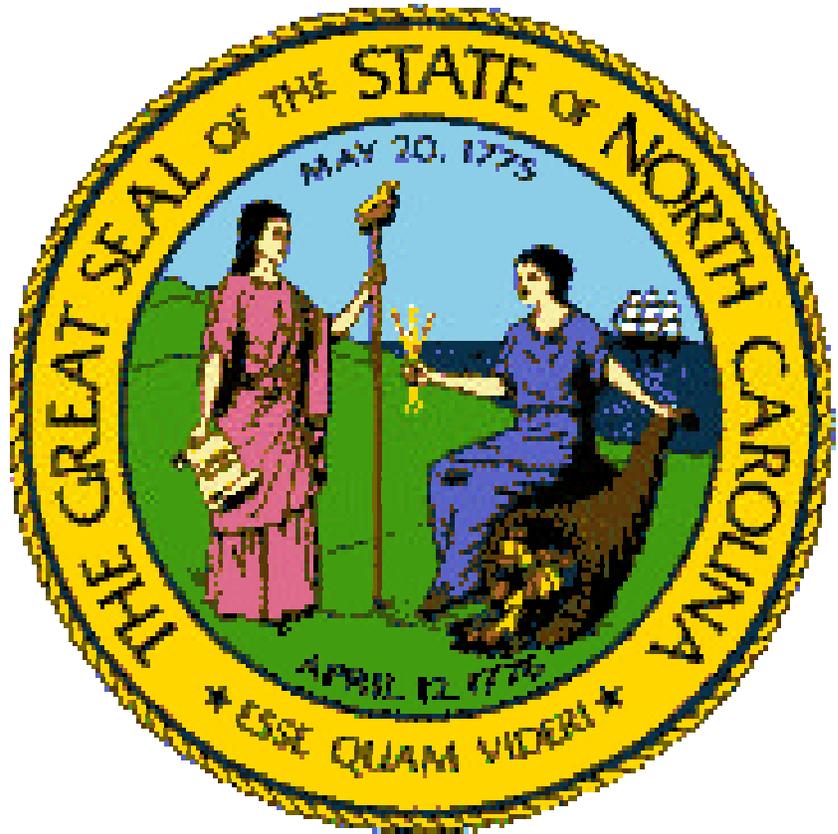


North Carolina

*Financial
Highlights
Fiscal Year
1999*



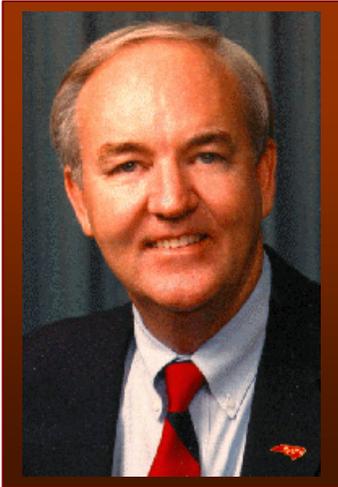
Edward Renfrow, State Controller

North Carolina Office of the State Controller

<http://www.state.nc.us/OSC>

North Carolina — Financial Highlights — Fiscal Year 1999

Prepared by the North Carolina Office of the State Controller
Edward Renfrow, State Controller
<http://www.state.nc.us/OSC>



I am pleased to present you with the **North Carolina Financial Highlights** for the fiscal year ended June 30, 1999. This **popular report** represents our continuing commitment in providing the highest standards of financial management and reporting, as well as fiscal accountability of the resources of the State of North Carolina reporting entity. We hope that you find this report both informative and beneficial and we welcome any questions or comments. If you need additional copies, or have questions about this report, please contact either me or our Statewide Accounting Division staff at (919) 981-5454.

Thank you for your interest in the State of North Carolina.

Sincerely,

A handwritten signature in black ink that reads "Edward Renfrow". The signature is written in a cursive style and is positioned above the printed name.

Edward Renfrow
State Controller
December 10, 1999

Introduction

This popular report, *North Carolina Financial Highlights*, is intended to summarize basic financial information about our State. This information is supported in more detail in the State's Comprehensive Annual Financial Report (CAFR). The CAFR is prepared in accordance with generally accepted accounting principles and is independently audited by the North Carolina Office of the State Auditor. Much of the information in the CAFR is necessarily technical and complex. As a result, the full financial statements and note disclosures may not be as useful to the citizens of the State wishing to gain a more general understanding of the State's finances.

The *popular report* is a report for the people. *North Carolina Financial Highlights* is the product of a coordinated effort on the part of state and local governments to issue simplified financial reports. It is our intent to provide you with information about the State's financial condition, without overwhelming detail and technical accounting terminology. This report contains financial information for the State's fiscal year ended June 30, 1999. The State's fiscal year starts July 1, and ends the following June 30.

Information is presented in this report on both the cash and generally accepted accounting principles (GAAP) basis. Labels have been used to note which basis of accounting is being shown.

The State's complete financial statements, known as the CAFR, can be obtained on the internet at <http://www.state.nc.us/OSC>, by telephone at (919)981-5454, or by writing to the N.C. Office of the State Controller, 1410 MAIL SERVICE CENTER, Raleigh, N.C. 27699-1410.

State Reporting Entity and Its Services

The State of North Carolina reporting entity includes all of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches of government.

In addition, the popular report includes financial information for legally separate component units for which the State is financially accountable.

The State's component units are the University of North Carolina system, the State's community colleges, and various proprietary organizations providing specific services to the public and private sector.

The State and its component units provide a broad range of services to its citizens, including

- public education;
- higher education;
- health and human services;
- economic development;
- environment and natural resources;
- public safety, corrections, and regulation;
- transportation;
- agriculture; and
- general government services.

The Economy

1999 was the eighth straight year of economic growth. One indicator of concern in 1999, interest rates, trended higher, especially during the second half of the year. Short-term interest rates rose one-half percentage point, while long-term interest rates rose over a full percentage point. Higher interest rates caused some jitters in the financial markets, particularly the stock market.

