 1,440,075
Departmental Receipts			
General Administration	\$ 988,050	\$ 920,055	\$ (67,995)
Escheat Operations	1,950,491	1,942,393	(8,098)
Investment Management Operations	100	-	(100)
Local Government Operations	698,434	725,408	26,974
State Bond Issuance cost	1,163,365	1,163,365	-
Retirement Operations	13,462,507	13,213,133	(249,374)
Financial Operations:			
Banking	140,118	235,900	95,782
Accounting	1,166,937	1,073,971	(92,966)
Total Receipts	19,570,002	19,274,225	(295,777)
Appropriation	\$ 7,840,035	\$ 6,695,737	\$ 1,144,298

Table 4

General Obligation Bonds / Local Government / Referenda and Authorizations Fiscal Year July 1, 2002 Through June 30, 2003

	Propositions			Bonds		
	# Proposed	# Approved	% Approved	\$ Proposed	\$ Approved	% Approved
COUNTIES:						
Voted Propositions:						
Schools	7	5	71.43%	\$ 471,400,000	\$ 435,900,000	92.47%
Community College	2	2	100.00%	\$ 19,500,000	\$ 19,500,000	100.00%
Jail-Law Enforcement Ctr.	1	1	100.00%	\$ 12,000,000	\$ 12,000,000	100.00%
Total	10	8	80.00%	\$ 502,900,000	\$ 467,400,000	92.94%
Nonvoted Propositions:						
Refunding	15	15	100.00%	453,200,000	453,200,000	100.00%
2/3rd issues	3	3	100.00%	12,600,000	12,600,000	100.00%
Total	18	18	100.00%	\$ 465,800,000	\$ 465,800,000	100.00%
DISTRICTS:						
Voted Propositions:						
Refunding	2	2	100.00%	\$ 19,700,000	\$ 19,700,000	100.00%
Water	4	4	100.00%	\$ 19,999,000	\$ 19,999,000	100.00%
Total	6	6	100.00%	\$ 39,699,000	\$ 39,699,000	100.00%
MUNICIPALITIES:						
Voted Propositions:						
Sewer	1	1	100.00%	5,000,000	5,000,000	100.00%
Housing	1	1	100.00%	20,000,000	20,000,000	100.00%
Streets	3	3	100.00%	213,625,000	213,625,000	100.00%
Recreation	1	1	100.00%	30,000,000	30,000,000	100.00%
Beach Renourish.	1	1	100.00%	1,600,000	1,600,000	100.00%
Total	7	7	100.00%	\$ 270,225,000	\$ 270,225,000	100.00%
Nonvoted Propositions:						
Refunding	15	15	100.00%	209,250,000	209,250,000	100.00%
2/3rd issues	4	4	100.00%	18,775,000	18,775,000	100.00%
Total	19	19	100.00%	\$ 228,025,000	\$ 228,025,000	100.00%
TOTAL VOTED	23	21	91.30%	\$ 812,824,000	\$ 777,324,000	95.63%
TOTAL NONVOTED	23	21	91.30%	\$ 812,824,000	\$ 777,324,000	95.63%
GRAND TOTALS	46	42	91.30%	\$ 1,625,648,000	\$ 1,554,648,000	95.63%

Installment Purchase Agreements Approved by Purpose Fiscal Year July 1, 2002 Through June 30, 2003

MUNICIPALITIES:		Amount
Utilities		
Sanitary Sewer	\$ 16,774,870	
Water	<u>\$ 24,228,819</u>	
		\$ 41,003,689
Public Buildings		
Fire Station	\$ 5,124,000	
City, Town or Village Hall	\$ 63,702,250	
Public Works	<u>\$ 100,000</u>	
		\$ 68,926,250
Refunding		\$ 182,839,447
Land Acquisition		\$ 62,747,000
Recreation		\$ 12,012,089
Streets & Sidewalks		\$ 17,800,000
Other		\$ 25,223,259
Equipment		<u>\$ 900,000</u>
		<u>\$ 411,451,734</u>
 COUNTIES:		
Schools		\$ 131,371,131
Public Buildings		
Administration Building	\$ 17,484,157	
Health & Social Services	<u>\$ 6,602,496</u>	
		\$ 24,086,653
Courthouse/Law Enforcement/Jail		\$ 46,115,853
Hospital		\$ 2,500,000
Refunding		\$ 111,086,206
Utilities		
Water	\$ 13,616,243	
Sanitary Sewer	\$ 36,158,297	
Solid Waste	<u>\$ 5,423,481</u>	
Other		\$ 14,056,428
Community College		\$ 15,526,401
Arena		\$ 23,175,000
Industrial Development		\$ 3,056,748
Telecommunications		\$ 14,700,000
Library		\$ 10,551,113
Qualified Zone Academy Bonds		<u>\$ 9,552,077</u>
		<u>\$ 460,975,631</u>
 COMMUNITY COLLEGES:		
Guaranteed Energy Savings Contracts		<u>\$ 9,976,824</u>
 AUTHORITIES:		
Adult Day/Mental Health Center		\$ 330,000
Energy Conservation		<u>\$ 367,500</u>
		<u>\$ 697,500</u>
 GRAND TOTAL		 <u><u>\$ 883,101,689</u></u>

