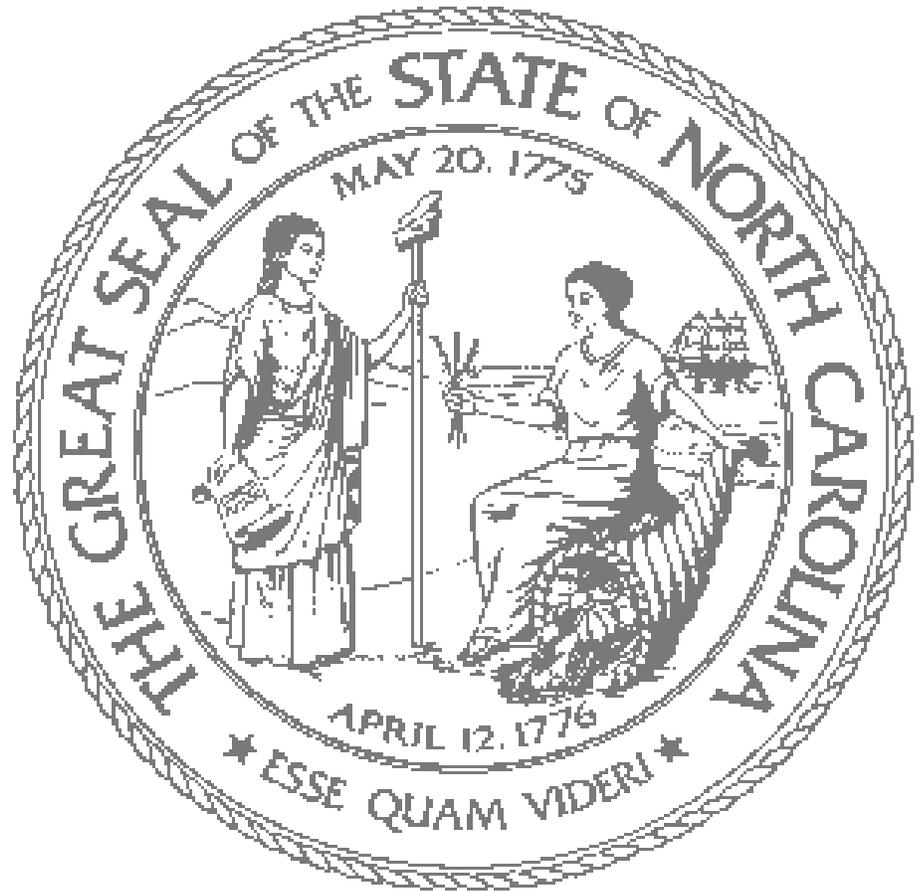


# North Carolina

*Financial  
Highlights  
Fiscal Year  
2003*



**Robert L. Powell, State Controller**

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**North Carolina Office of the State Controller**

**<http://www.osc.state.nc.us>**



I am pleased to present you with the *North Carolina Financial Highlights* for the fiscal year ended June 30, 2003. 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 "Robert L. Powell". The signature is written in a cursive, flowing style.

Robert L. Powell  
State Controller  
December 18, 2003

## ***Introduction***

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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. Our report provides information at the government-wide level in addition to the major fund level, and certain selected statistical information cited in our CAFR. Coverage of legally separate, but related organizations is limited to university and community colleges and is at a very high level.

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, 2003. The State's fiscal year starts July 1, and ends the following June 30. Information is presented in this report on the basis of generally accepted accounting principles (GAAP). This popular report and the State's complete financial statements, known as the CAFR, can be obtained on the internet at <http://www.osc.state.nc.us>, 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***

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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 other 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.



Horse Country, Southern Pines

## ***The Economy***

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There are some preliminary signs that the State's economy has begun to recover from the weakness this spring. Gross state and local sales tax receipts, adjusted for the recent tax hikes, grew at a 1.6% rate for the combined June and July period 2003. This contrasts to the 2.5% decline for the preceding three months. The growth accelerated to 2.6% in August and 3.3% in September as the federal rebates checks worked their way through the spending stream.

Withholding tax collections from large employers have moved to a slight growth path in recent months after being essentially flat for almost two years. One reason is the uptick in activity by the nonmanufacturing sectors that make up almost 82% of the economy. Finally, record real estate refinancing due to low mortgage rates put cash in consumers' pockets and zero percent financing by car dealers has propped up vehicle sales.

For the 2003-04 fiscal year, the North Carolina budget assumed a continued subpar economic recovery, both in terms of the absolute level (national outlook) and the usual growth premium specific to North Carolina during the years in recovery. This experience would be very different from the explosive growth after the last two recessions. One reason is the continued weakness in the telecommunications and tech sector due to continued overcapacity. As the state has diversified away from the traditional manufacturing industries (textiles, apparel, furniture, and

tobacco) to electronics and other technology-oriented companies, we have become more vulnerable to problems in the latter sectors. We are concerned that it may take some time for the nation's telecommunications companies to work down excess inventory.

Another major issue is the continued erosion of traditional manufacturers (textiles, apparel, furniture, tobacco) due to NAFTA or weakening market conditions. Even though these sectors are becoming a much smaller share of the economy, the magnitude of the decline is still a drag on total employment growth.

— *Economic analysis prepared by David Crotts*  
*Fiscal Research Division*  
*North Carolina General Assembly*  
*October 29, 2003*



NC Christmas Trees

## ***Overview of the Financial Statements***

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**Government-wide.** The State's total net assets increased slightly as a result of this year's operations. While net assets of governmental activities increased by \$771.6 million, or nearly 3.6%, net assets of business-type activities decreased by \$449.4 million, or about 31.9%. At year-end, net assets of governmental activities and business-type activities totaled \$22.31 billion and \$958.3 million, respectively.

Component units reported net assets of \$8.87 billion, an increase of \$704.6 million or 8.6% from the previous year. The State's largest component unity, the University of North Carolina System, had net assets of \$6.24 billion at June 30, 2003, an increase of \$466 million or 8.1% from fiscal year 2002.

**State Highway System.** The State highway system includes roadway surfaces, bridges, signage, railings, markings, traffic signal, and other structures related to the State's motor vehicle transportation system. The system includes 78,490 miles of roadway, constituting the second largest highway system in the nation. The system includes 17,250 bridges spanning 380 miles.

The State highway system is estimated to have a public service life of 50 years based on the planned maintenance schedule. Therefore, instead of charging the entire cost of additions to expense for the State highway system in the year of construction, the State highway system is capitalized and depreciated (costs allocated) over the estimated life of the highway system. The expenses are allocated over the periods of service to the public.

For fiscal year 2003, the State reflected \$12.4 billion (net of accumulated depreciation) of highway system infrastructure, an increase of \$897.7 million (net) or 7.8% from the previous year.

**Long-term Debt.** The State's general obligation debt payable increased during the fiscal year to \$4.07 billion, an increase of \$599.7 million or 17.3%.