Technological improvements and the resulting gains in labor productivity continued to drive the economy. Worker productivity rose 2.5% in 1999.

Consumer spending, after inflation, jumped 5%, faster than consumer take-home pay. As a result, consumers continued to take on more debt during the year, prompted by the good economy and a bullish stock market.

With international trade becoming a greater part of the economy, foreign economic conditions are increasingly important. Fortunately, after a shaky second half of 1998, foreign markets stabilized in 1999.

Most of North Carolina also enjoyed a good economy in 1999. The state's Gross State Product is estimated to have grown 5%, and the statewide unemployment rate averaged near 3%.

North Carolina's economy continues to undergo a transformation. Service jobs are increasing relative to manufacturing jobs. Also, within manufacturing, traditional industries like tobacco, textiles, and apparel continue to downsize in employment, while "growth" industries like electronic equipment, transportation equipment, and metals add jobs. This transformation is not occurring equally in all regions of North Carolina. In general, the urban centers, especially in the Piedmont, are attracting the growth manufacturing industries and business services, like computer software development, while many rural counties are suffering from the loss of tobacco and textile jobs.

Finally, Hurricane Floyd hit North Carolina in late 1999. Its aftermath will have profound economic impacts. Hurricane Floyd wrecked havoc on counties accounting for 20% of the State's economy. Millions of dollars of wealth were destroyed and thousands of lives were disrupted. Dealing with the aftermath of Hurricane Floyd will be a major challenge for North Carolina's economy in 2000.

The national economy is expected to continue expanding in 2000. Growth may be significantly down in the early part of the year due to adjustments related to Y2K. These adjustments are expected to be short-lived and won't prevent a ninth straight year of economic growth.

The U.S. economy is projected to grow somewhat slower in 2000 than in 1999, with real Gross Domestic Product increasing 2.7% compared to 1999's rate of 3.7%. The reason is the upward trend in interest rates. Interest rates are expected to rise one-fourth to one-half percentage point in 2000. Higher interest rates reduce borrowing by businesses and consumers and thereby slow spending in the economy.

Several leading inflationary indicators suggest the rate of price increases will be slightly faster in 2000. A key determinant of inflation is labor costs. To date in the current expansion, technological improvements, advances in labor productivity, and increased domestic and

foreign competition have kept labor costs in check. If these conditions remain, inflation will not be a problem in 2000.

A watchful eye should be kept on the stock market in 2000. Any sustained downward trend in the stock market could cause consumers to retrench, lower their spending plans, and potentially slow the economy to near recessionary levels.

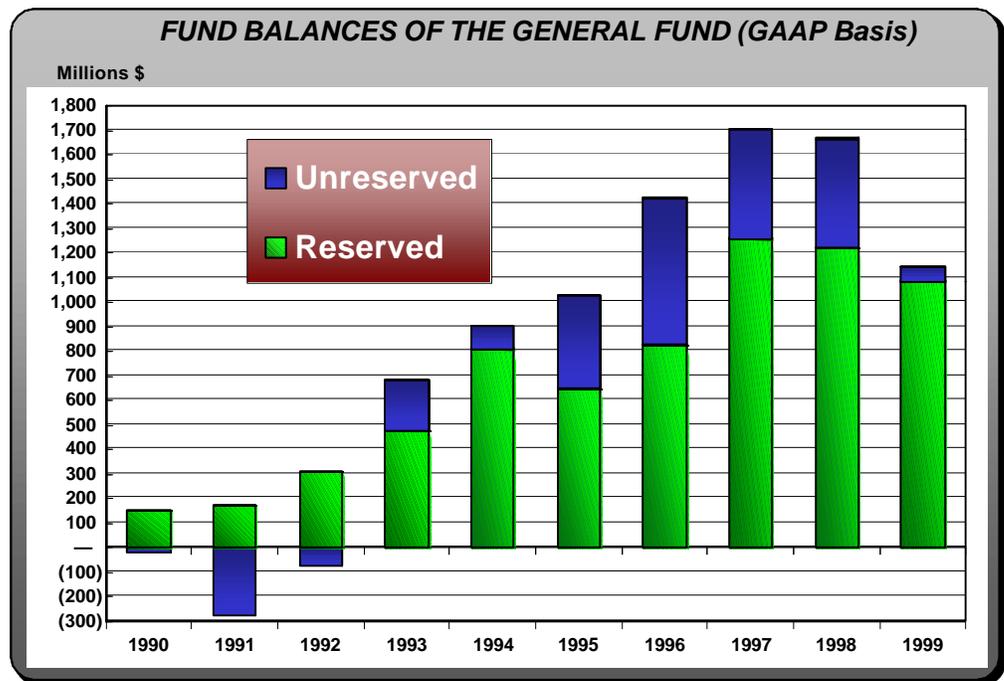
The North Carolina economy is also expected to grow in 2000, although also at a slower rate than in 1999. Growth in real Gross State Product will be closer to 4% in 2000, down from 1999's 5% rate.

Ironically, the spending associated with the rebuilding and recovery from Hurricane Floyd will boost the state's economic numbers in 2000. The real economic damper from the disaster will come in 2001 and thereafter, as businesses and households in the eastern part of the State will find their resources depleted by the recovery spending. Floyd will also likely speed the on-going economic transformation in the State's eastern counties. Recovering the wealth destroyed by Floyd will take several years.

*— Economic analysis prepared by Dr. Michael L. Walden, Professor
North Carolina State University
October 31, 1999*

General Fund GAAP Fund Balance

The fund balance of the General Fund declined by \$521 million in 1999. Expenditures and transfers out exceeded revenues and transfers in by \$478 million. At June 30, 1999, total fund balance of the General Fund on the modified accrual basis was \$1.144 billion, in comparison to a \$1.665 billion balance at the end of 1998.



