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NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY

Financial Statements

June 30, 2004 and 2003

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The Officers and Directors
North Carolina State Education Assistance Authority
Research Triangle Park, North Carolina

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the North Carolina State Education Assistance Authority, a component unit of the State of North Carolina, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina State Education Assistance Authority, as of June 30, 2004 and 2003, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Koonce, Wooten & Haywood, L.L.P.

Raleigh, North Carolina
August 31, 2004

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Management's Discussion and Analysis

Management of the North Carolina State Education Assistance Authority provides this *Management's Discussion and Analysis* for readers of the Authority's financial statements. This narrative overview and analysis of the financial activities of the Authority is for the fiscal years ended June 30, 2004 and 2003. We encourage readers to consider this information in conjunction with the Authority's financial statements which follow.

FINANCIAL HIGHLIGHTS

Net Assets -- The assets of the Authority exceeded its liabilities at fiscal years ending June 30, 2004 and 2003 by \$556 and \$560 million, respectively, (presented as "net assets"). Of this amount, \$3.3 and \$4.1 million, respectively, were reported as "unrestricted net assets." Unrestricted net assets represent the amount available to be used to meet the Authority's ongoing operating obligations.

Changes in Net Assets -- The Authority's total net assets decreased by \$5 million and increased by \$17 million, respectively, (.9% decrease and 3.2% increase, respectively) in fiscal years 2004 and 2003.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the North Carolina State Education Assistance Authority's financial statements. The Authority's financial statements include four components: 1) Statements of Net Assets, 2) Statements of Revenues, Expenses and Changes in Net Assets, 3) Statements of Cash Flows, and 4) Notes to the Financial Statements. The Authority meets the criteria detailed in Government Accounting Standards Board Statement No. 14 for component units and is discretely presented in the State of North Carolina Comprehensive Annual Financial Report (CAFR) by the State Auditor's Office and the Office of the State Controller. The financial statements contained herein report information pertaining to the Authority.

The financial statements provide a broad view of the Authority's operations in a manner similar to private-sector business. The statements provide both short-term and long-term information about the Authority's financial position, which assists in assessing the Authority's economic condition at the end of each fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal years even if cash involved has not been received or paid.

The statements of net assets present all of the Authority's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Authority's net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Management's Discussion and Analysis

The statements of revenues, expenses, and changes in net assets present information showing how the Authority's net assets changed during the most recent fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in these statements for some items that will not result in cash flows until future fiscal periods.

The statements of cash flows present a reconciliation of cash and cash equivalents between the beginning of a year and the end of a year. These statements assist in assessing the Authority's ability to generate future net cash flows, ability to meet obligations as they come due, reasons for differences in operating income and cash flows from operations, and the effect of noncash transactions.

FINANCIAL ANALYSIS

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. The Authority's net assets totaled \$556 million as of June 30, 2004, compared to \$560 million as of June 30, 2003.

NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY'S Net Assets		2004	2003
Current Assets		\$ 959,478,762	\$ 788,478,565
Noncurrent Assets		1,440,011,843	1,164,690,234
Capital Assets		6,918,831	8,890,801
Total Assets		\$ 2,406,409,436	\$ 1,962,059,600
Current Liabilities		\$ 13,287,321	\$ 9,120,591
Noncurrent Liabilities		1,837,366,266	1,392,267,413
Total Liabilities		1,850,653,587	1,401,388,004
Invested in Capital Assets		6,918,831	8,890,801
Restricted		545,548,597	547,681,884
Unrestricted		3,288,421	4,098,911
Total Net Assets		555,755,849	560,671,596
Total Liabilities and Net Assets		\$ 2,406,409,436	\$ 1,962,059,600

The largest portion of the Authority's net assets (98% at June 30, 2004 and 2003) represents resources that are subject to external restrictions on how they may be used. An additional portion (1.2% at June 30, 2004 and 1.6% at June 30, 2003) reflects the Authority's investment in capital assets such as equipment and data processing systems. The Authority uses these capital assets to provide educational assistance services; consequently, these assets are not available for future spending. The remaining balance of unrestricted net assets may be used to meet the Authority's ongoing operating obligations. Internally imposed designations of resources are not presented as restricted net assets.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Management's Discussion and Analysis

At the end of the current fiscal year, the Authority is able to report positive balances in all three categories of net assets. The same situation held true for the prior fiscal year.

Changes in Net Assets

The Authority's net assets decreased by \$5 million or .9% during the year ended June 30, 2004 (increased \$17 million or 3.2% during the year ended June 30, 2003).

NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY'S Changes in Net Assets	2004	2003
REVENUES:		
Operating Revenues:		
Interest Earnings on Loans	\$ 56,126,169	\$ 53,743,697
Miscellaneous	<u>3,287,929</u>	<u>5,195,565</u>
Total Operating Revenues	<u>59,414,098</u>	<u>58,939,262</u>
Nonoperating Revenues:		
State Operating Aid	36,356,125	36,390,575
Grants	25,471,113	13,973,490
Investment Earnings	<u>11,008,044</u>	<u>20,214,422</u>
Total Nonoperating Revenues	<u>72,835,282</u>	<u>70,578,487</u>
Total Revenues	<u>132,249,380</u>	<u>129,517,749</u>
EXPENSES:		
Operating Expenses:		
Services	40,912,470	36,903,194
Interest	21,741,328	22,028,079
Borrower Benefits	15,454,401	17,313,944
Student Loan Service Cancellations	10,281,074	8,933,209
Depreciation and Amortization	3,093,368	2,440,979
Guaranty Agency Reserve Recall		797,489
Other Expenses	<u>1,004,017</u>	<u>1,422,411</u>
Total Operating Expenses	<u>92,486,658</u>	<u>89,839,305</u>
Nonoperating Expenses:		
Grants, Aid and Subsidies	<u>44,678,469</u>	<u>22,213,843</u>
Total Nonoperating Expenses	<u>44,678,469</u>	<u>22,213,843</u>
Total Expenses	<u>137,165,127</u>	<u>112,053,148</u>
CHANGE IN NET ASSETS	(4,915,747)	17,464,601
NET ASSETS--Beginning of Year	<u>560,671,596</u>	<u>543,206,995</u>
NET ASSETS--End of Year	<u>\$ 555,755,849</u>	<u>\$ 560,671,596</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Management's Discussion and Analysis

Approximately 43% of the Authority's total revenues came from interest earnings on resources invested in student loans under various education programs originated by or assigned to the Authority. An additional 19% resulted from grants (includes federal and state aid). Approximately 28% of total revenues came from the State of North Carolina for interest earnings on escheated monies held by the State. These earnings were distributed to the Authority pursuant to State law for use in providing grants and loans to certain North Carolina residents. Lastly, an additional 8% resulted from investment earnings on cash, cash equivalents, and short-term and long-term investments during the fiscal year.

The Authority's expenses cover a range of services. The largest expenses (30%) were for personnel costs, fees paid to others in exchange for administration of education assistance programs, collection costs related to student loans, and fees for professional and specialized services incurred by the Authority to expand and enhance its information dissemination program on planning and paying for higher education. Approximately 16% of expenses were for interest incurred on bonds issued by the Authority in order to fund federally insured student loans, 33% were for grants and aid distributed for education assistance, 11% were for borrower benefits to students in the Federal Family Education Loan Program, and 7% were for student loan service cancellations related to certain state sponsored loan programs.

The decline in net assets of the Authority during the year ended June 30, 2004 is attributable to two factors. The first was a legislative decision to expend the income from interest earnings on escheated monies on grants for needy students rather than on loans. As a consequence, some \$10 million that in 2003 would have been booked as an asset was instead classified as an expense in 2004. The second factor involved a decline in the value of certain long term investments. Because of a lower rate of return throughout the year and because an interest rate increase late in the year caused the value of the bonds in which the Authority is invested to decline, the Authority experienced some \$10 million in realized and unrealized losses on investments as of June 30, 2004 compared with June 30, 2003. Absent these two factors, the net assets of the Authority would have increased in approximately the same way for the year ended June 30, 2004 as compared to the year ended June 30, 2003.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Authority's investment in capital assets as of June 30, 2004 amounts to \$12 million, net of accumulated depreciation of \$5.1 million, leaving a net book value of \$6.9 million. The Authority's investment in capital assets as of June 30, 2003 amounted to \$11.8 million, net of accumulated depreciation of \$2.9 million, leaving a net book value of \$8.9 million. This investment in capital assets includes office furniture and equipment, data processing systems, and other equipment.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Management's Discussion and Analysis

The total gross increase in the Authority's investment in capital assets for the fiscal years 2004 and 2003 was approximately \$.2 and \$2.3 million, respectively. This increase related to an upgrade of hardware and software for the Authority's overall computer system.

