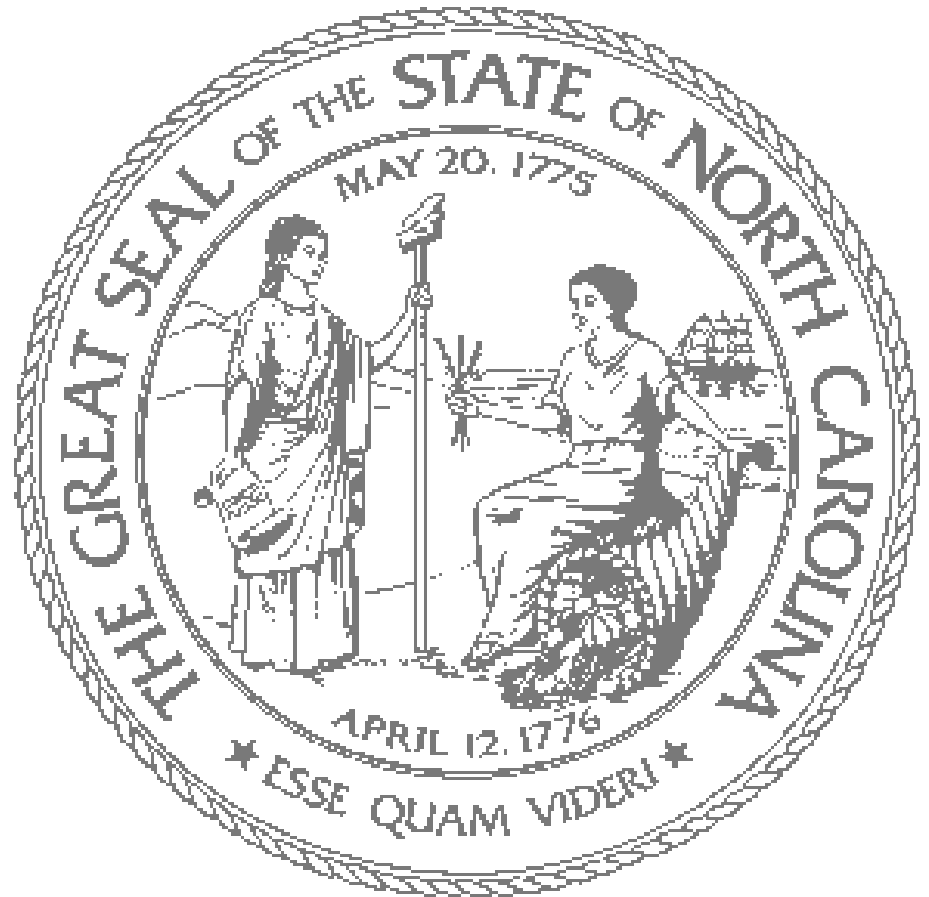


North Carolina

*Financial
Highlights
Fiscal Year
2002*



Robert L. Powell, State Controller

North Carolina Office of the State Controller

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

North Carolina — *Financial Highlights* — Fiscal Year 2002



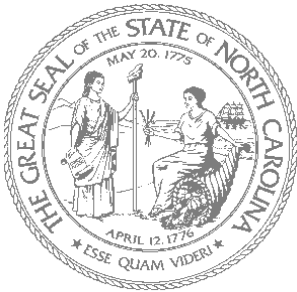
I am pleased to present you with the ***North Carolina Financial Highlights*** for the fiscal year ended June 30, 2002. This ***popular report*** represents our continuing commitment in providing the highest standards of financial management and reporting, as well as fiscal accountability of the resources 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 20, 2002



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. 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, 2002. 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

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.



NC Sailing Regatta

The Economy

There are some signs that the state's economy has begun to improve. For one thing, the unemployment rate has dropped from 6.9% in April to 6.0% in October and we have seen improvement in the unemployment claims numbers. State sales tax receipts during the quarter ending September 30 were up 1.7% over the same quarter last year and increased 2.3% during the second calendar quarter. This compares to -2.0% for the first quarter and -3.5% for the final quarter of 2001. Unit sales of cars and light trucks rose 2.9% in May and June this year. Finally, real estate conveyance tax collections, levied on a "percent of value" basis, continue to benefit from favorable mortgage rates.

Even with the recent improvements, the State is budgeting on the basis of a continued sluggish recovery. This would be very different from the explosive growth after the last two recessions. One reason is the continued weakness of tech stock prices. 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 new sectors.

A classic example is the experience of the Catawba Valley region (Hickory). During the late-1990s, this area had an unemployment rate as low as 1.5% due to the explosive growth of fiber

optic manufacturing. Now, the unemployment rate in this county is 9.4%, one of the highest rates in the state. We are concerned that it may take some time for the nation's telecommunications companies to work down excess inventory.

In addition, it is not clear how areas affected by the displacement of workers in traditional industries will recover. The prevailing view of many local officials is that not only are the jobs lost in recent years the textile, apparel, and furniture sectors gone forever but the shift away from U.S. production is spreading to other types of manufacturing operations.

— *Economic analysis prepared by David Crotts*
Fiscal Research Division
North Carolina General Assembly
November 15, 2002



State Capitol, Raleigh, NC

Overview of the Financial Statements

Government-wide. The State's total net assets remained virtually unchanged as a result of this year's operations. While this indicates that current year revenues were sufficient to cover current year expenses, the growth in net assets was limited by the slowdown in the State's economy and the associated increased demand for government services. At year-end, net assets of governmental activities and business-type activities totaled \$22.015 billion and \$886 million, respectively.

Component units reported net assets of \$8.2 billion, an increase of \$362.1 million from the previous year. The largest component unit, the University of North Carolina System had net assets of \$5.79 billion at June 30, 2002, an increase of \$178 million, or a 3.2% increase from fiscal year 2001.