Table 6

Installment and Lease Agreements
Approved by the Local Government Commission
Fiscal Years Ended June 30, 2003, 2002, and 2001

	FY <u>No.</u>	2002-03 <u>Amt.</u>	FY <u>No.</u>	2001-02 <u>Amt.</u>	FY <u>No.</u>	2000-01 <u>Amt.</u>
Counties	45	314.0	37	304.3	51	433.8
Municipalities	54	411.4	46	175.4	49	270.3
Authorities/Districts	2	0.9	2	2.3	0	-
Boards of Education	15	131.3	3	5.8	0	-
Community College /GESC	<u>9</u>	<u>25.5</u>	<u>4</u>	<u>6.1</u>	<u>2</u>	<u>2.8</u>
TOTAL	<u>125</u>	<u>883.1</u>	<u>92</u>	<u>493.9</u>	<u>102</u>	<u>706.9</u>

Summary of State and Local Government Debt and Authorization at June 30, 2003

	General Obligations		Total	Non-General Obligations		Industrial Revenue Bonds	Total Indebtedness		General Obligation Authorized and Unissued Bonds
	Bonds	Other		Bonds	Bonds		Bonds	Bonds	
State	\$ 4,059,067,828	\$ -	\$ 4,059,067,828	\$ 27,070,000	\$ -	\$ -	\$ 4,086,137,828	\$ 3,053,400,000	
State Authorities and Institutions	\$ -	\$ -	\$ -	\$ 14,887,277,814	\$ 10,450,000	\$ -	\$ 14,897,727,814	\$ -	
Totals	\$ 4,059,067,828	\$ -	\$ 4,059,067,828	\$ 14,914,347,814	\$ 10,450,000	\$ -	\$ 18,983,865,642	\$ 3,053,400,000	
Counties	\$ 5,356,610,251	\$ 9,455,000	\$ 5,366,065,251	\$ 2,518,981,750	\$ -	\$ -	\$ 7,885,047,001	\$ 1,095,493,000	
Municipalities	\$ 2,537,299,259	\$ 18,266,000	\$ 2,555,565,259	\$ 3,697,917,373	\$ -	\$ -	\$ 6,253,482,632	\$ 725,457,500	
Districts	\$ 313,593,540	\$ 26,608,000	\$ 340,201,540	\$ 160,188,648	\$ -	\$ -	\$ 500,390,188	\$ 125,176,600	
Authorities	\$ -	\$ -	\$ -	\$ 1,337,291,642	\$ 1,860,978,946	\$ -	\$ 3,239,698,130	\$ -	
Total	\$ 8,207,503,051	\$ 54,329,000	\$ 8,261,832,051	\$ 7,714,379,413	\$ 1,860,978,946	\$ -	\$ 17,878,617,952	\$ 1,946,127,100	
Grand Total	\$ 12,266,570,879	\$ 54,329,000	\$ 12,320,899,879	\$ 22,628,727,227	\$ 1,871,428,946	\$ -	\$ 36,862,483,594	\$ 4,999,527,100	

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.

Table 7

Annual Debt Service Requirements for State Bonds Issued and Outstanding at June 30, 2003