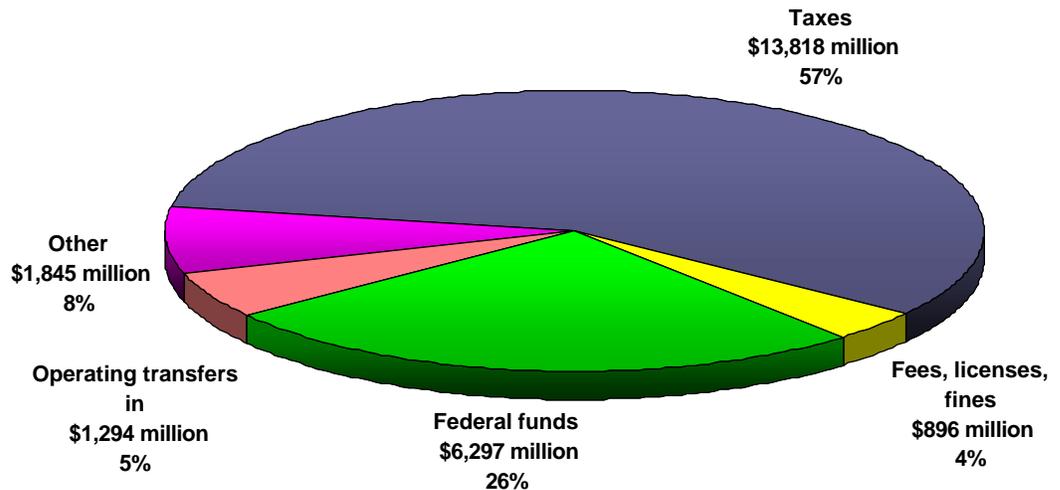
Reserved fund balance represents commitments of funds. The reserved portions indicate to the State's management that these monies are not available for discretionary spending.

Unreserved fund balance is what is available to fund future non-recurring needs of the State.

General Governmental Funds - GAAP Basis

Dollars Collected and Owed to the State

\$24.150 billion

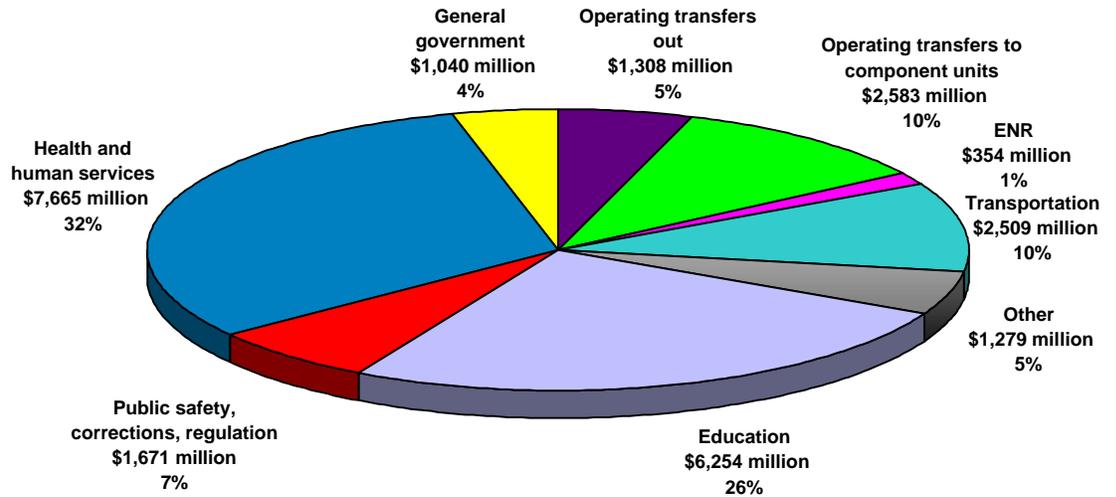


Tax Revenues. Tax revenues increased by \$530 million in 1999, reflecting a slower rate of growth in income tax collections. Individual income tax collections increased by \$461 million in 1999 to \$6.586 billion, a 7.53% increase over 1998. Sales tax collections grew by \$69.4 million in 1999, a 2.12% increase over 1998. Highway taxes were \$1.505 billion in 1999, \$27.7 million more than in 1998.

Federal Funds. Federal funds revenues grew by \$314 million in 1999, up by 5.2% over 1998. Increases in Federal revenues are due to increased Federal program expenditures for which the State is reimbursed.

Investment Earnings. Investment earnings of \$529 million reflect a decrease of \$47 million in 1999. Investment earnings include realized/unrealized gains, distributed and accrued interest on cash and investments, and securities lending activity. Cash and cash equivalents decreased by \$164.2 million, while investments decreased by \$616.4 million, with \$472 million of the decrease coming from the General Fund.

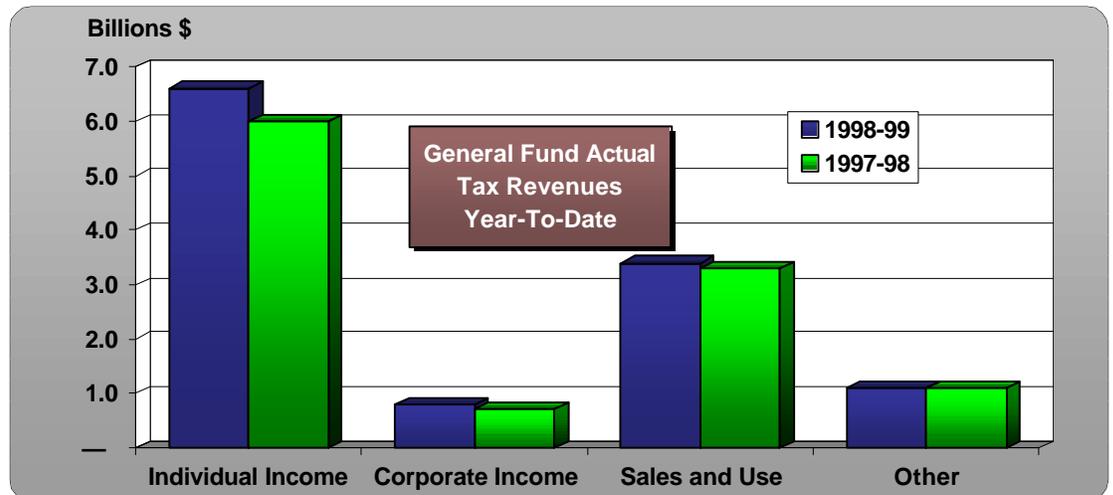
Dollar Outflows and Amounts Owed to Others \$23.663 billion



Significant changes in expenditures. The trend of increases in expenditures, an increase of \$1.8 billion for 1999, was directly related to the continued emphasis on education, health and human services, and transportation.