State Highway System. The State highway system includes roadway surfaces, bridges, signage, railings, markings and other structures related to the State's motor vehicle transportation system. The system includes 78,350 miles of roads, 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 2002, the State reflected \$11.5 billion (net of accumulated depreciation) of highway system infrastructure, an increase of \$917 million (net), or 8.6%.

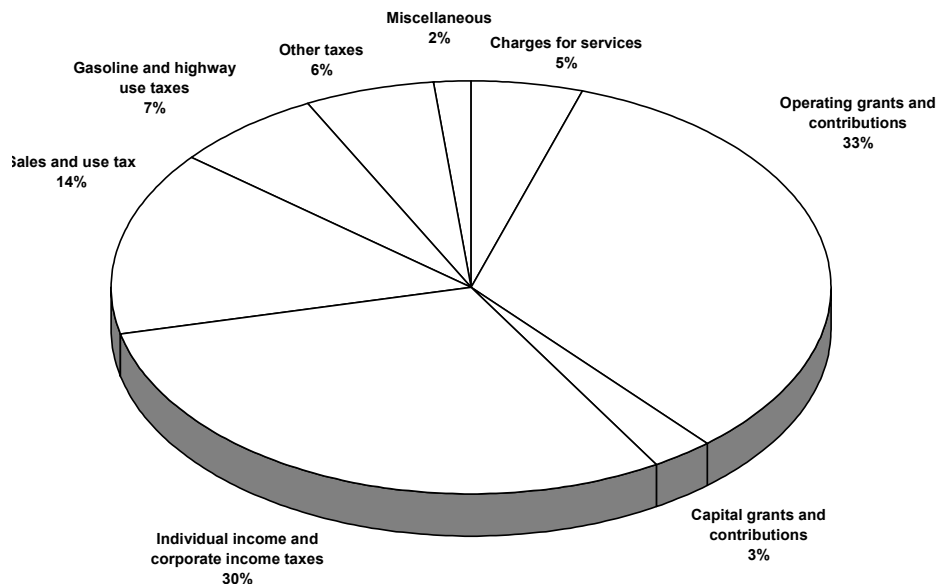
Long-term Debt. The State's general obligation debt payable increased during the fiscal year to \$3.478 billion, an increase of \$439 million (or by 14.5%), which represents the net difference between new issuances, and payments, recognition of accretion, and the amortization of premiums on outstanding debt. During the year the State issued general obligation bonds in the amount of \$605 million.

Business-type Activities. Net assets of the business-type activities decreased by \$509.4 million during the fiscal year. The primary factor contributing to these results was unemployment compensation. The Unemployment Compensation Fund accounts for the State's unemployment insurance program, which is part of a national system established to provide temporary benefit payments to eligible unemployed workers. The unemployment benefits are financed primarily by State unemployment insurance taxes, distributions of federal unemployment insurance taxes, and federal funding for the unemployment benefits.

For fiscal year 2002, employer contributions grew by \$52.5 million, or 13.8%. Federal Funds grew by \$361.3 million, or 2,465%. The drastic growth in revenues was driven by a slowing economy and an increasing unemployment rate in North Carolina. Unemployment benefits paid in fiscal year 2002 totaled \$1.3 billion, a 96.6% increase in payments over fiscal year 2001. Net assets of \$793 million at June 30, 2002 represented a decline of \$516.2 million, or 39.4%.

North Carolina — Financial Highlights — Fiscal Year 2002

Government-Wide. The following chart depicts revenues of the governmental activities for the fiscal year ended June 30, 2002:



Statement of Net Assets. The State's combined net assets increased \$68.3 million, or .3% over the course of this fiscal year's operations. The net assets of the governmental activities increased \$577.7 million or 2.7% and business-type activities had a decrease of \$509.4 million or 36.5%.

Net Assets as of June 30, 2002
(In Millions)

	Governmental Activities	Business-type Activities	Total Primary Government
Current and other non-current assets.....	\$ 10,312	\$ 1,142	\$ 11,454
Capital assets, net.....	22,340	42	22,382
Total assets.....	32,652	1,184	33,836
Long-term liabilities.....	3,711	10	3,721
Other liabilities.....	6,926	288	7,214
Total liabilities.....	10,637	298	10,935
Net assets:			
Invested in capital assets, net of related debt.....	22,025	38	22,063
Restricted.....	1,605	798	2,403
Unrestricted.....	(1,615)	50	(1,565)
Total net assets.....	\$ 22,015	\$ 886	\$ 22,901

The largest component (98%) of the State's net assets reflects its investment in capital assets (land, buildings, machinery and equipment, State highway systems, general infrastructure, and other capital assets), less any related debt outstanding that was needed to acquire or construct

the assets. In subsequent years, comparative data will provide the basis for more detailed analysis.

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 expand university and community college capacity, fund capital maintenance, build local schools, and to provide local access to clean water and natural gas utilities. Of the \$3.48 billion of outstanding general obligation debt at June 30, 2002, \$3.17 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 is left to 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.

The government-wide statement of net assets for governmental activities reflects a negative \$1.6 billion unrestricted net asset balance, with total net assets of \$22.015 billion, and capital assets, net of related debt of \$22.025 billion. Total restricted governmental assets for fiscal year 2002 was \$1.6 billion. From the governmental activities perspective, the fiscal year 2002 statement of net assets indicates that the State is over-committed by \$1.6 billion, primarily because of the distribution of debt proceeds mentioned previously and other unfunded liabilities.