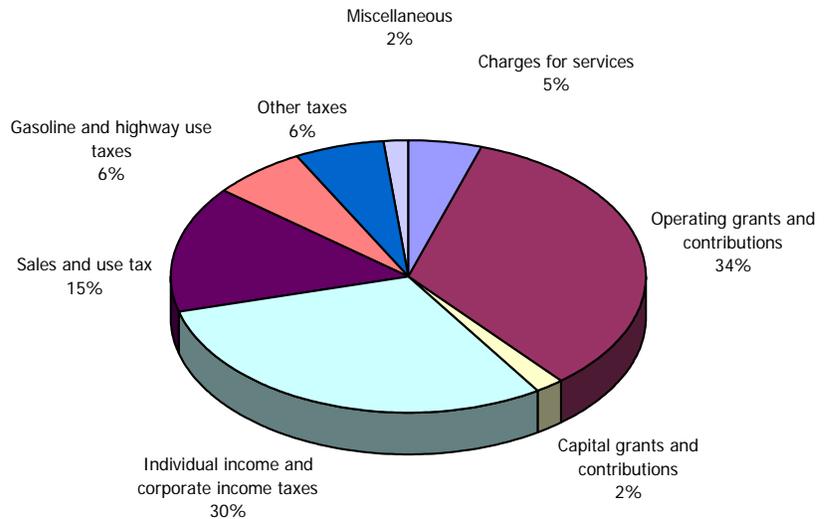
The State maintained its AAA bond rating with Standard and Poor's and Fitch. In August 2002, Moody's downgraded the State's credit rating for general obligation debt from "AAA" to "Aa1", representing the first time since 1960 that North Carolina had less than a "AAA" rating.



**Wilmington Waterfront**

# North Carolina — Financial Highlights — Fiscal Year 2003

**Government-Wide.** The following chart depicts revenues of the governmental activities for the fiscal year ended June 30, 2003:



**Statement of Net Assets.** The State's combined net assets increased \$322.2 million, or 1.4% over the course of this fiscal year's operations. The net assets of the governmental activities increased \$771.6 million or 3.6% and business-type activities had a decrease of \$449.4 million or 31.9%.

**Net Assets**  
June 30, 2003 and 2002  
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2003	2002	2003	2002	2003	2002
Current and other non-current assets.....	\$ 9,816,418	\$ 9,853,413	\$ 1,163,089	\$ 1,661,161	\$ 10,979,507	\$ 11,514,574
Capital assets, net.....	23,727,427	22,324,253	45,428	42,498	23,772,855	22,366,751
<b>Total assets.....</b>	<b>33,543,845</b>	<b>32,177,666</b>	<b>1,208,517</b>	<b>1,703,659</b>	<b>34,752,362</b>	<b>33,881,325</b>
Long-term liabilities.....	4,380,170	3,711,385	10,270	10,383	4,390,440	3,721,768
Other liabilities.....	6,853,153	6,927,395	239,923	285,523	7,093,076	7,212,918
<b>Total liabilities.....</b>	<b>11,233,323</b>	<b>10,638,780</b>	<b>250,193</b>	<b>295,906</b>	<b>11,483,516</b>	<b>10,934,686</b>
<b>Net assets:</b>						
Invested in capital assets, net of related debt.....	23,449,373	22,009,712	38,450	38,392	23,487,823	22,048,104
Restricted.....	1,071,626	1,084,614	863,426	1,317,595	1,935,052	2,402,209
Unrestricted.....	(2,210,477)	(1,555,440)	56,448	51,766	(2,154,029)	(1,503,674)
<b>Total net assets.....</b>	<b>\$ 22,310,522</b>	<b>\$ 21,538,886</b>	<b>\$ 958,324</b>	<b>\$ 1,407,753</b>	<b>\$ 23,268,846</b>	<b>\$ 22,946,639</b>

The largest component of the State's net assets (\$23.49 billion) reflects its investment in capital assets (land, buildings, machinery and equipment, State highway system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. Restricted net assets are the next largest component (\$1.94 billion) and represent resources that are subject to external restrictions on how they can be used. The remaining portion,

unrestricted net assets, consist of net assets that do not meet the definition of *restricted or invested in capital assets, net of related debt*.

The government-wide statement of net assets for governmental activities reflects a negative \$2.21 billion unrestricted net asset balance. The State of North Carolina, like many other state and local governments, issues general obligation debt and distributes the proceeds to local governments and component units. The proceeds are used to construct new buildings and renovate and modernize existing buildings on the State's community college and university campuses, assist county governments in meeting their public school building capital needs, and to provide grants and loans to local governments for clean water and natural gas projects. Of the \$4.07 billion of outstanding general obligation debt at June 30, 2003, \$3.78 billion of the outstanding debt is attributable to debt issued as State aid to component units (universities and community colleges) and local governments. The balance sheets of component unit and local government recipients reflect ownership of the related constructed capital assets without the burden of recording the debt obligation. The policy of selling general obligation bonds and funneling the cash proceeds to non-primary government (non-State) entities has been in place for decades. Through this policy the State was able to promote improved financial management, save bond issuance costs, and receive more attractive financing arrangements. However, by issuing debt and sending the cash proceeds outside of the State, the State must reflect significant liabilities on its statement of net assets (balance sheet) which are reflected in the unrestricted net asset component since there are no offsetting capital assets. Additionally, as of June 30, 2003, the State's governmental activities have significant unfunded liabilities for compensated absences in the amount of \$274.5 million and a \$20 million cost settlement payable to the federal government. These unfunded liabilities also contribute to the negative unrestricted net asset balance for governmental activities.

# North Carolina — Financial Highlights — Fiscal Year 2003

**Statement of Activities.** The following financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year ended June 30, 2003:

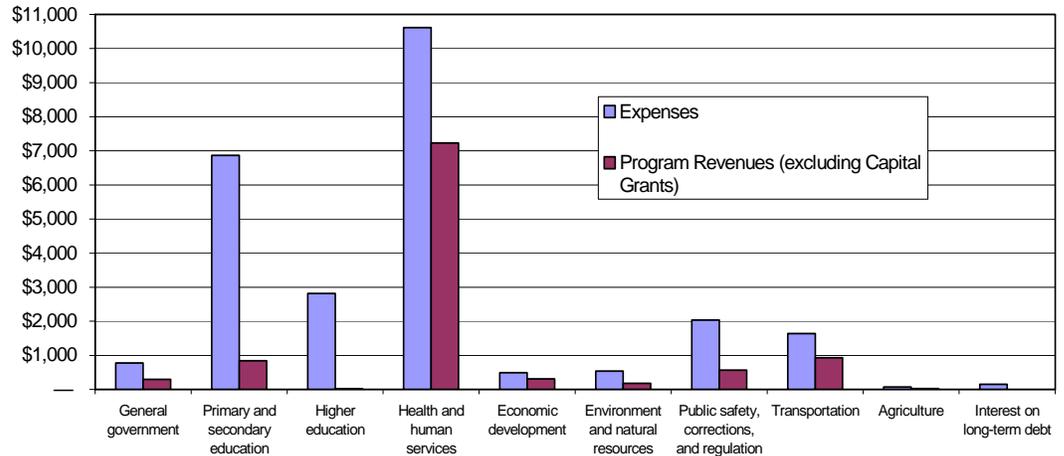
<b>Changes in Net Assets</b>						
<b>For the Fiscal Years Ended June 30, 2003 and 2002</b>						
<i>(dollars in thousands)</i>						
	<b>Governmental Activities</b>		<b>Business-type Activities</b>		<b>Total Primary Government</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
<b>Revenues:</b>						
<b>Program revenues:</b>						
Charges for services.....	\$ 1,350,749	\$ 1,301,564	\$ 688,517	\$ 487,443	\$ 2,039,266	\$ 1,789,007
Operating grants and contributions.....	9,043,064	8,725,315	504,550	485,492	9,547,614	9,210,807
Capital grants and contributions.....	527,498	714,084	1,241	1,121	528,739	715,205
<b>General revenues:</b>						
<b>Taxes</b>						
Individual income tax.....	7,122,099	7,234,431	—	—	7,122,099	7,234,431
Corporate income tax.....	921,611	599,382	—	—	921,611	599,382
Sales and use tax.....	4,029,403	3,778,873	—	—	4,029,403	3,778,873
Gasoline tax.....	1,154,986	1,212,788	—	—	1,154,986	1,212,788
Franchise tax.....	584,584	590,992	—	—	584,584	590,992
Highway use tax.....	552,759	555,320	—	—	552,759	555,320
Insurance tax.....	417,126	347,893	—	—	417,126	347,893
Beverage tax.....	198,848	200,593	—	—	198,848	200,593
Inheritance tax.....	112,150	106,491	—	—	112,150	106,491
Other taxes.....	289,261	278,740	—	—	289,261	278,740
Tobacco settlement.....	173,256	175,836	—	—	173,256	175,836
Federal grants not restricted to specific programs.....	136,859	—	—	—	136,859	—
Unrestricted investment earnings.....	103,987	139,350	—	—	103,987	139,350
Miscellaneous.....	41,137	57,484	—	—	41,137	57,484
<b>Total revenues.....</b>	<b>26,759,377</b>	<b>26,019,136</b>	<b>1,194,308</b>	<b>974,056</b>	<b>27,953,685</b>	<b>26,993,192</b>
<b>Expenses:</b>						
General government.....	773,835	874,208	—	—	773,835	874,208
Primary and secondary education.....	6,865,921	6,802,979	—	—	6,865,921	6,802,979
Higher education.....	2,814,375	2,519,703	—	—	2,814,375	2,519,703
Health and human services.....	10,614,411	10,376,807	—	—	10,614,411	10,376,807
Economic development.....	489,062	469,102	—	—	489,062	469,102
Environment and natural resources.....	537,540	623,351	—	—	537,540	623,351
Public safety, corrections and regulation.....	2,034,225	2,109,488	—	—	2,034,225	2,109,488
Transportation.....	1,639,866	1,530,869	—	—	1,639,866	1,530,869
Agriculture.....	73,972	121,729	—	—	73,972	121,729
Interest on long-term debt.....	151,258	148,595	—	—	151,258	148,595
Unemployment compensation.....	—	—	1,603,796	1,336,718	1,603,796	1,336,718
EPA Revolving Loan.....	—	—	4,266	4,018	4,266	4,018
Other business-type activities.....	—	—	30,757	25,431	30,757	25,431
<b>Total expenses.....</b>	<b>25,994,465</b>	<b>25,576,831</b>	<b>1,638,819</b>	<b>1,366,167</b>	<b>27,633,284</b>	<b>26,942,998</b>
Increase (decrease) in net assets before contributions and transfers.....	764,912	442,305	(444,511)	(392,111)	320,401	50,194
Contributions to permanent funds.....	1,806	2,019	—	—	1,806	2,019
Transfers.....	4,918	40,887	(4,918)	(40,887)	—	—
<b>Increase (decrease) in net assets.....</b>	<b>771,636</b>	<b>485,211</b>	<b>(449,429)</b>	<b>(432,998)</b>	<b>322,207</b>	<b>52,213</b>
Net assets - beginning - restated.....	21,538,886	21,053,675	1,407,753	1,840,751	22,946,639	22,894,426
<b>Net assets - ending.....</b>	<b>\$ 22,310,522</b>	<b>\$ 21,538,886</b>	<b>\$ 958,324</b>	<b>\$ 1,407,753</b>	<b>\$ 23,268,846</b>	<b>\$ 22,946,639</b>

As a result of this year's operations, the net assets of governmental activities increased by \$771.6 million or 3.6%. The net asset increase is primarily related to the receipt of federal fiscal relief in June 2003, an overall increase in tax revenues, and the State's ability to limit the growth in expenses. Total expenses of governmental activities grew by only 1.6% during the current period despite funding increases in the State's two largest functional areas, education and health and human services. The growth in education spending is related to enrollment increases at the State's universities and community colleges and the corresponding increases in State capital aid. The growth in health and human services is related to increased spending for the State's Medicaid program, which is the State's largest public assistance program. These funding

# North Carolina — Financial Highlights — Fiscal Year 2003

increases were partially offset by significant spending reductions by other State agencies, which were necessary to manage a budgetary shortfall.

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



Business-type activities reflect a decrease in net assets of \$449.4 million or 31.9%. The key reason for the decline was the State's high unemployment rate, resulting in the unemployment compensation fund finishing the year with a decrease in net asset of \$515.6 million or 65%. The Unemployment Compensation Fund and the EPA Revolving Loan Fund are the predominant activities, comprising 89.7% of the total net assets of business-type activities.

# North Carolina — Financial Highlights — Fiscal Year 2003

**CAPITAL ASSETS AND DEBT ADMINISTRATION.** Capital Assets: As of June 30, 2003, the State's investment in capital assets was \$23.77 billion, which represents an increase of 6.3% from the previous fiscal year-end.