Debt Administration

All bonds are the obligations of the Authority and are not deemed to constitute a debt or liability of the State of North Carolina. The general revenue bonds are secured by federally insured student loans of the Authority. All bonds are rated Aaa by Moody's and AAA by Fitch, with the exceptions of the 1995 Series A (Subordinate Lien) of \$14.35 million and the 1996 Series C (Subordinate Lien) of \$25 million, which are rated A by both agencies.

The Authority's total debt increased by approximately \$386 million (30%) and \$196 million (18%) during the fiscal years 2004 and 2003, respectively. Tax-exempt student loan revenue bonds in the amount of \$470 million were issued. Approximately \$84 million was paid on outstanding bonds.

Additional information on the Authority's long-term debt obligations can be found in Note 7 of the notes to the financial statements of this report.

ECONOMIC FACTORS

The Authority does not anticipate any significant changes in its operations for the year ending June 30, 2005. It does intend to issue approximately \$397 million in tax exempt student loan revenue bonds for purposes of financing student and parent loans during the 2004-2005 academic year. This new indebtedness will be offset by the value of the guaranteed loans which it finances.

STATEMENTS OF NET ASSETS

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Net Assets
June 30, 2004 and 2003

ASSETS

	2004	2003
CURRENT ASSETS:		
Cash and Cash Equivalents	\$ 3,475,554	\$ 3,354,802
Restricted Cash and Cash Equivalents	273,068,091	223,435,790
Restricted Investments	221,395,657	163,156,365
Receivables:		
Accounts Receivable	1,257,713	710,198
Intergovernmental Receivables	5,373,131	4,088,337
Interest Receivable	16,538,166	16,985,950
Due From Component Unit	520,000	347,992
Due from Primary Government	36,356,125	36,390,575
Notes Receivable	400,441,721	339,150,320
Unamortized Bond Issuance Expenses	885,512	767,742
Inventories	12,925	20,559
Prepaid Expense	154,167	69,935
Total Current Assets	959,478,762	788,478,565
NONCURRENT ASSETS:		
Restricted Cash and Cash Equivalents	47,567,852	38,333,512
Restricted Investments	159,285,772	119,214,176
Notes Receivable	1,224,119,273	999,535,335
Unamortized Bond Issuance Expenses	9,038,946	7,607,211
Total Noncurrent Assets	1,440,011,843	1,164,690,234
CAPITAL ASSETS:		
Office Furniture and Equipment	209,614	201,721
Data Processing Systems	11,691,932	11,457,444
Other Equipment	125,576	125,576
Accumulated Depreciation	(5,108,291)	(2,893,940)
Net Capital Assets	6,918,831	8,890,801
Total Assets	\$ 2,406,409,436	\$ 1,962,059,600

The accompanying notes are an integral part of the financial statements.

LIABILITIES AND NET ASSETS

	<u>2004</u>	<u>2003</u>
CURRENT LIABILITIES:		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 490,796	\$ 350,824
Accrued Payroll	62,838	55,990
Intergovernmental Payables	18,822	34,286
Due to IRC Section 529 Plan Participants	7,282,819	4,401,062
Interest Payable	4,423,538	3,268,504
Bonds Payable	1,000,000	1,000,000
Accrued Vacation Leave	8,508	9,925
Total Current Liabilities	<u>13,287,321</u>	<u>9,120,591</u>
 NONCURRENT LIABILITIES:		
Due to IRC Section 529 Plan Participants	149,416,868	90,818,070
Bonds Payable	1,684,968,000	1,298,806,000
Arbitrage Rebate Payable	2,794,468	2,487,957
Accrued Vacation Leave	186,930	155,386
Total Noncurrent Liabilities	<u>1,837,366,266</u>	<u>1,392,267,413</u>
 Total Liabilities	<u>1,850,653,587</u>	<u>1,401,388,004</u>
 NET ASSETS:		
Invested in Capital Assets, net of Related Debt	6,918,831	8,890,801
Restricted for Educational Assistance Programs	545,548,597	547,681,884
Unrestricted	3,288,421	4,098,911
Total Net Assets	<u>555,755,849</u>	<u>560,671,596</u>
 Total Liabilities and Net Assets	<u>\$ 2,406,409,436</u>	<u>\$ 1,962,059,600</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Revenues, Expenses and Changes in Net Assets
For The Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
OPERATING REVENUES:		
Interest Earnings on Loans	\$ 56,126,169	\$ 53,743,697
Miscellaneous	3,287,929	5,195,565
Total Operating Revenues	<u>59,414,098</u>	<u>58,939,262</u>
OPERATING EXPENSES:		
Personal Services	1,986,202	1,924,131
Supplies and Materials	45,339	33,032
Services	38,926,268	34,979,063
Interest	21,741,328	22,028,079
Depreciation and Amortization	3,093,368	2,440,979
Borrower Benefits	15,454,401	17,313,944
Student Loan Service Cancellations	10,281,074	8,933,209
Guaranty Agency Reserve Recall		797,489
Other Expenses	958,678	1,389,379
Total Operating Expenses	<u>92,486,658</u>	<u>89,839,305</u>
Operating Loss	<u>(33,072,560)</u>	<u>(30,900,043)</u>
NONOPERATING REVENUES (EXPENSES):		
State Operating Aid	36,356,125	36,390,575
Noncapital Grants	19,473,745	8,547,708
Federal Grants	5,997,368	5,425,782
Investment Earnings	11,008,044	20,214,422
Grants, Aid and Subsidies	(44,678,469)	(22,213,843)
Total Nonoperating Revenues (Expenses)	<u>28,156,813</u>	<u>48,364,644</u>
Change in Net Assets	(4,915,747)	17,464,601
NET ASSETS--Beginning of Year	<u>560,671,596</u>	<u>543,206,995</u>
NET ASSETS--End of Year	<u>\$ 555,755,849</u>	<u>\$ 560,671,596</u>