North Carolina — Financial Highlights — Fiscal Year 2002

Statement of Activities. The following condensed 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, 2002:

Changes in Net Assets
For the Fiscal Year Ended June 30, 2002
(In Millions)

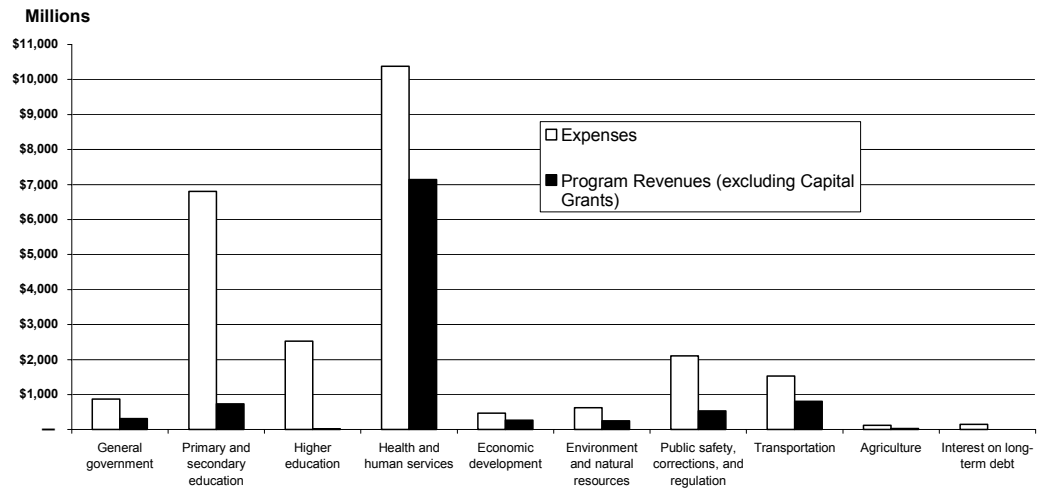
	Governmental Activities	Business-type Activities	Total Primary Government
Revenues			
Program revenues			
Charges for services.....	\$ 1,313	\$ 461	\$ 1,774
Operating grants and contributions.....	8,787	439	9,226
Capital grants and contributions.....	714	1	715
General revenues			
Taxes			
Individual income tax.....	7,235	—	7,235
Corporate income tax.....	599	—	599
Sales and use tax.....	3,779	—	3,779
Gasoline tax.....	1,213	—	1,213
Franchise tax.....	591	—	591
Highway use tax.....	555	—	555
Insurance tax.....	348	—	348
Beverage tax.....	201	—	201
Inheritance tax.....	107	—	107
Other taxes.....	279	—	279
Tobacco settlement.....	176	—	176
Unrestricted investment earnings.....	139	—	139
Miscellaneous.....	57	—	57
Total revenues.....	26,093	901	26,994
Expenses			
General government.....	874	—	874
Primary and secondary education.....	6,803	—	6,803
Higher education.....	2,520	—	2,520
Health and human services.....	10,377	—	10,377
Economic development.....	469	—	469
Environment and natural resources.....	627	—	627
Public safety, corrections and regulation.....	2,109	—	2,109
Transportation.....	1,531	—	1,531
Agriculture.....	122	—	122
Interest on long-term debt.....	149	—	149
Unemployment compensation.....	—	1,337	1,337
Other business-type activities.....	—	25	25
Total expenses.....	25,581	1,362	26,943
Excess (deficiency) before contributions and transfers.....	512	(461)	51
Contributions to permanent funds.....	2	—	2
Transfers.....	48	(48)	—
Increase (decrease) in net assets.....	562	(509)	53
Net assets - beginning - restated.....	21,453	1,395	22,848
Net assets - ending.....	\$ 22,015	\$ 886	\$ 22,901

North Carolina — Financial Highlights — Fiscal Year 2002

Business-type activities reflect a decrease in net assets of \$509 million. The Unemployment Compensation Fund is the predominant activity accounting for 89.5% of the total net assets of the business type activities.

The State sales tax was increased by a half-cent from 4% to 4.5%, effective October 16, 2001. This increase is scheduled to expire July 1, 2003. Effective July 1, 2002, the provisions for local government tax reimbursements were repealed, and local governments now have the optional authority to impose an additional half-cent sales tax. Effective for the tax years January 1, 2001 through December 31, 2003, the highest individual income tax rate increased from 7.75% to 8.25%.

The following chart depicts the net expenses of the governmental activities for the fiscal year ended June 30, 2002:



CAPITAL ASSETS AND DEBT ADMINISTRATION. Capital Assets: At the end of the fiscal year 2002, the Statement of Net Assets reflected \$22.382 billion, net of accumulated depreciation, in a broad range of capital assets (see the table below). Depreciation charges for this fiscal year totaled \$515.7 million.

Capital Assets, Net as of June 30, 2002
(In Millions)

	Governmental Activities	Business-type Activities	Total Primary Government
Land.....	\$ 7,209	\$ 3	\$ 7,212
Buildings.....	1,330	15	1,345
Machinery and equipment.....	576	1	577
General infrastructure.....	88	7	95
State highway system.....	11,547	—	11,547
Other.....	135	—	135
Subtotal.....	20,885	26	20,911
Construction in progress.....	1,455	16	1,471
Total.....	\$ 22,340	\$ 42	\$ 22,382

The effort to manage the State's General Fund budget shortfall resulted in the postponement of most construction and maintenance activity. The State's fiscal year 2001-2002 capital outlay budget included spending \$32.9 million for new projects at various state agency buildings.

For fiscal year 2002, the State reflected \$11.5 billion (net of accumulated depreciation) of highway system infrastructure, an increase of \$917 million (net), or 8.6%. Depreciation expense for the highway system was \$315 million for fiscal year 2002. Based on the requirements of GASB Statement No. 34, governments were only required to capitalize major infrastructure systems back to July 1, 1980. The North Carolina Department of Transportation was able to recall and capitalize construction expenditure information to include highway system construction costs since 1953.