	General		Highway		Total	
	Principal	Principal & Interest	Principal	Principal & Interest	Principal	Principal & Interest
	\$217,128,448.80	\$386,479,342.36	\$16,675,000	\$24,606,050	\$233,803,448.80	\$411,085,392.36
	220,992,952.60	380,932,434.86	16,675,000	23,855,675	237,667,952.60	404,788,109.86
	220,990,431.80	380,753,734.86	16,675,000	23,105,300	237,665,431.80	403,859,034.86
	221,005,722.90	370,625,174.86	16,675,000	22,354,925	237,680,722.90	392,980,099.86
	221,260,014.55	360,630,607.36	16,675,000	21,604,550	237,935,014.55	382,235,157.36
	220,425,257.30	349,279,766.10	16,675,000	20,837,500	237,100,257.30	370,117,266.10
	220,835,000.00	337,601,833.60	16,675,000	20,003,750	237,510,000.00	357,605,583.60
	221,170,000.00	327,097,758.60	16,675,000	19,170,000	237,845,000.00	346,267,758.60
	221,830,000.00	316,705,506.10	16,675,000	18,336,250	238,505,000.00	335,041,756.10
	222,890,000.00	306,836,472.78	16,550,000	17,377,500	239,440,000.00	324,213,972.78
	222,315,000.00	296,132,572.94			222,315,000.00	296,132,572.94
	221,715,000.00	285,459,323.06			221,715,000.00	285,459,323.06
	221,585,000.00	275,245,504.02			221,585,000.00	275,245,504.02
	219,115,000.00	262,034,191.68			219,115,000.00	262,034,191.68
	222,265,000.00	256,269,679.30			222,265,000.00	256,269,679.30
	221,465,000.00	246,018,262.34			221,465,000.00	246,018,262.34
	121,500,000.00	136,877,862.34			121,500,000.00	136,877,862.34
	65,500,000.00	75,739,529.02			65,500,000.00	75,739,529.02
	46,500,000.00	53,867,862.50			46,500,000.00	53,867,862.50
	39,455,000.00	44,587,862.50			39,455,000.00	44,587,862.50
	16,500,000.00	19,717,500.00			16,500,000.00	19,717,500.00
	16,500,000.00	18,975,000.00			16,500,000.00	18,975,000.00
	16,500,000.00	18,232,500.00			16,500,000.00	18,232,500.00
	16,500,000.00	17,490,000.00			16,500,000.00	17,490,000.00
	16,500,000.00	16,995,000.00			16,500,000.00	16,995,000.00
	<u>\$ 3,892,442,827.95</u>	<u>\$ 5,540,585,281.18</u>	<u>\$ 166,625,000</u>	<u>\$ 211,251,500</u>	<u>\$ 4,059,067,827.95</u>	<u>\$ 5,751,836,781.18</u>

Revenue Bonds and Other Indebtedness of State Authorities and Institutions at June 30, 2003

The following chart outlines the revenue bonds and other indebtedness of State authorities and institutions at June 30, 2003. The State is not responsible for debt service on any of the revenue bonds and other indebtedness represented in this chart.

Appalachian State University.....	\$ 112,131,127
East Carolina University.....	70,860,000
Elizabeth City State University.....	6,815,000
Fayetteville State University.....	7,435,000
North Carolina A & T State University.....	16,485,000
North Carolina Central University.....	10,720,000
North Carolina School of the Arts.....	4,580,000
North Carolina State University at Raleigh.....	153,159,000
University of North Carolina at Asheville.....	30,200,000
University of North Carolina at Chapel Hill.....	390,786,054
University of North Carolina at Charlotte.....	87,259,000
University of North Carolina at Greensboro.....	78,645,000
University of North Carolina at Pembroke.....	5,305,000
University of North Carolina at Wilmington.....	73,343,774
Western Carolina University.....	17,632,080
Winston-Salem State University.....	13,800,000
North Carolina Capital Facilities Finance Agency.....	1,319,254,527
North Carolina Eastern Municipal Power Agency.....	3,056,816,000
North Carolina Housing Finance Agency.....	1,305,637,000
North Carolina Medical Care Commission.....	4,779,353,715
North Carolina Municipal Power Agency No. 1.....	2,027,570,000
North Carolina State Education Assistance Authority.....	1,299,806,000
North Carolina State Ports Authority.....	19,684,537
Total.....	<u>\$14,887,277,814</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	December 31, 2002	December 31, 2001
Current Assets:		
Annuity Savings Fund	\$ 6,767,321,423	\$ 6,421,852,841
Pension Accumulation Fund	36,459,515,794	35,682,233,185
Total Current Assets	43,226,837,217	42,104,086,026
 Future Member Contributions to Annuity Savings Fund	 5,727,430,260	 5,527,713,120
 Prospective Contributions to Pension Accumulation Fund:		
Normal Contributions	6,405,176,174	6,144,974,418
Accrued liability contributions	(3,362,853,828)	(4,390,422,826)
Undistributed gain contributions	269,001,016	98,550,093
Total Prospective Contributions	3,311,323,362	1,853,101,685
Total Assets	\$ 52,265,590,839	\$ 49,484,900,831
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 6,767,321,423	\$ 6,421,852,841
Future member contributions	5,727,430,260	5,527,713,120
Total Contributions to Annuity Savings Fund	12,494,751,683	11,949,565,961
 Pension Accumulation Fund:		
Benefits currently in payment	17,993,715,435	16,308,089,907
Benefits to be paid to current active members	21,273,364,500	20,792,144,356
Reserve for increases in retirement allowances effective July 1, 2003 (July 1, 2002 for December 31, 2001 figure)	234,758,205	336,550,514
Reserve from undistributed gains	269,001,016	98,550,093
Total Benefits Payable from Pension Accumulation Fund	39,770,839,156	37,535,334,870
Total Liabilities	\$ 52,265,590,839	\$ 49,484,900,831