A large portion of the increase in governmental expenditures, tax judgments, is the result of the North Carolina Supreme Court ruling in the Bailey case. On June 9, 1998, representatives of the State and the various retirees involved in the Bailey and Patton cases announced a settlement, which was later approved by the court, in the amount of \$799 million. Of this amount, \$400 million was disbursed in refunds in fiscal year 1998-99, and \$399 million was paid in refunds early in fiscal year 1999-2000. Educational expenditures increased by \$838 million largely because of growth in dollars spent on State administered programs and the increasing costs associated with providing public education. Health and human services increased by \$365 million in 1999. Transportation expenditures increased in fiscal year 1999 by \$125 million. Debt service will continue to climb, a \$58 million increase from 1998 to 1999, as the State continues to issue general obligation debt to fund capital projects for education, highways and utilities.

General Fund Cash Basis Tax Revenues

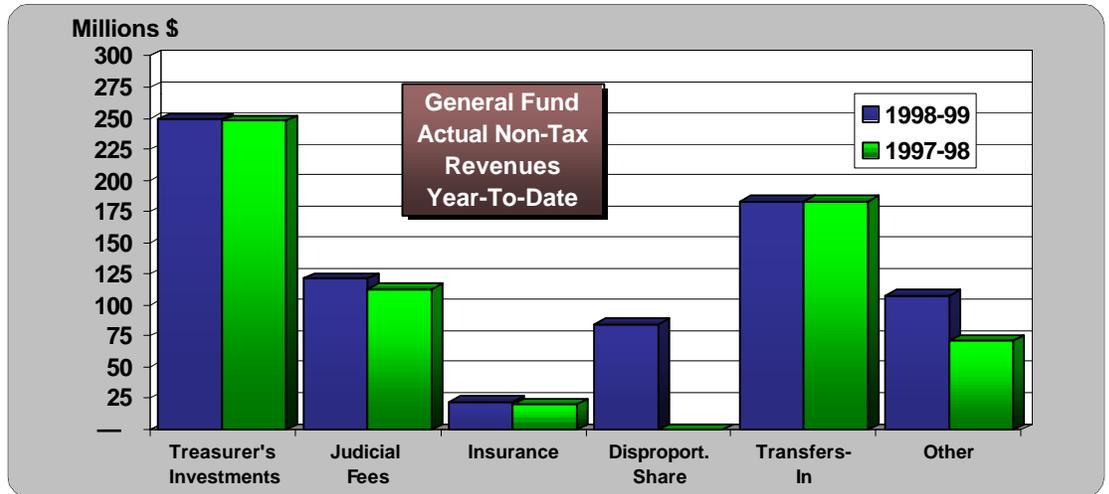


The State's General Fund reflects the efforts of the State to provide for education, health and human services, public safety, regulation, corrections and general government administration.

Monies collected in the General Fund must be authorized to be spent by the General Assembly. Individual income tax, corporate income tax and sales and use tax are the primary sources of income for the State's General Fund.

Primary sources of income will vary from state to state depending on a particular state's tax revenue structure.

General Fund Cash Basis Non-Tax Revenues



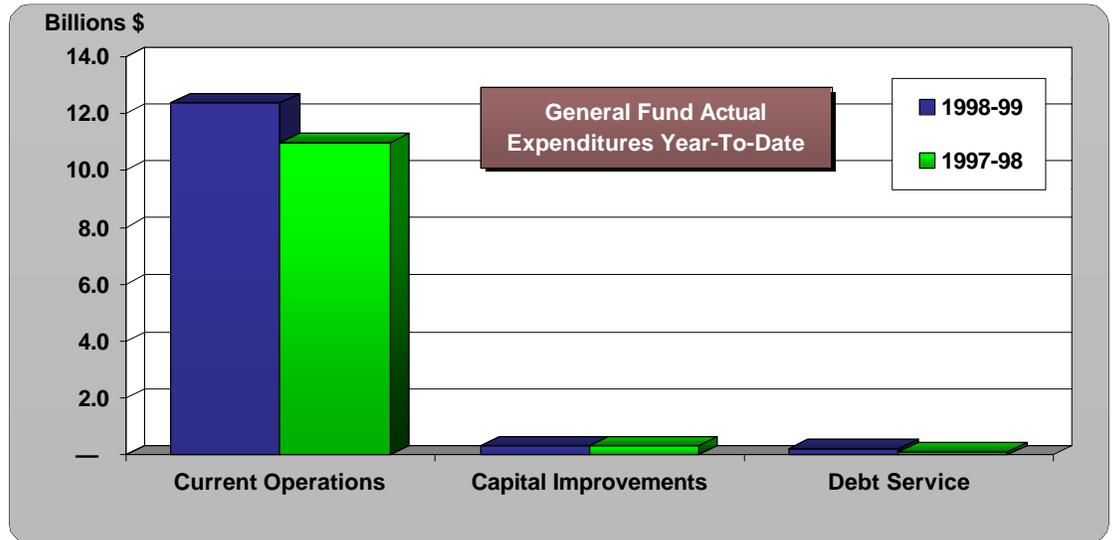
Along with tax revenues, the State collects various fees (judicial, insurance) and other miscellaneous revenues.

Treasurer's investment earnings are the result of the investment of available General Fund cash during the fiscal year.

Disproportionate share receipts are Medicaid payments received by hospitals which serve a disproportionate share of indigent patients.

Transfers-in consist primarily of funds reallocated to the General Fund from the Highway Trust Fund.