Long-term Debt: The State authorizes, issues, and sells debt obligations. General obligation bonds, issued by the State, are backed by the full faith and credit of the State. The State also issues revenue dedicated bonded debt, whose payment for principal and interest comes solely out of funds that receive legally restricted revenues.

Outstanding Bonded Debt as of June 30, 2002
(In Millions)

	Governmental Activities	Business-type Activities	Total Primary Government
General obligation bonds (backed by the state).....	\$ 3,478	\$ —	\$ 3,478
Revenue bonds and notes (backed by specific tax and fee revenues).....	—	10	10
Total	\$ 3,478	\$ 10	\$ 3,488

During fiscal year 2002, the State issued general obligation debt totaling \$605 million (\$300 million for capital maintenance and expanding the capacity of universities and community colleges; \$215 million for clean water; \$55 million for local school construction; and \$35 million for natural gas).

The State is in the process (\$300 million referred to above issued in fiscal year 2002) of fulfilling a significant commitment to increase the capacity of the universities and community colleges and to provide funding for renovations. In November 2000, the State's voters approved \$3.1 billion of University and Community College general obligation bonds. The General Assembly has predetermined the specific building projects to be funded by the bond proceeds. At June 30, 2002, there was a remaining bond authorization of \$2.55 billion of higher education bonds yet to be issued, constituting 82.3% of the original \$3.1 billion higher education bond authorization.

Major Funds

As the State completed the year, the governmental funds reflected fund balances of \$3.08 billion. This represented a decline in fund balances of \$513.5 million in fiscal year 2002. The General Fund decline of \$319.5 million, and the Highway Trust Fund decline of \$274.6 million represent the largest portion of the overall decrease in governmental funds.

General Fund. The General Fund is the chief operating fund of the State. At the end of fiscal year 2002, the State's General Fund reported a total fund balance deficit (negative) of \$349 million, with unreserved fund balance of negative \$576.3 million and reserved fund balance of \$227.8 million. With the addition of management designations as described in Note 8, the State's General Fund was over-committed by \$1.1 billion at June 30, 2002. Total fund balance diminished significantly during the fiscal year (\$319.5 million), primarily the result of lower tax collections and the general slowing of the economy. The public's demand for government services tends to grow or remain strong during times of economic difficulty, particularly in relation to the primary functions funded by General Fund operations (education, health and human services). By the end of fiscal year 2002, General Fund revenues had declined .21% from the prior year. On a modified accrual basis, individual income tax decreased by \$385.7 million, or 5%. Corporate income tax decreased by \$164 million, or 23%. Franchise tax revenues decreased by \$154.4 million, or 20.7%. Sales and use tax increased by \$336.8 million, or 9.8%, although the rate of increase was less than expected given the half-cent rate increase effective for fiscal year 2002. Despite the decline in revenues, General Fund expenditures increased by 366.4 million, or 1.7%.

General Fund Budgetary Highlights. For fiscal year 2002, the State experienced a shortfall in tax and non-tax receipts on the order of \$1.55 billion. Typical with the experience of other state governments, the slowing national and state economy resulted in a general decline in tax collections. Net of refunds to taxpayers, individual income taxes fell short of estimates by \$1.04 billion, corporate income taxes were less than expected by \$177 million, sales and use tax was \$90.5 million less than expected, and franchise tax was \$192.7 million under budget estimates. Inheritance tax collections fell short of estimates by \$25.4 million. Higher unemployment, lower individual business and corporate earnings, and a declining stock market, resulting in lower capital gains, represented the common thread in the general tax revenue decline.

In the effort to meet the State constitutional mandate of balancing the General Fund budget, reductions of \$789.2 million were implemented, with the remainder of the budget funded by \$437.7 million of non-General Fund dollars, and \$239.3 million transferred from the Savings Reserve account.

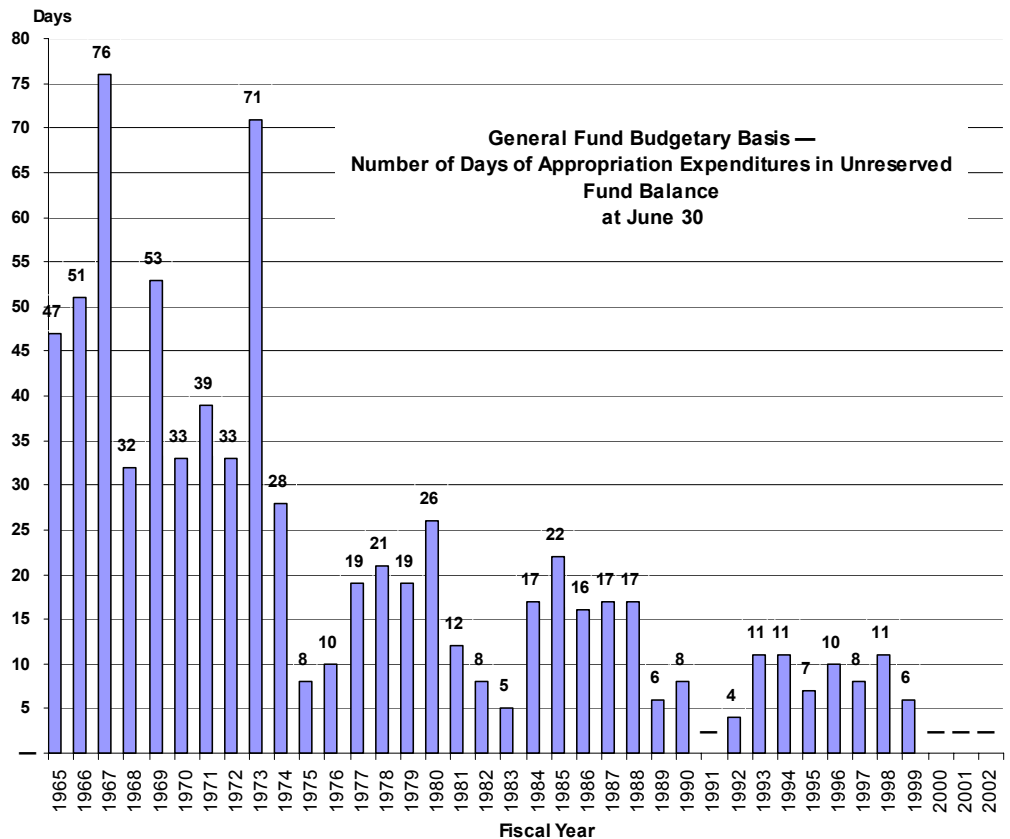
Budget reductions affecting the major General Fund functions of our State government were as follows: general government, 9.9%; primary and secondary education, 1.8%; community colleges, 7.1%; public universities, 8.6%; health and human services, 3.9%; economic development, 12.9%; environment and natural resources, 18.9%, public safety, correction, and regulation, 4.5%; and agriculture, 12.5%.