The accompanying notes are an integral part of the financial statements.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Cash Flows
For The Years Ended June 30, 2004 and 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Customers	\$ 1,015,408	\$ (4,625,715)
Collection of Loans from Students	589,660,762	463,690,819
Payments to Employees and Fringe Benefits	(1,949,227)	(1,868,517)
Payments to Vendors and Suppliers	23,143,813	(20,987,205)
Loans Issued to Students	(845,229,494)	(683,865,350)
Payments of Operating Interest Expense	(21,741,328)	(22,028,079)
Net Cash Used by Operating Activities	(255,100,066)	(269,684,047)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from Sale of Bonds	470,000,000	260,000,000
Repayment of Bond Principal	(83,838,000)	(63,600,000)
Bond Issuance Costs	(2,418,166)	(1,639,885)
State Operating Aid	36,356,125	36,390,575
Noncapital Grants	19,473,745	8,547,708
Federal Grants	5,997,368	5,425,782
Grants, Aid and Subsidies	(44,678,469)	(22,213,843)
Net Cash Provided by Noncapital Financing Activities	400,892,603	222,910,337
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of Fixed Assets	(252,737)	(2,310,088)
Net Cash Used by Capital and Related Financing Activities	(252,737)	(2,310,088)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the Sale and Maturities of Non-State Treasurer Investments	1,758,725,331	840,126,157
Redemptions from the State Treasurer Long-Term Investment Pool	14,660,000	
Interest on Investments	12,298,951	14,191,376
Purchase of Non-State Treasurer Investments	(1,872,236,689)	(868,287,878)
Net Cash Used by Investing Activities	(86,552,407)	(13,970,345)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	58,987,393	(63,054,143)
CASH AND CASH EQUIVALENTS--Beginning of Year	265,124,104	328,178,247
CASH AND CASH EQUIVALENTS--End of Year	\$ 324,111,497	\$ 265,124,104

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Cash Flows
For The Years Ended June 30, 2004 and 2003

	2004	2003
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:		
Operating Loss	\$ (33,072,560)	\$ (30,900,043)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation and Amortization	3,093,368	2,440,979
Student Loan Principal Repayments	523,212,937	401,100,221
Student Loans Issued	(811,289,697)	(653,346,351)
Student Loan Cancellations and Write-offs	10,428,156	8,422,401
Allowances and Uncollectible Accounts	(106,500)	424,500
Capitalized Interest and Other	(8,120,235)	(4,206,127)
(Increase) Decrease in Assets:		
Accounts Receivable	(547,515)	(454,225)
Intergovernmental Receivables	(1,284,794)	1,538,427
Investment Earnings Receivable	(302,654)	731,735
Due from Component Units	(172,008)	(347,992)
Due from Primary Government	34,450	(11,094,217)
Inventories	7,635	(6,696)
Prepaid Expense	(84,232)	(69,935)
Increase (Decrease) in Liabilities:		
Accounts Payable	1,601,517	(8,350,563)
Accrued Payroll	6,848	5,618
Intergovernmental Payables	(15,464)	(27,340,664)
Due to IRC Section 529 Plan Participants	61,480,555	51,828,889
Accrued Vacation Leave	30,127	49,996
Deferred Revenue		(110,000)
Net Cash Used by Operating Activities	\$ (255,100,066)	\$ (269,684,047)
 SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash Paid During the Year for Interest	\$ 19,813,504	\$ 21,058,556
 NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Noncash Distributions from State Treasurer		
Long-Term Investment Pool	\$ 3,160,468	\$ 4,010,050
Write-up (down) of Investments to Fair Market Value	\$ (4,868,857)	\$ 3,116,642