**Capital Assets as of June 30, 2003**  
(net of depreciation, dollars in thousands)

	<b>Governmental</b>		<b>Business-type</b>		<b>Total</b>	
	<b>Activities</b>		<b>Activities</b>			
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Land.....	\$ 7,714,059	\$ 7,209,632	\$ 2,563	\$ 2,563	\$ 7,716,622	\$ 7,212,195
Buildings.....	1,332,508	1,329,529	13,816	14,603	1,346,324	1,344,132
Machinery and equipment.....	551,041	561,897	1,046	857	552,087	562,754
Infrastructure:						
State highway system.....	12,444,210	11,546,521	—	—	12,444,210	11,546,521
Other infrastructure.....	84,093	87,709	7,984	8,800	92,077	96,509
Intangible assets.....	105,650	106,629	—	—	105,650	106,629
Art, literature, and other artifacts.....	29,977	28,594	—	—	29,977	28,594
Construction in progress.....	1,465,889	1,453,742	20,019	15,675	1,485,908	1,469,417
<b>Total.....</b>	<b>\$ 23,727,427</b>	<b>\$ 22,324,253</b>	<b>\$ 45,428</b>	<b>\$ 42,498</b>	<b>\$ 23,772,855</b>	<b>\$ 22,366,751</b>
Total percent change between fiscal years 2002 and 2003		<b>6.3 %</b>		<b>6.9 %</b>		<b>6.3 %</b>

The largest component of capital assets is the State highway system. The State has approximately a 78,490-mile highway system, making it the second largest State-maintained highway system in the nation. The system continues to increase as roads are widened and new roads and bridges are constructed.

In an effort to manage a budgetary shortfall for the 2002-2003 fiscal year, the Office of State Budget and Management (OSBM) reduced capital spending. OSBM halted, as necessary, capital improvement projects for which State funds had been appropriated but not placed under State contract and transferred unused capital improvement funds to the General Fund.

In July 2003, the N.C. Infrastructure Finance Corporation (i.e., a blended component unit of the State) acquired three close security correctional facilities by issuing \$218.4 million in lease-purchase revenue bonds. The Department of Correction is undertaking construction initiatives to address a cell shortfall and to allow for the implementation of sentencing reform.

**Long-term Debt:** The State's general obligation bonds are secured by a pledge of the faith, credit, and taxing power of the State. The revenue bonds issued by the State are secured solely by specified revenue sources. The certificates of participation issued by the N.C. Infrastructure Finance Corporation, a blended component unit for the State, are secured solely by lease payments made by the State, and in the event of default, by a security interest in the leased facilities pursuant to a leasehold deed of trust.

# North Carolina — Financial Highlights — Fiscal Year 2003

At year-end, the State had total long-term debt outstanding of \$4.10 billion, an increase of 17.6% from the previous fiscal year-end.

**Outstanding Debt as of June 30, 2003**  
(dollars in thousands)

	<b>Governmental Activities</b>		<b>Business-type Activities</b>		<b>Total</b>	
	2003	2002	2003	2002	2003	2002
General obligation bonds.....	\$ 4,066,990	\$ 3,467,325	\$ —	\$ —	\$ 4,066,990	\$ 3,467,325
Revenue bonds.....	—	—	9,570	9,805	9,570	9,805
Certificates of participation.....	17,500	—	—	—	17,500	—
Notes payable.....	9,629	11,753	—	—	9,629	11,753
<b>Total.....</b>	<b>\$ 4,094,119</b>	<b>\$ 3,479,078</b>	<b>\$ 9,570</b>	<b>\$ 9,805</b>	<b>\$ 4,103,689</b>	<b>\$ 3,488,883</b>
Total percent change between fiscal years 2002 and 2003	17.7 %		(2.4)%		17.6 %	

During the 2003 fiscal year, the State issued \$711.6 million in general obligation bonds (excluding refunding issues) and \$17.5 million in certificates of participation (COPs). The new general obligation debt consisted of \$25.3 million in clean water bonds, \$83.0 million in natural gas bonds, and \$603.3 million in public improvement bonds (consolidation of clean water bonds and higher education bonds). The proceeds of the COPs will be used to acquire, construct, and equip wildlife education centers and administrative facilities for the North Carolina Wildlife Resources Commission. In addition, the State refinanced \$502.4 million of its existing debt in 2003 to improve cash flow and to take advantage of lower interest rates. By refinancing the debt, the State will reduce its future debt service payments by approximately \$39.0 million over the next 16 years.

The 1999-2000 Session of The General Assembly of North Carolina authorized the issuance of up to \$3.1 billion of higher education improvement bonds, which were subsequently approved by the voters of the State on November 7, 2000. The proceeds of these general obligation bonds will be used solely to construct new buildings and to renovate and modernize existing buildings on the State's 58 community college and 16 University of North Carolina campuses. These improvements are needed to meet the enrollment demand and to ensure that the State's college and university buildings meet modern code requirements and are equipped to prepare graduates for twenty-first century jobs. The bond legislation passed by the General Assembly specifies the amount of bond funding that will flow to each community college and university campus. At year-end, the authorized but unissued higher education bonds were \$1.99 billion.

The State obtained authorization from the General Assembly in 2003 to enter into financing agreements or special indebtedness to:

- Provide \$300 million for the repair and renovation of State facilities and related infrastructure;
- Provide \$110 million for the construction of a new State mental health facility, which will replace two hospitals being closed;
- Lease purchase three prison facilities;
- Acquire two private prisons that are currently being leased by the State; and
- Provide \$6.8 million for the planning and design of three youth development centers and some utility infrastructure and site work.

The timing of these issues has not been determined; however, funds were provided in the biennium budget ending June 30, 2005 for debt service for the \$300 million of repair and renovation special indebtedness. The use of alternative financing methods, which do not require voter approval, will provide financing flexibility to the State and will permit the State to take advantage of changing financial and economic environments.

## Major Funds

As of the end of the fiscal year, the State's governmental funds reported combined ending fund balances of \$2.64 billion, a slight increase (less than one percent) from the prior fiscal year-end (as restated).

**General Fund.** The General Fund is the chief operating fund of the State. The fund deficit of the General Fund was reduced from \$348.79 million at June 30, 2002 to \$166.96 million at June 30, 2003. Key factors in reducing the deficit were higher corporate income and sales tax collections, the accelerated repeal of local government reimbursements, increased transfers from other funds, and significant spending reductions by State agencies. Additionally, the State received \$136.9 million in federal fiscal relief in June 2003.