North Carolina — Financial Highlights — Fiscal Year 2002

Investment income fell short of estimated budgetary receipts by \$34.2 million as a result of lower General Fund cash available for investment and lower investment rates of return.

Refunds to individual income taxpayers of \$1.373 billion represented 15.9% of total gross individual income collections for fiscal year 2002. Refunds to corporate taxpayers of \$230.8 million represented 23.2% of gross corporate income tax collections. Refunds of sales and use tax totaled \$398.7 million in fiscal year 2002, or 6.8% of gross collections.

For fiscal year 2002, the General Fund again closed the year with an extremely low unreserved fund balance. For the fiscal years ended June 30, 2000, 2001, and 2002, the ending unreserved fund balance was zero, zero, and \$3.8 million, respectively. To gain a sense of perspective, since 1965 unreserved fund balance in the General Fund averaged \$200 million per year, or 3.9% of total appropriation expenditures, equivalent to 10 business days disbursements of appropriation expenditures. In the decade of the 1990's, unreserved fund balance averaged \$293 million, or 3.1% of appropriation expenditures, equivalent to eight business days worth of disbursements of appropriation expenditures. North Carolina is required by its constitution to balance the General Fund on a budgetary basis.



General Fund Fiscal Year 2003 Budget. The General Fund State appropriations budget for fiscal year 2003 is \$14.35 billion. The General Assembly took action on several revenue enhancements for fiscal year 2003, totaling \$866.1 million. The most significant action was the accelerated repeal of the local government reimbursements paid to replace revenues lost by local governments as the result of actions taken by the State (\$333.4 million for fiscal year 2003). 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 2002-2003, of which \$80 million is to be on a recurring basis, with \$125 million established a one-time advance to be repaid in the future. Additional non-recurring transfers of \$38 million, from the Tobacco Trust Fund, and \$40 million, from the Health and Wellness Trust Fund were approved by the General Assembly for fiscal year 2003.

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 primary, secondary, and urban road systems. The principal revenues of the Highway Fund are gasoline (motor fuels) taxes, motor vehicle registration fees, driver's license fees, and federal aid.

While the effects of the slowing economy have had an impact on business travel, commercial transportation and general consumer travel and tourism, the States highway fund taxes and fees have still shown growth. Although total revenue of the Highway Fund declined by \$29 million, or 1.3%, gasoline tax increased by \$20 million, or 2.3%, and fees, licenses, and fines increased by \$18.8 million, or 4.8%. The largest decrease came in the decline of accrued federal funds, \$52 million, or 5.8%. Expenditures for highway construction, maintenance, and administration grew by \$103 million, or 4.5%.

Highway Trust Fund. The Highway Trust Fund was established to provide a dedicated funding mechanism to meet highway construction needs for North Carolina. Taxes were increased for the specific purpose of improving identified primary transportation corridors within the State and for the completion of urban loops around seven major metropolitan areas. Additionally, this fund provides supplemental allocations for secondary road construction and supplemental assistance to municipalities for local street projects. The fund also makes transfers to the General Fund and the Highway Fund. The principal revenues of the Highway Trust Fund are highway use taxes, motor fuels taxes, and various title and registration fees.

Total revenues of the Highway Trust Fund declined by \$10.8 million, or 1%. The decline in investment and interest earnings of \$26.7 million, as a result of lower cash balances to invest, had the largest impact on the Highway Trust Fund. Gasoline tax increased by \$8.3 million, or 2.9%, and highway use tax grew by \$9 million, or 1.7%. Transportation related expenditures of the Highway Trust Fund grew by \$63.5 million, or 11.9%.

Major Issues

It is important to note some of the budget and program realities that have contributed to our current condition. With the adoption of the General Fund budget for fiscal year ended June 30, 2003, North Carolina will have experienced its third straight year in which spending needs exceeded recurring revenues. This problem has been increased by the economic downturn experienced nationally and in North Carolina. The increase in spending needs is attributed to enrollment growth in the public schools and higher education institutions along with continued increased costs in the health and human services areas such as Medicaid and children services. The result is that North Carolina has spent more money than it has realized in the General Fund during the last four consecutive years.

In order to meet the constitutional requirement of a balanced budget for the General Fund, the Governor has exercised his constitutional powers through the enactment of Executive Orders to control spending and to identify resources to meet spending requirements. Among these resources are the Highway Trust Fund, the Tobacco Trust Fund, agency special funds, and reductions to employer contributions to some of the State retirement systems. State agencies and institutions have been operating under Executive Orders since February 2001. The current Executive Order allows spending at an average of 96.5% of the authorized General Fund budget for fiscal year 2003.