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

ASSETS	<u>December 31, 2002</u>	<u>December 31, 2001</u>
Current Assets:		
Annuity Savings Fund	\$ 2,260,286,364	\$ 2,094,105,014
Pension Accumulation Fund	9,133,173,848	8,669,927,020
Total Current Assets	<u>11,393,460,212</u>	<u>10,764,032,034</u>
 Future Member Contributions to Annuity Savings Fund	 <u>2,190,528,300</u>	 <u>2,134,912,134</u>
 Prospective Contributions to Pension Accumulation Fund:		
Normal Contributions	1,722,611,829	1,274,570,909
Accrued liability contributions	69,245,642	72,427,629
Undistributed gain contributions	4,324,305	408,247,921
Total Prospective Contributions	<u>1,796,181,776</u>	<u>1,755,246,459</u>
Total Assets	<u><u>\$ 15,380,170,288</u></u>	<u><u>\$ 14,654,190,627</u></u>
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 2,260,286,364	\$ 2,094,105,014
Future member contributions	2,190,528,300	2,134,912,134
Total Contributions to Annuity Savings Fund	<u>4,450,814,664</u>	<u>4,229,017,148</u>
 Pension Accumulation Fund:		
Benefits currently in payment	3,899,297,173	3,549,931,729
Benefits to be paid to current active members	6,862,389,785	6,392,657,970
Reserve for increases in retirement allowances effective July 1, 2003 (July 1, 2002 for December 31, 2001 figure)	163,344,361	74,335,859
Reserve from undistributed gains	4,324,305	408,247,921
Total Benefits Payable from Pension Accumulation Fund	<u>10,929,355,624</u>	<u>10,425,173,479</u>
Total Liabilities	<u><u>\$ 15,380,170,288</u></u>	<u><u>\$ 14,654,190,627</u></u>

Table 12

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

ASSETS	December 31, 2002	December 31, 2001
Current Assets:		
Annuity Savings Fund	\$ 32,674,936	\$ 31,154,848
Pension Accumulation Fund	290,709,113	280,066,096
Total Current Assets	<u>323,384,049</u>	<u>311,220,944</u>
Future Member Contributions to Annuity Savings Fund	<u>38,258,564</u>	<u>36,997,536</u>
Prospective Contributions to Pension Accumulation Fund:		
Normal Contributions	108,370,777	103,050,681
Accrued liability contributions	(22,352,690)	(25,528,777)
Undistributed gain contributions	570,985	5,381,386
Total Prospective Contributions	<u>86,589,072</u>	<u>82,903,290</u>
Total Assets	<u>\$ 448,231,685</u>	<u>\$ 431,121,770</u>
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 32,674,936	\$ 31,154,848
Future member contributions	38,258,564	36,997,536
Total Contributions to Annuity Savings Fund	<u>70,933,500</u>	<u>68,152,384</u>
Pension Accumulation Fund:		
Benefits currently in payment	161,966,659	146,821,585
Benefits to be paid to current active members	212,607,715	208,705,495
Reserve for increases in retirement allowances effective July 1, 2003 (July 1, 2002 for December 31, 2001 figure)	2,152,826	2,060,920
Reserve from undistributed gains	570,985	5,381,386
Total Benefits Payable from Pension Accumulation Fund	<u>377,298,185</u>	<u>362,969,386</u>
Total Liabilities	<u>\$ 448,231,685</u>	<u>\$ 431,121,770</u>

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

ASSETS	June 30, 2002	June 30, 2001
Current Assets:		
Annuity Savings Fund	\$ 28,908,316	\$ 27,021,271
Pension Accumulation Fund	211,010,083	198,254,967
Total Current Assets	<u>239,918,399</u>	<u>225,276,238</u>
 Future Member Contributions to Annuity Savings Fund	 <u>20,503,967</u>	 <u>20,114,028</u>
 Prospective Contributions to Pension Accumulation Fund:		
Normal Contributions	32,076,414	29,830,069
Accrued liability contributions	9,398,006	5,519,663
Total Prospective Contributions	<u>41,474,420</u>	<u>35,349,732</u>
Total Assets	<u>\$ 301,896,786</u>	<u>\$ 280,739,998</u>
LIABILITIES		
Annuity Savings Fund:		
Past member contributions	\$ 28,908,316	\$ 27,021,271
Future member contributions	20,503,967	20,114,028
Total Contributions to Annuity Savings Fund	<u>49,412,283</u>	<u>47,135,299</u>
 Pension Accumulation Fund:		
Benefits currently in payment	131,408,453	119,688,831
Benefits to be paid to current active members	121,076,050	113,915,868
Total Benefits Payable from Pension Accumulation Fund	<u>252,484,503</u>	<u>233,604,699</u>
Total Liabilities	<u>\$ 301,896,786</u>	<u>\$ 280,739,998</u>