### General Fund Comparative Income Statement GAAP Basis

Expressed in thousands

	2003	2002	2001	2000	1999
<b>Beginning fund balance.....</b>	<b>\$ (348,551)</b>	<b>\$ (32,433)</b>	<b>\$ 265,675</b>	<b>\$ 1,144,130</b>	<b>\$ 1,664,787</b>
<b>Adjustment.....</b>	<b>(237)</b>	<b>4,347</b>	<b>(51,802)</b>	<b>(208)</b>	<b>—</b>
	<b><u>(348,788)</u></b>	<b><u>(28,086)</u></b>	<b><u>213,873</u></b>	<b><u>1,143,922</u></b>	<b><u>1,664,787</u></b>
<b>Revenues and other sources</b>					
Individual income tax.....	7,126,655	7,219,794	7,605,542	7,097,514	6,586,153
Corporate income tax.....	922,936	548,046	712,161	989,280	920,583
Sales and use tax.....	4,020,923	3,766,285	3,429,532	3,361,189	3,342,157
Other taxes.....	1,485,626	1,420,093	1,556,541	1,360,175	1,320,098
Federal funds.....	7,564,627	7,256,016	6,777,503	6,156,189	5,361,839
Local funds.....	562,498	682,310	737,063	482,387	436,609
Investment earnings.....	139,140	188,310	285,311	323,645	365,685
Fees, licenses, fines.....	269,962	237,236	239,464	209,674	277,168
Transfers-in and other sources....	1,111,761	627,869	517,035	542,531	340,405
Other revenues.....	524,035	406,596	427,606	229,684	250,263
	<b><u>23,728,163</u></b>	<b><u>22,352,555</u></b>	<b><u>22,287,758</u></b>	<b><u>20,752,268</u></b>	<b><u>19,200,960</u></b>
<b>Expenditures and other uses</b>					
Current operating.....	22,335,173	22,139,246	19,070,274	17,696,762	15,974,052
Tax judgements.....	—	—	58,679	440,000	399,000
Debt service.....	296,025	302,348	254,606	237,269	199,272
Transfers-out and other uses.....	915,132	231,426	3,150,505	3,256,484	3,149,293
	<b><u>23,546,330</u></b>	<b><u>22,673,020</u></b>	<b><u>22,534,064</u></b>	<b><u>21,630,515</u></b>	<b><u>19,721,617</u></b>
<b>Change in fund balance.....</b>	<b>181,833</b>	<b>(320,465)</b>	<b>(246,306)</b>	<b>(878,247)</b>	<b>(520,657)</b>
<b>Ending fund balance.....</b>	<b><u>\$ (166,955)</u></b>	<b><u>\$ (348,551)</u></b>	<b><u>\$ (32,433)</u></b>	<b><u>\$ 265,675</u></b>	<b><u>\$ 1,144,130</u></b>

**General Fund Budgetary Highlights.** The General Fund revenue forecast for fiscal year 2002-2003 was derived on the basis of a continued slow economic recovery. Accordingly, the General Assembly assumed a zero percent growth in the underlying State economic base. This

conservative assumption recognized the many uncertainties facing the North Carolina economy, including the potential for further terrorist attacks and unsteady United States financial markets. Actual General Fund baseline revenue collections under the State tax laws as of January 1, 2002 increased slightly reflecting the annualization of revenue enhancements enacted by the 2001 Session of the General Assembly.

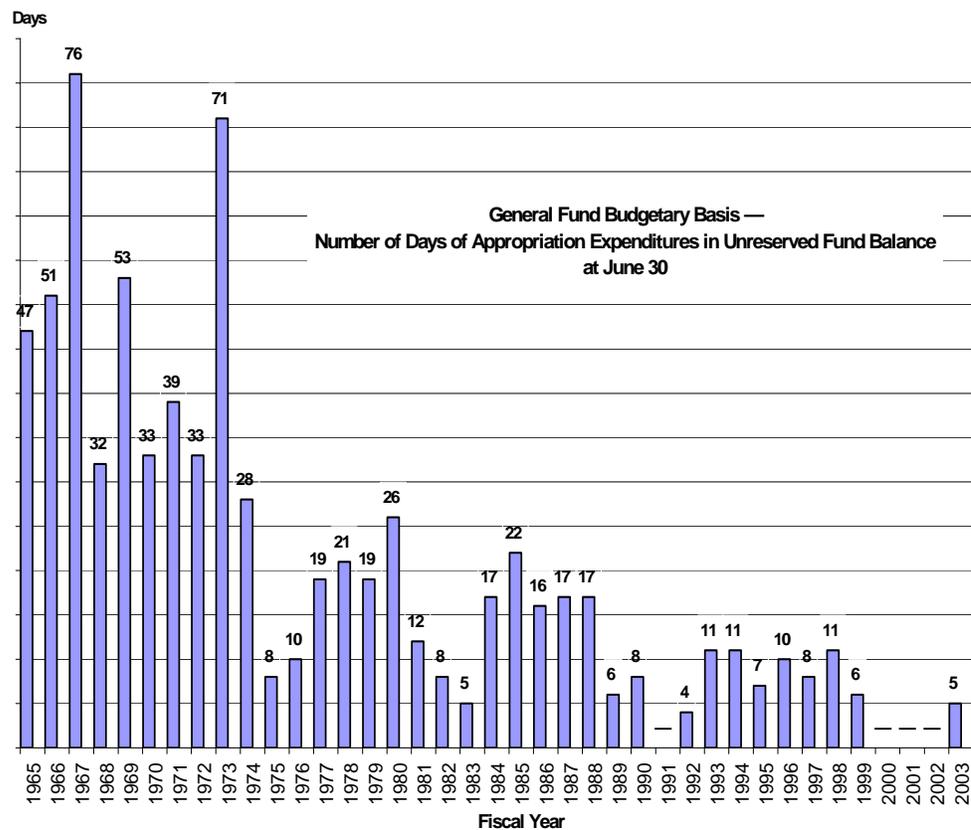
Baseline revenues alone were insufficient to continue essential State services. Consequently, the General Assembly enacted General Fund enhancements for fiscal year 2002-2003 totaling \$866 million. The most significant enhancement was the accelerated repeal of the local government reimbursements (\$333 million), which were payments by the State to replace revenues lost by local governments as a result of taxes repealed by the State. Local governments were granted the authority to establish a one-half cent local option sales tax to replace the reimbursements. Additionally, the annual transfer from the Highway Trust Fund was increased by \$205 million for fiscal year 2002-2003, of which \$80 million was a recurring transfer and \$125 million was an advance to be repaid in future years. Also, \$78 million in tobacco settlement revenues accounted for in special revenue funds were transferred to the General Fund. The State's tax laws were also changed to eliminate several tax preferences. Specifically, the General Assembly took steps to ensure that businesses organized as partnerships pay the franchise tax. The General Assembly also broadened and clarified the definition of business income to minimize the ability of multi-state corporations to avoid taxes on certain income.

The following table summarizes the 2003 revenue enhancements (amounts expressed in millions):

### **Revenue Enhancements - 2003 Fiscal Year**

Repeal of local government reimbursements.....	\$ 333.4
Transfers from :	
Highway Trust Fund – nonrecurring advance.....	125.0
Highway Trust Fund – recurring inflation adjustment.....	80.0
Tobacco settlement funds – nonrecurring.....	78.0
Other funds - nonrecurring.....	20.4
Business tax revisions.....	90.0
Delay of individual income tax breaks.....	51.7
Departmental fee increases.....	38.2
Other .....	49.4
<b>Total 2003 enhancements.....</b>	<b>\$ 866.1</b>

For fiscal year 2003, the General Fund closed the year with a low unreserved fund balance of \$250.5 million, equivalent to 5 business days of disbursements of appropriation expenditures. For fiscal years ended June 30, 2000, 2001, and 2002, the ending unreserved fund balance was significantly low at zero, zero, and \$3.8 million, respectively. In the decade of the 1990's, unreserved fund balance averaged \$293 million, or 3.1% of appropriation expenditures, equivalent to eight business days of disbursements of appropriation expenditures. The trend for the State appears to be on an upward swing for ending unreserved fund balance. North Carolina is required by its constitution to balance the General Fund on a budgetary basis.