General Fund Cash Basis Appropriated State Dollars



Examples of current operations expenditures include expenditures for education, health and human services, public safety, regulation, corrections, and general government administration.

Generally each year, a large portion of funding for the infrastructure of the State is funded through capital improvement expenditures from the General Fund.

Debt service will begin to grow in proportion to total expenditures as the State issues new general obligation bonds whose funding purpose is the maintenance and construction of infrastructure within the State.

Major Issues

Hurricane Floyd

Hurricane Floyd passed through the eastern portion of North Carolina on September 15 and 16. Hurricane and tropical force winds, torrential rains, and flooding left one-third of North Carolina suffering from an unprecedented natural disaster. The record-high floodwaters of Hurricane Floyd forced thousands of people from their homes. Many citizens lost homes, farms, and businesses. Governor Hunt is seeking \$5.3 billion in federal disaster aid to help the recovery efforts in rebuilding homes, restoring transportation systems, and other infrastructure, and in providing resources for critical environmental cleanup efforts. Disputes in the U.S. Congress may delay the requested federal aid. The State is estimating that it will need to set-aside \$500 million in state matching funds over the next several years to satisfy federal requirements.

Year 2000

As of June 30, 1999, 1,093 application systems existed in the statewide inventory. Of those, 399 were reported by the agencies and universities as Year 2000 ready without remediation. The remaining 694 systems are in the following phases of remediation: 16 are in the assessment stage; 35 are in the remediation stage; 102 are in the validation/testing stage; and 541 have been fully remediated and placed back into production. The systems that have yet to be fully remediated have been grouped by function in the following table.

Functional Category	Assessment	Remediation	Validation/ Testing
General government	1	2	11
Education	10	5	4
Health and human services	—	3	19
Economic development	—	—	4
Environment and natural resources	1	1	8
Public safety, corrections, and regulation	1	5	5
Transportation	—	—	7
Agriculture	—	2	3
Universities	3	17	41
Total	<u>16</u>	<u>35</u>	<u>102</u>

The assessment process for computer systems is continuous and ongoing. The Year 2000 Project Team is also working with agencies and universities to address Year 2000 readiness issues in the other following areas: PC/LAN hardware and software, workplace infrastructure (facilities, telephones), embedded chips (medical/lab equipment, transportation vehicles, enforcement systems), supply chain partners, and business continuity planning.

Because of the unprecedented nature of the Year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the State and its component units are or will be Year 2000 ready, that the State's and its component units' remediation efforts will be successful in whole or in part, or that parties with whom the State and its component units do business will be Year 2000 ready. In addition, the completion of these stages is not a guarantee that systems and equipment will be Year 2000-compliant.

Tobacco Settlement

On November 23, 1998, 46 states' Attorneys General and the major tobacco companies signed a proposed settlement that reimburses states for smoking-related medical expenses paid through Medicaid and other health care programs. North Carolina could receive approximately \$4.6 billion over the next 25 years. The settlement was approved in a Consent Decree in December 1998. On March 16, 1999, the General Assembly enacted a law approving the establishment of a foundation to provide economic impact assistance to economically affected or tobacco dependent regions in North Carolina. The court must review the law for compliance with the intent outlined in the Consent Decree. The foundation would receive 50 percent of the settlement. The remaining half would be split equally between two trust funds established by the General Assembly. One trust fund would be for the benefit of tobacco farmers, quota holders, and persons in tobacco-related businesses, and the second trust fund would be for health programs.

Intangibles Tax Ruling

On May 25, 1999, the North Carolina Superior Court entered judgement in *Smith* against the State in the amount paid by non-protesting taxpayers for tax years 1991-1994. In a closely related class action tax refund case, *Shaver v. State of North Carolina*, filed July 16, 1998, non-protesting taxpayers sought refunds, totaling approximately \$100 million, for tax year 1990. On July 8, 1999, class counsel in *Smith* and *Shaver* entered into a settlement agreement with the State, subject to the General Assembly's approval, providing for the payment of the *Smith* and *Shaver* claims for a total of \$440 million to be paid in two installments. The settlement agreement provides for an initial payment of \$200 million to be paid on October 1, 1999, and a final payment of \$240 million on July 10, 2000. On July 9, 1999, the Superior Court entered judgement against the State in *Shaver*, formalizing the memorandum ruling to that effect on July 1, 1999.

New Debt Issues

In November 1996, the voters of North Carolina approved bonds in the amount of \$1.8 billion for school construction and \$950 million for highway construction. In November 1998, North Carolina voters approved \$800 million of new debt to finance grants and loans to local government units for water supply systems, wastewater collection systems, wastewater treatment works, and water conservation and water reuse projects; and an additional \$200 million of new debt to finance grants, loans, or other financing to public or private entities for construction of natural gas facilities. The amount of authorized, but unissued bonds was \$2.15 billion as of June 30, 1999.

The third bond issue related to the \$1.8 billion of school construction bonds which were approved in November 1996 was issued April 1, 1999 in the amount of \$450 million. These bonds were issued at rates ranging from 4.5% to 5.0% with a final maturity of April 1, 2018.