Because of the budget shortfalls, the need to use State reserves, and the inability to replenish reserves, the result has been an overall reduction in the net worth of the General Fund (GAAP basis) component of the State budget. In the last three years, the unreserved balance has gradually declined to its current level of negative \$575 million for the fiscal year ended June 30, 2002. The Savings Reserve Account balance was used to balance the budget in fiscal year 2001, and the General Assembly authorized new funds to replenish that reserve in fiscal year 2002. But the Savings Reserve Account balance again was required to manage the budget shortfall for fiscal year 2001. As of June 30, 2002, the Savings Reserve had a zero balance.

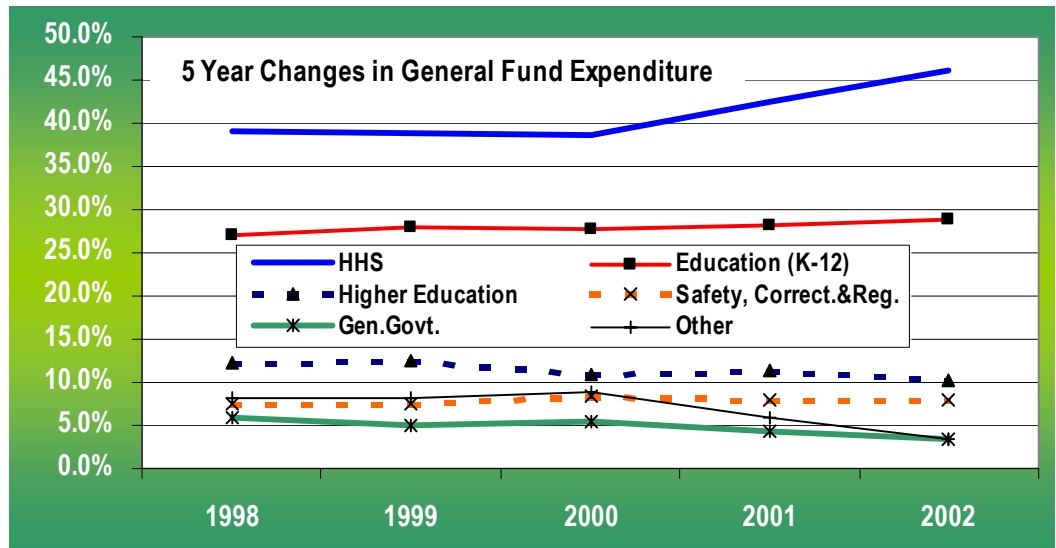
For fiscal year 2003 through November 30, \$265.6 million has been set-aside in the Governor's Executive Order Reserve and is available to manage any potential budget shortfall that may occur. It is important to note, however, that some of these funds may be needed for the continued recovery of eastern North Carolina from the aftermath of Hurricane Floyd. This Reserve coupled with spending restrictions and zero economic revenue growth are the tools the Governor is using to manage the 2003 budget.

In August 2002, Moody's investors service advised North Carolina of a downgrade in its credit from AAA to Aa1 representing the first time since 1960 that North Carolina had less than AAA credit. Moody's advised that the North Carolina budget had been under too much financial strain for too long and that the North Carolina economy was not sufficient to retain our rating at this time. While the rating service praised the strength of executive powers available to insure a balanced budget, they cited lack of structural balance, a weakened GAAP balance sheet, and the continued reliance on non-recurring resources as major factors in the downgrade. They made specific note of the reversal of GAAP balances that have reversed from positives to negatives in a relatively short period of time.

Challenges continue to exist for State government financial and program managers as we move further into this decade. The Governor will propose his 2003-05 budget to the 2003 Session of the General Assembly and many of the fiscal issues will continue into this legislative session.

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.



The expenditure allocation for health and human services increased from 37.9% in 1998 to 38.2% in 2002. 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 25.0% of the total expenditures and uses (State, federal, and local dollars) in 2002 compared to 27.1% in 1998. Dollars allocated to higher education declined from 12.3% in 1998 to 10.3% in 2002, 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.

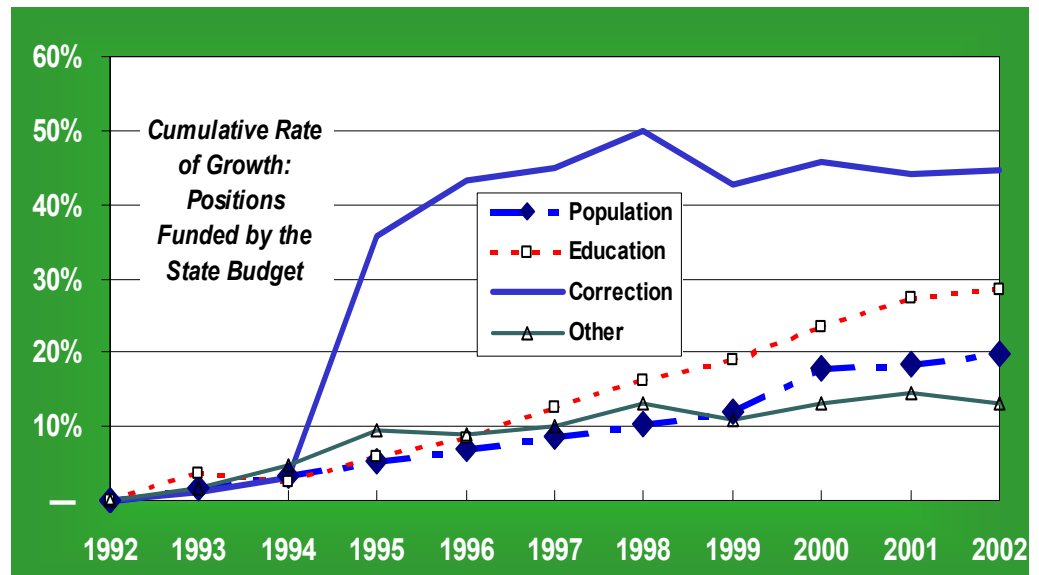
HHS =Health and human services;
 Education (K-12) =Department of Public Instruction
 Higher Education =UNC system and community colleges
 Safety, Correct. & Reg. =Public safety, corrections, and regulation
 Gen. Govt. =General Government

State Government Growth

As the State continues to experience population growth (20%, or 1,378,219 people since 1993), 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 2001-2002 school year, there were 2,137 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 2001-2002, the State housed approximately 32,483 inmates on a daily basis, with 23,736 entering the prison system and 22,978 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 30,964 positions, and corrections, which has increased by 5,726 positions.