**General Fund Fiscal Year 2004 Budget.** The General Fund budget for fiscal year 2003-04 was signed into law on June 30, 2003. The enacted budget was founded upon an overall nominal (real growth plus inflation) economic growth rate of 3.5% for 2003-04. The appropriated budget included provisions that were designed to increase General Fund revenues. The most significant revenue adjustment was the continuation of two temporary tax increases that were scheduled to expire in 2003. In 2001, the General Assembly temporarily raised the State sales tax rate by a half-cent to 4.5% and the highest individual income tax rate from 7.75% to 8.25%. The budget continues the State sales tax rate at 4.5% and the 8.25% income tax bracket for an additional two years. Additionally, the Department of Revenue was given broader authority and resources to collect unpaid tax liabilities.

**Highway Fund.** The Highway Fund accounts for most of the activities of the North Carolina Department of Transportation, including the construction and maintenance of the State's primary, secondary, and urban road systems, the State Highway Patrol, the Division of Motor Vehicles, and transit and rail. The primary revenue sources of the Highway Fund are three-fourths gasoline taxes, vehicle registration fees, driver's license fees, and federal funds.

The fund balance of the State Highway Fund decreased from \$410.2 million at June 30, 2002, to \$299.9 million at June 30, 2003, a decrease of 26.9%. The decline was the result of total expenditures exceeding total revenues for the current period. Total revenues decreased by \$54 million or 2.5% during fiscal year 2003, primarily because of decreases in gasoline taxes and federal funds. In addition, operation transfers from other funds decreased by \$79.9 million.

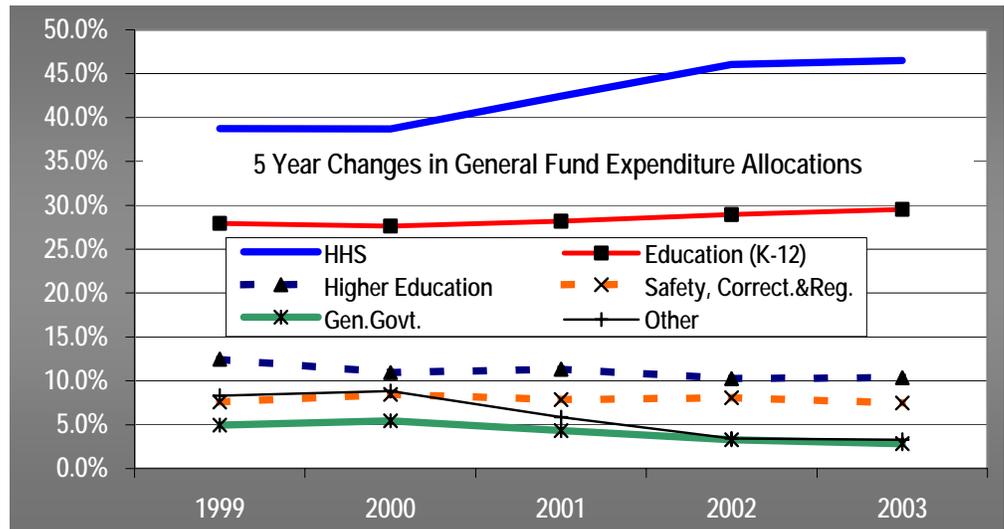
**Highway Trust Fund.** Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet highway construction needs in North Carolina. The principal revenue sources of the Highway Trust Fund are highway use taxes, one-fourth of gasoline taxes, and various title and registration fees.

The fund balance of the Highway Trust Fund decreased from \$425.99 million at June 30, 2002 to \$208.2 million at June 30, 2003, a decrease of 51.1 percent. The decline was caused, in part, by an \$80 million increase in the annual transfer to the General Fund (see Note 9B to the financial statements). Additionally, total revenues decreased by \$45.1 million or 4.6 percent, primarily because of decreases in investment earnings and gasoline taxes. Investment earnings decreased because of reduced cash balances resulting from advances and transfers to the General Fund.

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

## Changes in How Your Dollars are Spent

The following chart reflects very little shift in funding in the General Fund over the last five years. The data below is derived from the State’s CAFR and includes accrual adjustments.



HHS = .....Health and human services;  
 Education (K-12) = .....Department of Public Instruction  
 Higher Education = .....UNC system and community colleges  
 Safety, Correct. & Reg. = .....Public safety, corrections, and regulation  
 Gen. Govt. = .....General Government

The expenditure allocation for health and human services increased from 38.8% in 1999 to 46.5% in 2003. A significant increase in the health and human services budget allocation occurred from fiscal year 2000 to 2001, with expenditures growing by \$1.2 billion or 14.4%. Offsetting decreases in budget allocation occurred in general government, tax judgements, and public safety expenditures (disaster relief). Education (K-12) received 29.5% of the total expenditures and uses (State, federal, and local dollars) in 2003 compared to 28% in 1999. Dollars allocated to higher education declined from 12.5% in 1999 to 10.3% in 2003, primarily due to a change in accounting for community college tuition in fiscal year 2000.

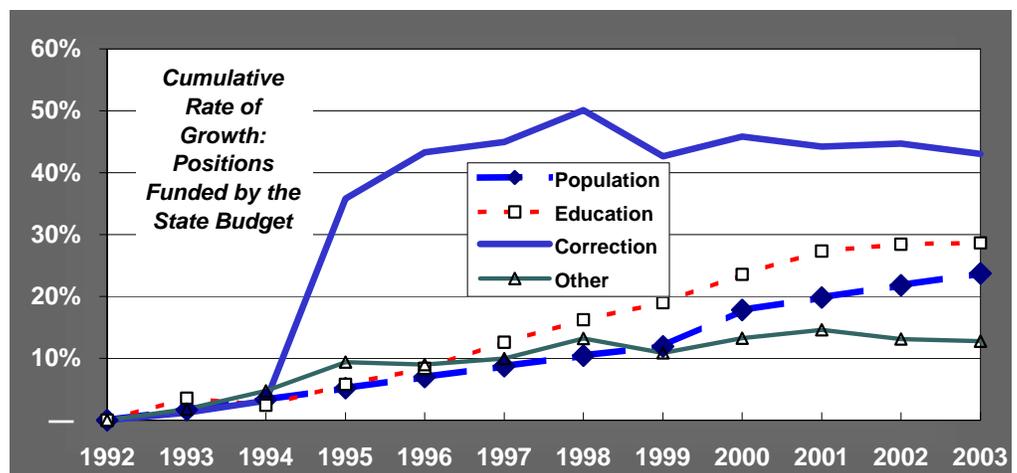
The primary cause of change in expenditure allocations is the result of changes in spending requirements for federal funds in our State. In recent years, court case settlements and natural disasters have had a significant impact on spending.