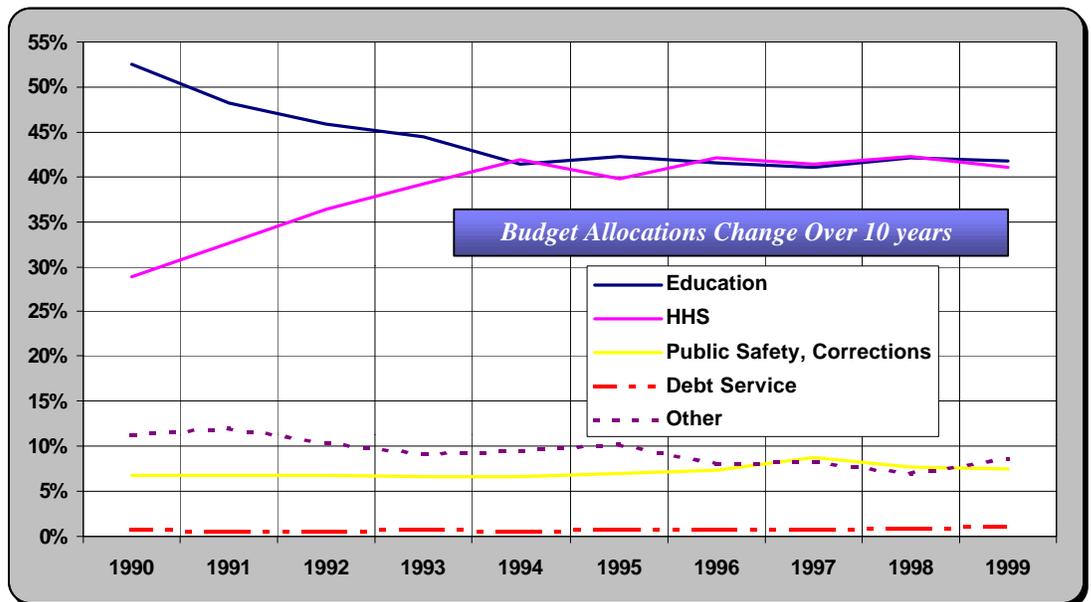
The State sold \$450 million of general obligation school construction bonds on March 17, 1999. Additionally, the State sold \$25.905 million of Clean Water Refunding Bonds on March 17, 1999. The refunding bonds provided funds for refunding \$24 million of Clean Water Bonds, Series 1994A.

Changes in How Your Dollars are Spent - General Fund Cash Basis

The following chart reflects the changes in budgetary allocations in the General Fund over the last 10 years.

The State's "budget", as approved by the General Assembly, typically only addresses State dollars. The revenue and expenditure amounts used to compile the chart below are higher than those referenced during the General Assembly's budget deliberations because of the inclusion of State, federal and local dollars.

Education received 52.4% of the annual budget (State, federal, and local dollars) in 1990, while funding decreased proportionally to 41.8% in 1999 when compared to other funding needs. During the same period, the budget allocation for health and human services grew from 28.8% to just over 41.1%. The remaining portions of the budget remained relatively the same over the last 10 years.



The primary cause of change in allocations is the result of changes in spending requirements for federal funds in our State.

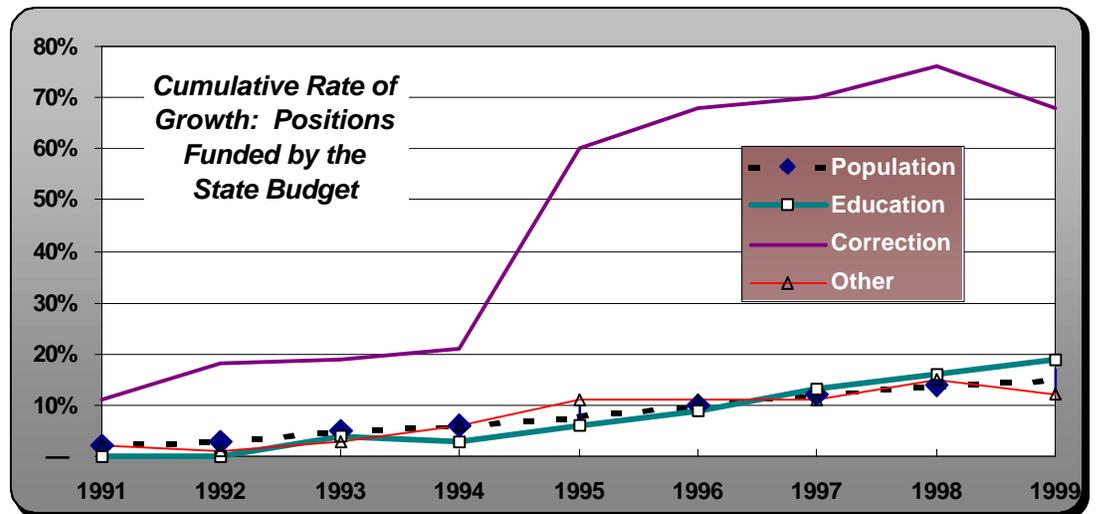
State Government Growth

As the State continues to experience population growth (15.5%, or 1.026 million people since 1990), the various functions of State government have been and will continue to be affected.

In addition to the pressures of population growth on education, the plan to improve elementary and secondary education in North Carolina has included class size reduction and the addition of teaching assistants. During the last 10 years, 345 new schools, funded by State and local dollars, were constructed in North Carolina. When we provide for the construction of new public schools, we must then fill our new schools with qualified classroom personnel and administrators.

As our population grows, so does the number of criminals that must be supervised in our correctional facilities. In addition, litigation during the late 1980's resulted in additional square footage requirements for inmates, and sentencing laws were strengthened, hence the need for more prison facilities. During fiscal year 1998-99, the State housed approximately 31,914 inmates on a daily basis, with 25,156 entering the prison system and 25,859 exiting the prison system.

Most of the position growth in State government during the last 10 years has been in public education, which has increased by 25,281 positions, and corrections which has increased by 7,587 positions.



During the last 10 years, the rate of growth in public education (k-12) positions (24% increase) has exceeded the rate of growth in North Carolina's population (15.5% increase). During the same period, primarily due to new legal requirements for housing inmates, the rate of growth in correctional positions (67.7% increase) has far and away exceeded North Carolina's population growth.