The accompanying notes are an integral part of the financial statements.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

1. Summary of Significant Accounting Policies

A. Organization and Reporting Entity:

Governmental Accounting Standards Board Statement No. 14 requires the discrete presentation of condensed financial statements for certain significant component units in the State of North Carolina's annual financial report. The North Carolina State Education Assistance Authority meets the criteria for a component unit and is discretely presented in the June 30, 2004 and 2003, State of North Carolina Comprehensive Annual Financial Reports (CAFR) by the State Auditor's Office and the Office of the State Controller.

The accompanying financial statements present all funds subject to the direct administrative authority and responsibility of the Authority. These funds are as follows:

1. Student Aid Funds
2. North Carolina Student Loan Fund
3. Guaranteed Student Loan Revenue Bond Fund
4. North Carolina Student Incentive Grant Program
5. UNC Need-Based Grant Program
6. North Carolina Student Loan Program for Health, Science and Mathematics
7. North Carolina Nurse Scholars Program
8. North Carolina Masters Nurse Scholars Program
9. North Carolina Nurse Education Scholarship Loan Program
10. Principal Fellows Loan Program
11. Social Workers Scholarship Loan Fund
12. Paul Douglas Teacher Scholarship Program
13. Golden LEAF Scholars Program
14. North Carolina National College Savings Program
15. Alternative Loan and Collection Programs
16. State Budget Code 66011

A special restricted trust fund, maintained in State budget code 66010, is used to insure loans to students by eligible lenders according to the provisions of the Higher Education Act of 1965 and the National Vocational Student Loan Insurance Act of 1965.

B. Basis of Presentation:

The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the State does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989 unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, the full scope of the Authority's activities is considered to be a single business type activity (BTA) and accordingly, is reported within a single column in the financial statements.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

1. Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting:

The financial statements of the Authority have been prepared on the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

Nonexchange transactions, in which the Authority receives (or gives) value without directly giving (or receiving) equal value in exchange includes state appropriations and certain grants. Revenues are recognized as soon as all eligibility requirements imposed by the provider have been met.

The Authority is a sub-agency of the University of North Carolina - General Administration (UNC-GA). As a sub-agency, its records are maintained on the UNC-GA accounting system under the National Association of Colleges and University Business Offices fund structure. For state level (CAFR) reporting requirements, the financial records of the Authority are presented under the GASB enterprise proprietary fund format. This enterprise proprietary fund includes all resources, liabilities and transactions pertaining to primary and supportive operational activities of the Authority.

Accounting records for funds with state appropriated budgets are maintained on the cash basis of accounting. The cash basis records are adjusted as of the end of the fiscal year in order to prepare accrual basis financial statements. State budgets are maintained in compliance with provisions of the Executive Budget Act, North Carolina General Statutes 143-1 through 143-34.5, and trust funds are maintained in compliance with General Statute 116-36.1.

The Statements of Net Assets include a self-balancing set of assets, liabilities, and net assets that report the financial position of the Authority at the end of the fiscal years ended June 30, 2004 and 2003. The Statements of Revenues, Expenses and Changes in Net Assets include the one accounting fund group and identify activities which changed net asset balances during the fiscal years.

D. Cash and Cash Equivalents:

This classification includes deposits held by the State Treasurer in the short-term investment portfolio more fully discussed in Note 2, as well as cash on deposit and money market accounts with trustees/custodians. Investments are deemed to be cash equivalents if they are readily convertible to cash and have original maturities of three months or less with the exception of commercial repurchase agreements which are considered short-term investments. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. Investments:

This classification includes deposits held by the State Treasurer in certain long-term investment portfolios more fully discussed in Note 2, as well as investments with trustees/custodians. Investments are generally accounted for at fair value. Additional investment valuation information is provided in Note 2. The net increase (decrease) in the fair value of investments is recognized as a component of investment earnings.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

1. Summary of Significant Accounting Policies (Continued)

F. Receivables:

Provision for expenses and losses on receivables is made in amounts required to maintain an adequate allowance to cover receivables paid through service cancellations and bad debts. At year end, the allowance is adjusted by management based on review of the receivables.