## State Government Growth

As the State continues to experience population growth (20%, or 1,393,000 people since 1994), 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. For the 2002-2003 school year, there were 2,158 public schools and 93 charter schools 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 2002-2003, the State housed approximately 33,484 inmates on a daily basis, with 23,593 entering the prison system and 22,852 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 38,166 positions, and corrections, which has increased by 5,253 positions.

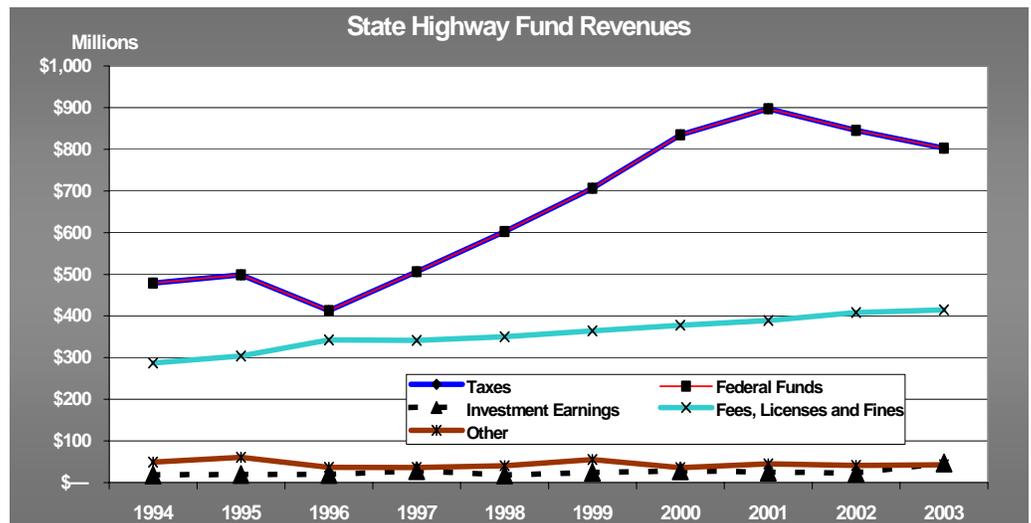
During the last 10 years, the rate of growth in public education (K-12) positions (26% increase) has exceeded the rate of growth in North Carolina's population (20% increase). During the same period, primarily due to new legal requirements for housing inmates, the rate of growth in correctional positions (39% increase) has far and away exceeded North Carolina's population growth.

## ***North Carolina's Growth vs. Investment in Transportation Infrastructure***

During the last 10 years, the State's highway programs have added in excess of 1,092 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 78,490 miles of roadway.

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 for the Highway Fund.

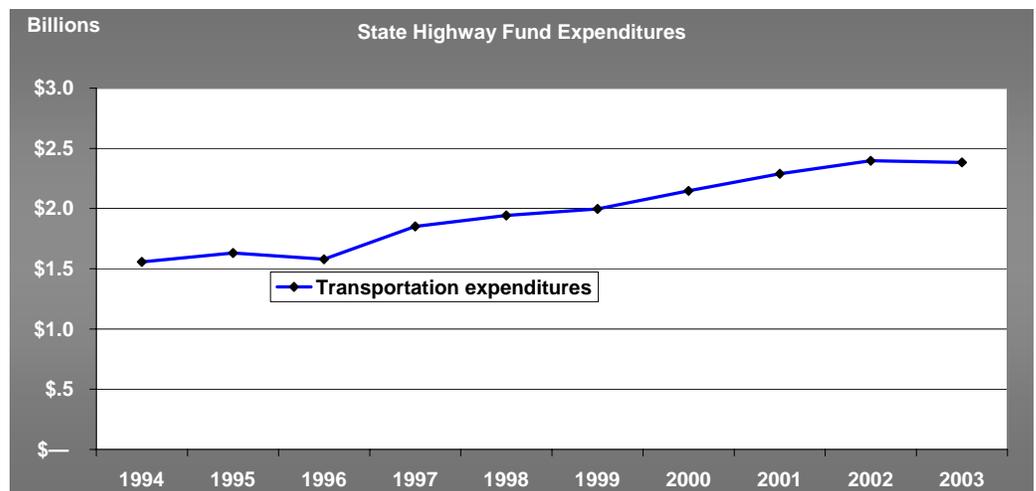


The Department of Transportation is required to survey and report on the condition of the State highway system. The North Carolina Department of Transportation develops a statewide annual maintenance program for the State highway system, which is subject to the approval of the North Carolina Board of Transportation and takes into consideration the general maintenance needs, special maintenance needs, vehicular traffic, and other factors deemed pertinent. A

detailed assessment is conducted of the State's pavements, structures, and roadway features. The methodologies used in the survey and assessments are based on acceptable practices used in other state transportation departments across the country.

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 road maintenance issue.