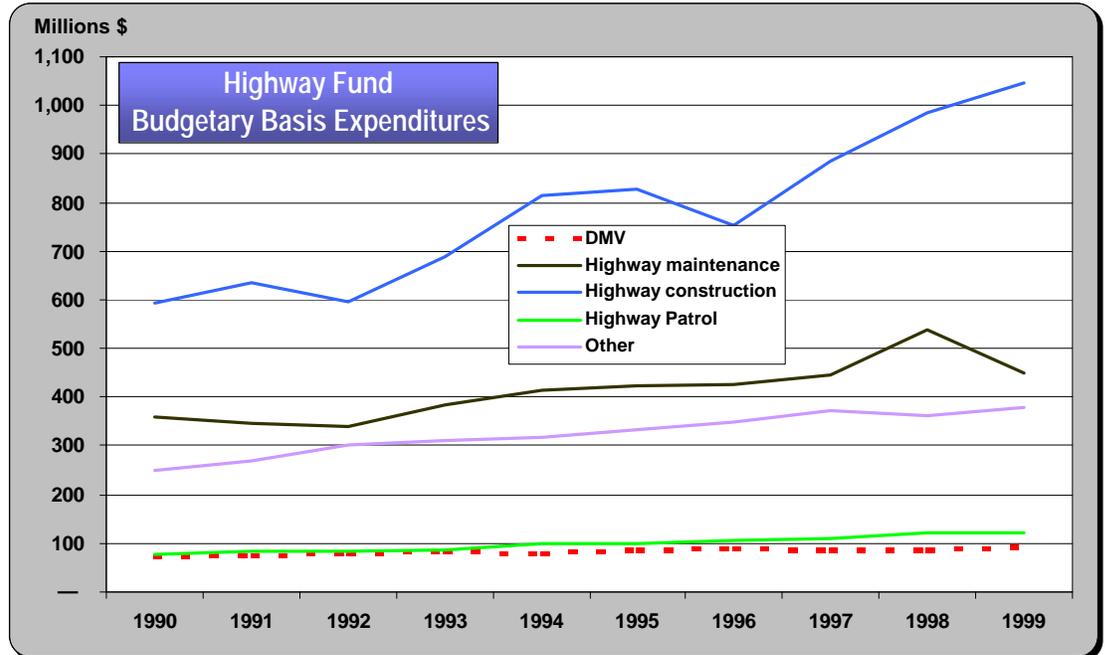
North Carolina's Growth Demands Spending for Transportation Infrastructure

During the last 10 years, the State's highway programs have added in excess of 1,170 miles of roadways to our State, or roughly the equivalent of traveling roundtrip from the Town of Manteo on the Atlantic Coast to the Town of Murphy in the Appalachian mountains. With these additions, our State must maintain an estimated 77,978 miles of roadway.

Funding for Highway Maintenance and Construction

The State's Highway Fund, referred to as a Special Revenue Fund, is funded by specific taxes and fees dedicated to expenditures for the purpose of constructing and maintaining the State's highway system.

The following chart presents information on a budgetary (cash basis) for the Highway Fund.



A major new financial reporting requirement for governments is the inclusion of infrastructure assets in governments' financial statements, to include depreciation and accumulated depreciation. One allowable alternative to depreciating infrastructure assets is to demonstrate that the infrastructure assets are being maintained at an acceptable condition level. The Department of Transportation is required to survey and report on the condition of the State highway system.

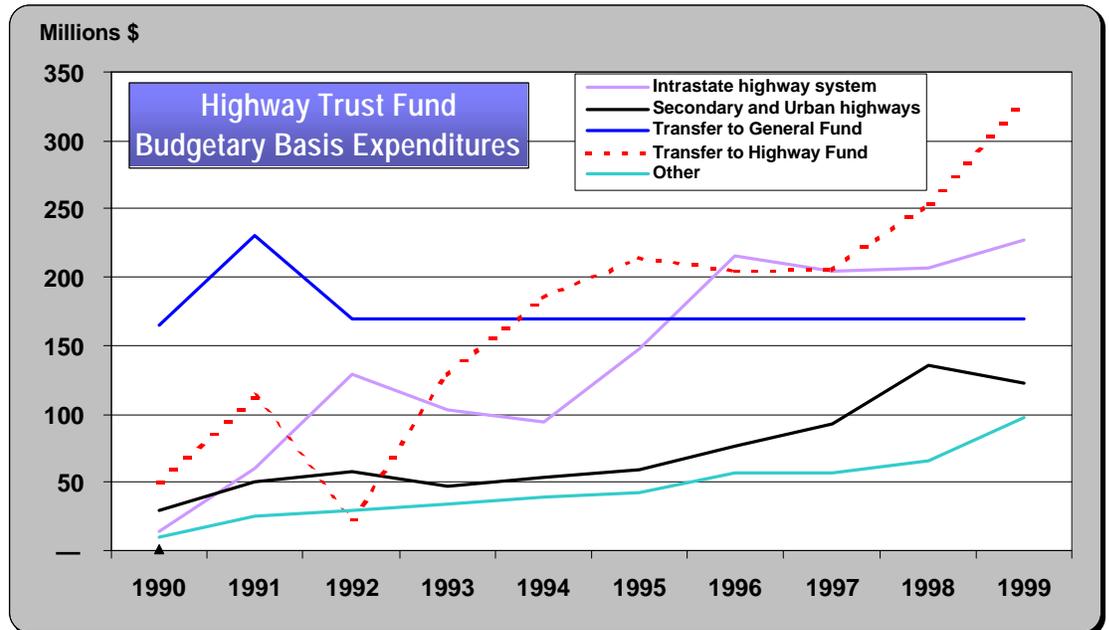
The North Carolina Department of Transportation develops a statewide annual maintenance program for the State highway system, which is subject to the approval of the North Carolina Board of Transportation and takes into consideration the general maintenance needs, special maintenance needs, vehicular traffic, and other factors deemed pertinent. Transportation engineers, at the end of the fiscal year, certify the maintenance of highways in each division in accordance with an annual work program, along with explanations of any deviations. The report on the condition of the State highway system and the annual maintenance program are presented to the Joint Legislative Transportation Oversight Committee by November 30 of each even-numbered year. A detailed assessment is conducted of the State's pavements, structures, and roadway features. The methodologies used in the survey and assessment are based on acceptable practices used in other state transportation departments across the country.