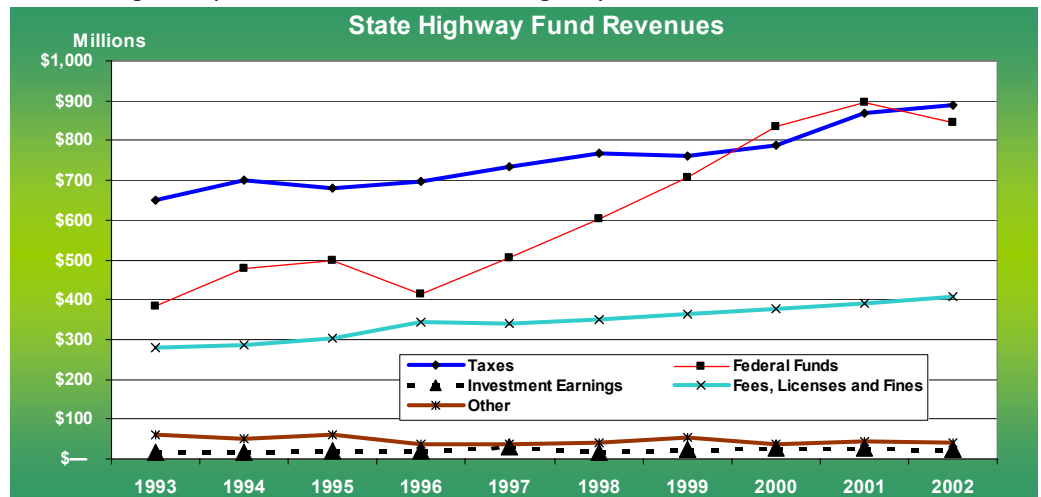
During the last 10 years, the rate of growth in public education (K-12) positions (24% increase) has exceeded the rate of growth in North Carolina's population (20% increase). During the same period, primarily due to new legal requirements for housing inmates, the rate of growth in correctional positions (42.94% 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 78,350 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.

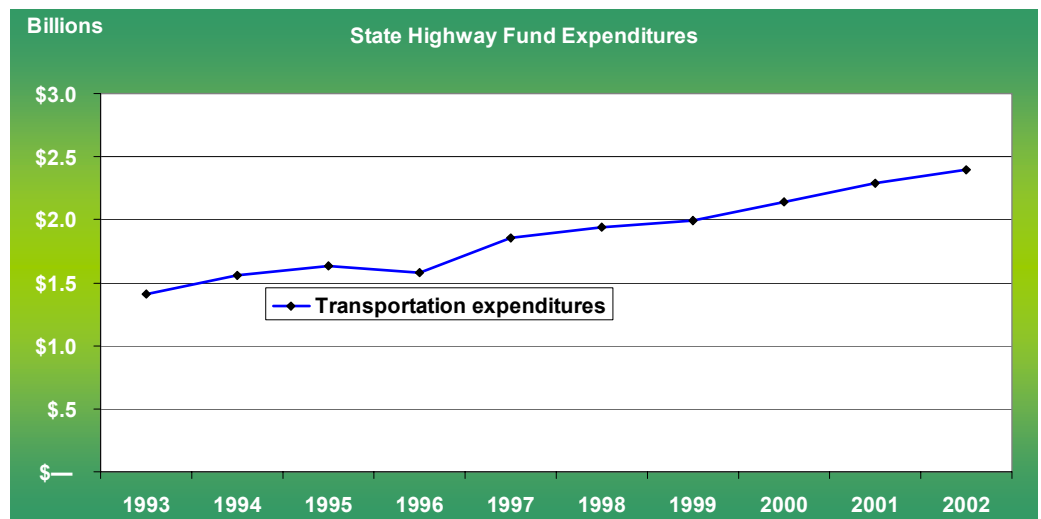
The following chart presents information for the Highway Fund.



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 assessment 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.