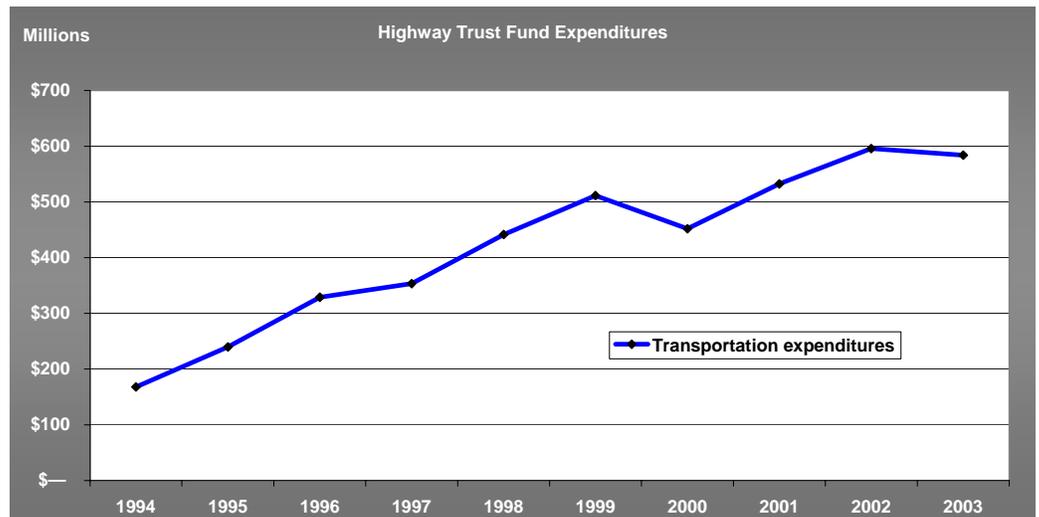
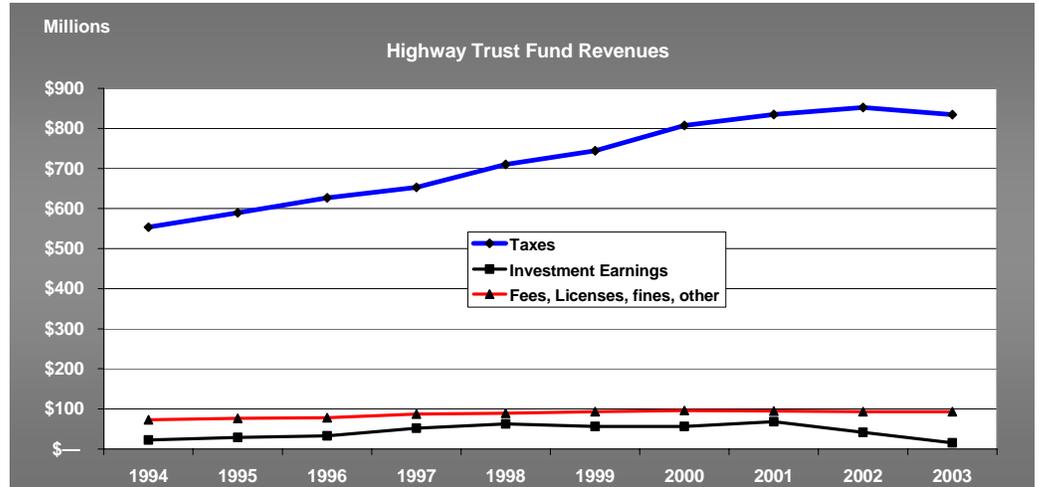
The most current assessment report highlights that while road maintenance funding has increased over the last decade, the increase in funding has not kept pace with inflation. According to the December 2002 report, \$620.6 million is needed to fund routine maintenance and to provide for an acceptable level of transportation service in North Carolina. According to the report, it would take an additional \$247.3 million (\$24.7 million per year) over the next 10 years to eliminate the current road maintenance backlog, with an additional \$103.7 million (\$10.4 million per year) needed over the next 10 years to eliminate the contract-resurfacing backlog. The annual cost of resurfacing the State's primary, secondary, and urban road systems is \$227.4 million.



The estimated total maintenance needs, including backlogs, ranges from \$919.4 million in fiscal year 2003-2004, to \$1.254 billion in fiscal year 2010-2011 (averaging \$1.084 million per year). For the year ended June 30, 2003, \$547 million was spent on road maintenance. The approved State budget included \$585 million of road maintenance funding for fiscal year 2003-2004.

# North Carolina — Financial Highlights — Fiscal Year 2003

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.



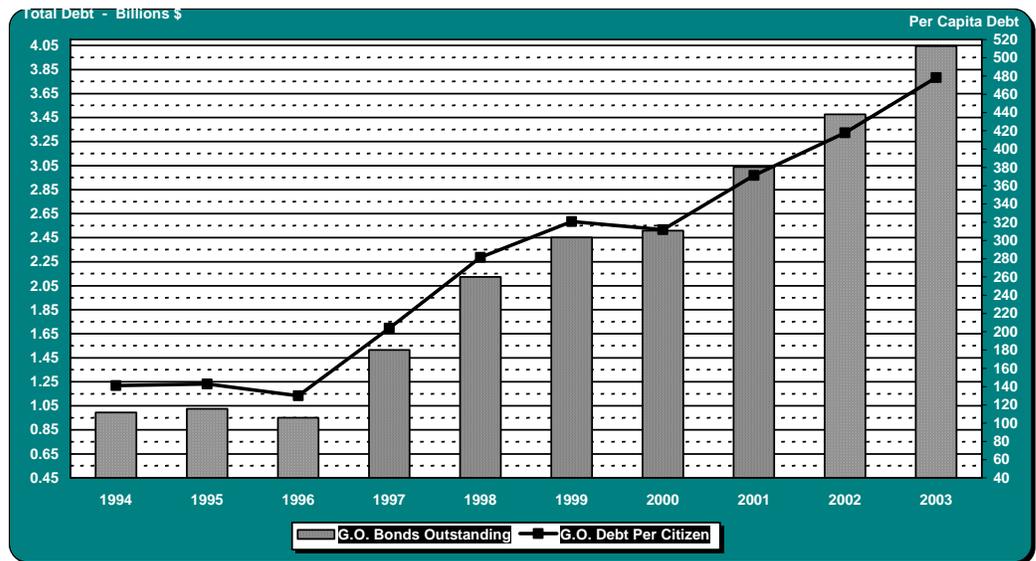
## North Carolina's Infrastructure and Capital Improvement Needs Continue to Grow

As stated earlier, the State's population has grown by 20% since 1994. 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, public schools, universities, community colleges, and 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 Expenditures	Total General Expenditures	Ratio
2003	8,456,596 [1]	\$ 4,045,603,000	\$ 478.40	\$ 321,529,000	\$ 27,444,013,000	1.17%
2002	8,320,146	\$ 3,477,953,000	\$ 418.02	\$ 328,712,000	\$ 27,242,998,000	1.21%
2001	8,186,268	\$ 3,038,693,000	\$ 371.19	\$ 281,463,000	\$ 23,883,482,000	1.18%
2000	8,049,313	\$ 2,509,986,000	\$ 311.83	\$ 264,877,000	\$ 22,721,905,000	1.17%
1999	7,647,934	\$ 2,451,973,000	\$ 320.61	\$ 227,630,000	\$ 20,744,877,000	1.10%
1998	7,545,735	\$ 2,123,944,000	\$ 281.48	\$ 170,039,000	\$ 19,292,584,000	0.88%
1997	7,428,579	\$ 1,514,477,000	\$ 203.87	\$ 131,249,000	\$ 17,646,075,000	0.74%
1996	7,307,565	\$ 951,082,000	\$ 130.15	\$ 150,741,000	\$ 15,978,166,000	0.94%
1995	7,185,327	\$ 1,025,167,000	\$ 142.68	\$ 141,031,000	\$ 14,755,972,000	0.96%
1994	7,060,881	\$ 996,365,000	\$ 141.11	\$ 123,376,000	\$ 13,333,832,000	0.93%

**Total General Obligation Debt and Long-Term Debt Per Capita**



[1] Since the 2003 population estimates are not available, the Office of State Controller used the growth rate of the previous year to project the 2003 amount.

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

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***Award for Outstanding Achievement***

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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, 2002. 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.

**Award for  
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PRESENTED TO

**STATE OF  
NORTH CAROLINA**

For the fiscal year ending  
June 30, 2002



*Edward Hamrick*  
President

*Jeffrey L. Esser*  
Executive Director