G. Inventories:

Inventories held by the Authority are priced at the lower of cost or market using the first-in, first-out method. The inventory consists of postage.

H. Capital Assets:

Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The Authority capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows: Office furniture and equipment and data processing systems and other equipment, 5 years.

I. Restricted Assets:

Restricted assets represent assets whose use is restricted by external parties or by law through constitutional provisions or enabling legislation.

J. Noncurrent Long-Term Liabilities:

Noncurrent long-term liabilities include arbitrage rebate payable, amounts due to participants in the IRC Section 529 savings plan, principal amounts of bonds payable, and compensated absences that will not be paid within the next fiscal year.

K. Compensated Absences:

The Authority's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1st or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30th equals the leave carried forward at the previous December 31st, plus the leave earned, less the leave taken between January 1st and June 30th.

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002 and as of July 1, 2003. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

There is no liability for unpaid accumulated sick leave because the Authority has no obligation to pay sick leave upon termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last in, first out (LIFO) method.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

1. Summary of Significant Accounting Policies (Continued)

L. Net Assets:

The Authority's net assets are classified as follows:

Invested in Capital Assets, net of Related Debt: This represents the Authority's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted Net Assets -- Nonexpendable: Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by donors or other outside sources and as a condition of the gift, the principal is to be maintained in perpetuity. The Authority currently has no nonexpendable restricted net assets.

Restricted Net Assets -- Expendable: Expendable restricted net assets include resources which the Authority is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets: Unrestricted net assets include resources derived from noncapital state grants and related state-supported loan programs.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. Resources are applied on a transactional basis with unrestricted resources applied to expenses of a general unrestricted nature and to expenses of a restricted nature when restricted resources are unavailable. Restricted resources, when available, are applied to appropriate restricted expenses.

M. Revenue and Expense Recognition:

The Authority classifies its revenues and expenses as operating or nonoperating in the accompanying Statements of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) interest earned on loans and (2) borrower fees. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and State appropriations that represent subsidies to the Authority, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

1. Summary of Significant Accounting Policies (Continued)

N. Income Taxes:

The Authority is a political subdivision of the State of North Carolina. Accordingly, exemption from state and local taxation is provided by Chapter 116, Article 23 of the North Carolina General Statutes. Internal Revenue Code Section 115 provides exemption from federal income taxes.

O. Accounting Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Deposits and Investments

A. Deposits:

Cash and cash equivalents include cash in the State Treasurer's Cash and Investment Pool, State Treasurer's Budget Code Cash, and funds held by trustees/custodians in interest bearing money market accounts. Cash and cash equivalents totaled \$324,111,497 at June 30, 2004 and \$265,124,104 at June 30, 2003. The Authority's portion of the Cash and Investment Pool and Budget Code Cash at June 30, 2004 and 2003 was \$312,804,435 and \$257,171,168, respectively. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for the investments to be held by the State's agent in the State's name. The carrying amount of the Authority's deposits not with the State Treasurer at June 30, 2004 and 2003 was \$11,307,062 and \$7,952,936, respectively. These deposits were held by trustees/custodians in money market funds and were uninsured and uncollateralized.

North Carolina General Statutes 147.69.1(c) and 147-69.2 authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper, and asset-backed securities with specific ratings; specified bills of exchange or time drafts and corporate bonds and notes with specified ratings; general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

B. Investments:

The Authority is authorized by the University of North Carolina Board of Governors pursuant to General Statute 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina to invest its special funds in the same manner as the State Treasurer is required to invest, as previously discussed.

In accordance with bond resolutions, bond proceeds and debt service funds are invested in obligations that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

2. Deposits and Investments (Continued)

Investments at June 30, 2004 and 2003, are summarized as follows:

	<u>2004</u>	<u>2003</u>
State Treasurer Long-Term Investment Pool	\$ 34,134,571	\$ 49,335,041
Repurchase Agreements	148,588,144	163,156,366
Mutual Funds	92,532,098	51,195,538
Investment Agreements	72,807,513	
Annuity Contracts	13,300,531	7,970,980
Corporate Stocks	12,270,498	6,382,784
U. S. Government Obligations	7,048,074	4,329,832
	<u>\$ 380,681,429</u>	<u>\$ 282,370,541</u>

The Authority's non-pooled investments can be categorized to give an indication of the level of risk assumed by the entity at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that an entity will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment transactions fails. There are three categories of credit risk. Category 1 includes investments that are insured or registered or for which the securities are held by the Authority or its agent in the Authority's name. Repurchase Agreements and U.S. Government Obligations are considered Category 1 investments. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the Authority's name. The Authority currently has no Category 2 investments. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by a counterparty's trust department or agent but not in the Authority's name. Corporate Stocks are considered Category 3 investments. All other investments of the Authority are not categorized.