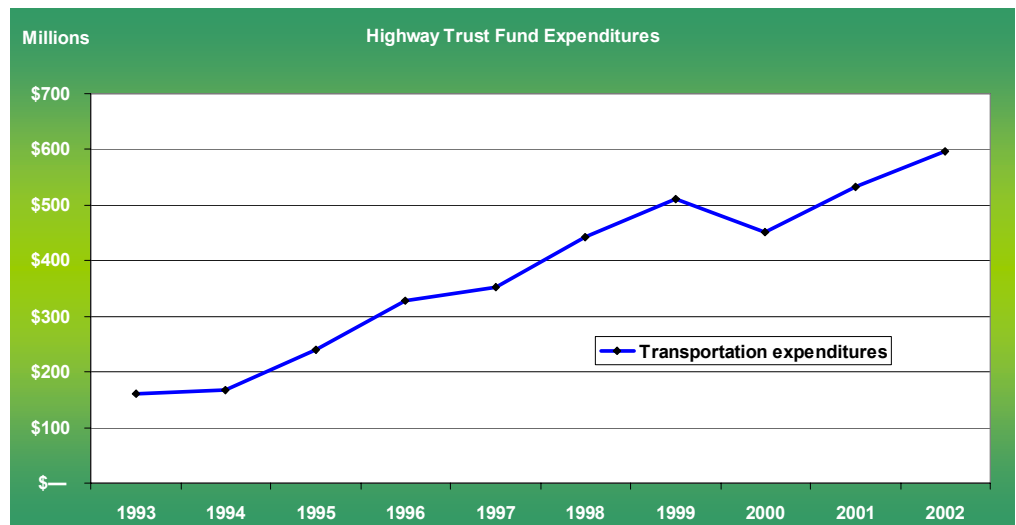
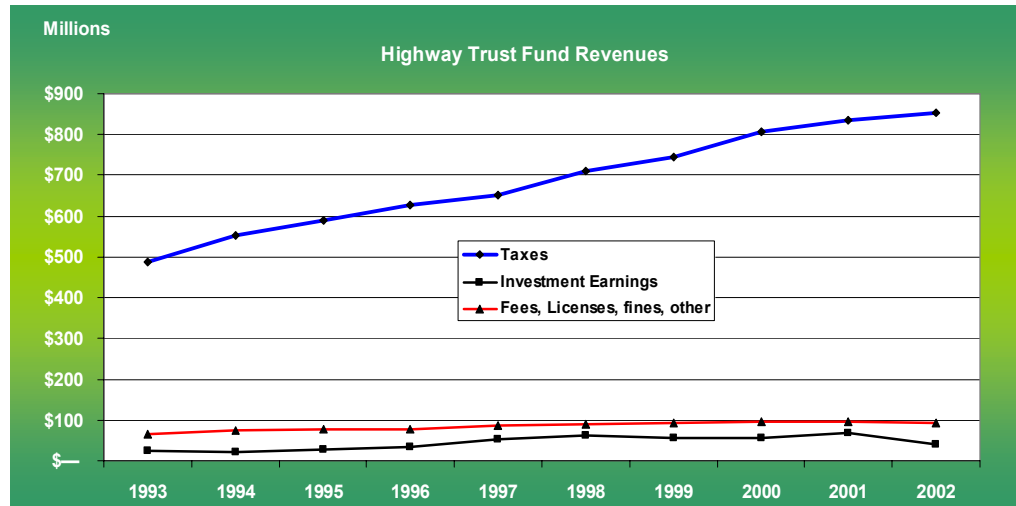
The most current assessment report highlights that while road maintenance funding has increased over the last decade, the increase in funding has not kept pace with inflation. According to the December 2000 report, \$500.2 million is needed to fund routine maintenance and to provide for an acceptable level of transportation service in North Carolina. According to the report, it would take an additional \$214.4 million (\$21.4 million per year) over the next 10 years to eliminate the current road maintenance backlog, with an additional \$75.6 million (\$7.56 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 \$221.4 million.



The estimated total maintenance needs, including backlogs, ranges from \$785.6 million in fiscal year 2001-2002, to \$1.116 billion in fiscal year 2009-2010 (averaging \$935.72 million per year). For the year ended June 30, 2002, \$553 million was spent on road maintenance. The approved State budget included \$585 million of road maintenance funding for fiscal year 2002-2003.

North Carolina — Financial Highlights — Fiscal Year 2002

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.



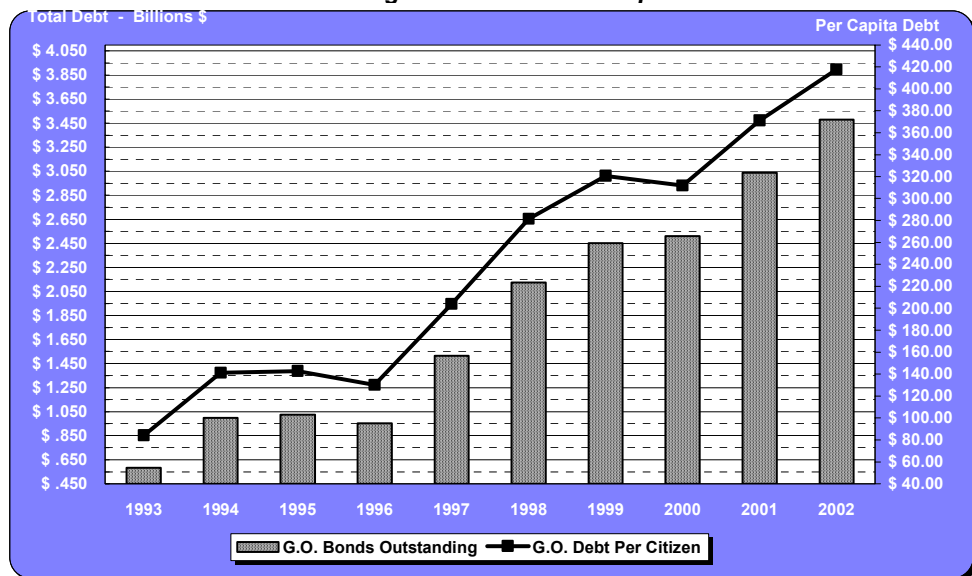
North Carolina's Infrastructure and Capital Improvement Needs Continue to Grow

As stated earlier, the State's population has grown by 20% since 1993. 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 (Principal and Interest)	Total General Expenditures	Ratio
2002	8,325,435	\$ 3,477,953,000	\$ 417.75	\$ 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%
1993	6,947,216	\$ 584,905,000	\$ 84.19	\$ 124,314,000	\$ 12,870,325,000	0.97%

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 Planning

For 2002, the Office of the State Controller used the growth rate of the prior year to estimate the state population.

350 copies of this public document were printed at a cost of \$329, or \$.94 per copy.

Award for Outstanding Achievement

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, 2001. 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 Outstanding Achievement in Popular Annual Financial Reporting

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**STATE OF
NORTH CAROLINA**

**For the fiscal year ending
June 30, 2001**



William Robert Harts
President

Jeffrey L. Essler
Executive Director