The *1998 Report on the Condition of the State Highway System* concludes that the condition of the State highway system is directly related to the level of funding, and that current funding levels for routine maintenance and resurfacing are inadequate. In a high growth State such as North Carolina, the trend of increasing lane miles and increased traffic on existing roads, along with general deterioration from the elements, are at the heart of the problem. Of course, the forces of Hurricane Floyd's torrential rain and flooding dealt a destructive blow to many roads, bridges, and drainage systems in eastern North Carolina.

The most current *Condition* report highlights that while road maintenance funding has increased over the last decade, the increase in funding has not kept pace with inflation. The December 1998 report estimated total maintenance needs, including backlogs, ranges from \$705 million in fiscal year 1999-2000, to \$1.035 billion in fiscal year 2008-2009 (averaging \$849.5 million per year). The approved State budget included \$493.1 million road maintenance funding for fiscal year 1999-2000. In addition, \$20 million per year from secondary construction funds are used to stabilize unpaved roads scheduled to be paved in the next few years. These stabilization functions are actually maintenance. By adding this \$20 million, maintenance funding equals \$513.1 million per year, or \$191.9 million (27%) less than the estimated funding needs for fiscal year 1999-2000.

Highway Trust Fund

The State's Highway Trust Fund, referred to as a Special Revenue Fund, is funded by specific taxes and fees, and is dedicated to expenditures for the purpose of constructing intrastate highway systems and urban loops, with supplements for city streets and secondary roads.



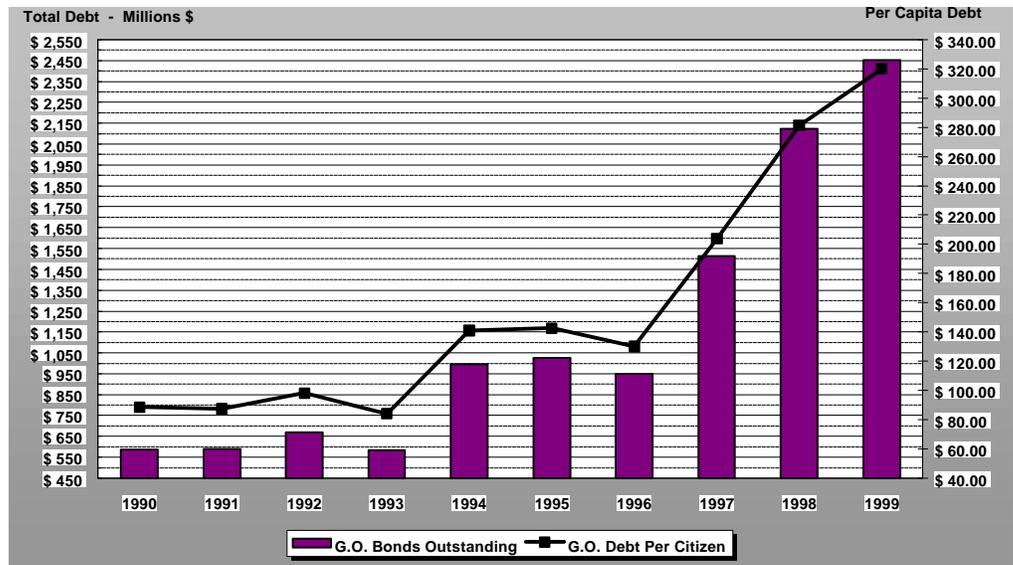
North Carolina's Infrastructure and Capital Improvement Needs Continue to Grow

As stated earlier, the State's population has grown by 15.5% since 1990. The drawing cards of excellent climate, geography, affordable higher education, and the State's efforts to recruit new industry and jobs have been major contributors.

With population growth comes the need to increase and improve the capacities of our infrastructure, i.e., our roads and highways, our public schools, and our clean water.

Fiscal Year Ended June 30	General Obligation Debt Per Capita			Ratio of Annual Debt Service To General Expenditures		
	N.C. Population	General Obligation Bonds Outstanding	G.O. Debt per Citizen	Debt Service (Principal and Interest)	Total General Expenditures	Ratio
1999	7,658,145	\$ 2,451,973,000	\$ 320.18	\$ 227,630,000	\$ 20,744,877,000	1.10%
1998	7,547,090	\$ 2,123,944,000	\$ 281.43	\$ 170,039,000	\$ 19,292,584,000	0.88%
1997	7,430,250	\$ 1,514,477,000	\$ 203.83	\$ 131,249,000	\$ 17,646,075,000	0.74%
1996	7,307,943	\$ 951,082,000	\$ 130.14	\$ 150,741,000	\$ 15,978,166,000	0.94%
1995	7,186,050	\$ 1,025,167,000	\$ 142.66	\$ 141,031,000	\$ 14,755,972,000	0.96%
1994	7,061,352	\$ 996,365,000	\$ 141.10	\$ 123,376,000	\$ 13,333,832,000	0.93%
1993	6,948,745	\$ 584,905,000	\$ 84.17	\$ 124,314,000	\$ 12,870,325,000	0.97%
1992	6,832,503	\$ 670,380,000	\$ 98.12	\$ 114,928,000	\$ 12,078,683,000	0.95%
1991	6,747,433	\$ 590,014,000	\$ 87.44	\$ 106,692,000	\$ 11,366,952,000	0.94%
1990	6,632,448	\$ 588,004,000	\$ 88.66	\$ 110,396,000	\$ 9,999,131,000	1.10%

Total General Obligation Debt and Long-Term Debt Per Capita



Source: Population - U.S. Department of Commerce, Bureau of the Census, and N.C. Office of State Budget and Management

625 copies of this public document were printed at a cost of \$.94.

The Government Finance Officers Association of the United States and Canada (GFOA) has given an Award for Outstanding Achievement in Popular Annual Financial Reporting to the State of North Carolina for its Popular Annual Financial Report for the fiscal year ended June 30, 1998. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular reports.

In order to receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a Popular Annual Financial Report, whose contents conform to program standards of creativity, presentation, understandability and reader appeal. An Award for Outstanding Achievement in Popular Annual Financial Reporting is valid for a period of one year only. We believe our current report continues to conform to the Popular Annual Financial Reporting requirements, and we are submitting it to GFOA.