3. Receivables

The gross student loan receivables and related allowances for service cancellations and doubtful accounts at June 30, 2004 were:

	<u>Total</u>	<u>Current</u>	<u>Noncurrent</u>
Gross Student Loan Receivables	\$ 1,663,253,994	\$ 410,375,504	\$ 1,252,878,490
Less: Allowance for Service Cancellations and Doubtful Accounts	<u>38,693,000</u>	<u>9,933,783</u>	<u>28,759,217</u>
Net Receivables	<u>\$ 1,624,560,994</u>	<u>\$ 400,441,721</u>	<u>\$ 1,224,119,273</u>

The gross student loan receivables and related allowances for service cancellations and doubtful accounts at June 30, 2003 were:

	<u>Total</u>	<u>Current</u>	<u>Noncurrent</u>
Gross Student Loan Receivables	\$ 1,377,485,155	\$ 347,627,630	\$ 1,029,857,525
Less: Allowance for Service Cancellations and Doubtful Accounts	<u>38,799,500</u>	<u>8,477,310</u>	<u>30,322,190</u>
Net Receivables	<u>\$ 1,338,685,655</u>	<u>\$ 339,150,320</u>	<u>\$ 999,535,335</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

4. Capital Assets

A summary of changes in capital assets for the year ended June 30, 2004 is presented as follows:

	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Capital Assets:				
Office Furniture and Equipment	\$ 201,721	\$ 18,249	\$ 10,356	\$ 209,614
Data Processing Systems	11,457,444	234,488		11,691,932
Other Equipment	<u>125,576</u>			<u>125,576</u>
Total Capital Assets	<u>11,784,741</u>	<u>252,737</u>	<u>10,356</u>	<u>12,027,122</u>
Less Accumulated Depreciation for:				
Office Furniture and Equipment	176,743	12,041	10,356	178,428
Data Processing Systems	2,617,301	2,200,076		4,817,377
Other Equipment	<u>99,896</u>	<u>12,590</u>		<u>112,486</u>
Total Accumulated Depreciation	<u>2,893,940</u>	<u>2,224,707</u>	<u>10,356</u>	<u>5,108,291</u>
Net Capital Assets	\$ <u>8,890,801</u>	\$ <u>(1,971,970)</u>	\$ <u>0</u>	\$ <u>6,918,831</u>

A summary of changes in capital assets for the year ended June 30, 2003 is presented as follows:

	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003
Capital Assets:				
Office Furniture and Equipment	\$ 211,916	\$	\$ 10,195	\$ 201,721
Data Processing Systems	9,173,930	2,310,088	26,574	11,457,444
Other Equipment	<u>133,531</u>		<u>7,955</u>	<u>125,576</u>
Total Capital Assets	<u>9,519,377</u>	<u>2,310,088</u>	<u>44,724</u>	<u>11,784,741</u>
Less Accumulated Depreciation for:				
Office Furniture and Equipment	156,402	30,536	10,195	176,743
Data Processing Systems	1,044,775	1,599,100	26,574	2,617,301
Other Equipment	<u>89,652</u>	<u>18,199</u>	<u>7,955</u>	<u>99,896</u>
Total Accumulated Depreciation	<u>1,290,829</u>	<u>1,647,835</u>	<u>44,724</u>	<u>2,893,940</u>
Net Capital Assets	\$ <u>8,228,548</u>	\$ <u>662,253</u>	\$ <u>0</u>	\$ <u>8,890,801</u>

5. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities at June 30, 2004 and 2003 were as follows:

	2004	2003
Accounts Payable	\$ 490,796	\$ 350,824
Accrued Payroll	62,838	55,990
Intergovernmental Payables	<u>18,822</u>	<u>34,286</u>
	\$ <u>572,456</u>	\$ <u>441,100</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

6. Revolving Line of Credit

The Authority had a revolving line of credit with three banks in effect at June 30, 2003. The amount of the line of credit at June 30, 2003 was \$10,000,000 and there was no balance outstanding. This line was secured by pledged student loans. Any proceeds of the line of credit were to be used for the funding of eligible student loans. Interest accrued at a variable rate as determined by the credit agreement. The line of credit expired on December 31, 2003.

7. Noncurrent Liabilities

A. Changes in Noncurrent Liabilities:

A summary of changes in noncurrent liabilities for the year ended June 30, 2004 is presented as follows:

	Balance <u>July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2004</u>	Current <u>Portion</u>
Bonds Payable	\$ 1,299,806,000	\$ 470,000,000	\$ 83,838,000	\$ 1,685,968,000	\$ 1,000,000
Accrued Vacation Leave	165,311	36,739	6,612	195,438	8,508
Arbitrage Rebate Payable	2,487,957	306,511		2,794,468	
Due to IRC Section 529 Plan Participants	<u>95,219,132</u>	<u>66,482,129</u>	<u>5,001,574</u>	<u>156,699,687</u>	<u>7,282,819</u>
Total Noncurrent Liabilities	<u>\$ 1,397,678,400</u>	<u>\$ 536,825,379</u>	<u>\$ 88,846,186</u>	<u>\$ 1,845,657,593</u>	<u>\$ 8,291,327</u>

A summary of changes in noncurrent liabilities for the year ended June 30, 2003 is presented as follows:

	Balance <u>July 1, 2002</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2003</u>	Current <u>Portion</u>
Bonds Payable	\$ 1,103,406,000	\$ 260,000,000	\$ 63,600,000	\$ 1,299,806,000	\$ 1,000,000
Accrued Vacation Leave	115,315	56,915	6,919	165,311	9,925
Arbitrage Rebate Payable	2,649,873	5,896	167,812	2,487,957	
Due to IRC Section 529 Plan Participants	<u>43,390,243</u>	<u>53,918,875</u>	<u>2,089,986</u>	<u>95,219,132</u>	<u>4,401,062</u>
Total Noncurrent Liabilities	<u>\$ 1,149,561,431</u>	<u>\$ 313,981,686</u>	<u>\$ 65,864,717</u>	<u>\$ 1,397,678,400</u>	<u>\$ 5,410,987</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

7. Noncurrent Liabilities (Continued)

B. Bonds Payable:

All bonds are obligations of the Authority and are not deemed to constitute a debt or liability of the State of North Carolina. The bonds are secured by federally insured student loans of the Authority. The bonds are summarized as follows:

	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2004</u>
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 1995 Series A (Subordinate Lien):				
Serial Bonds:				
Due 7-01-03 (5.30%)	\$ 1,000,000	\$	\$ 1,000,000	\$ 0
Due 7-01-04 (5.40%)	1,000,000			1,000,000
Due 7-01-05 (5.50%)	1,000,000			1,000,000
Term Bonds:				
Due 7-01-10 (6.05%)	5,350,000			5,350,000
Due 7-01-15 (6.30%)	<u>7,000,000</u>			<u>7,000,000</u>
	<u>15,350,000</u>		<u>1,000,000</u>	<u>14,350,000</u>
Taxable Guaranteed Student Loan Revenue Bonds, 1995 Series B (Senior Lien):				
Auction Rate Bonds:				
Due 7-01-15 (Variable Rate)	121,900,000			121,900,000
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 1996 Series C (Subordinate Lien)				
Term Bonds:				
Due 7-01-16 (6.35%)	25,000,000			25,000,000
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 1997 Series E (Senior Lien):				
Auction Rate Bonds:				
Due 7-01-27 (Variable Rate)	30,000,000			30,000,000
Taxable Guaranteed Student Loan Revenue Bonds, 1998 Series F (Senior Lien):				
Auction Rate Bonds:				
Series F-1				
Due 7-01-28 (Variable Rate)	120,000,000			120,000,000
Series F-2				
Due 7-01-28 (Variable Rate)	<u>120,000,000</u>			<u>120,000,000</u>
	<u>240,000,000</u>			<u>240,000,000</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

7. Noncurrent Liabilities (Continued)

	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2004</u>
Taxable Guaranteed Student Loan Revenue Bonds, 2000 Series G (Senior Lien): LIBOR Indexed:				
Due 6-01-09 (Variable Rate)	\$ 122,556,000	\$	\$ 66,942,000	\$ 55,614,000
Taxable Guaranteed Student Loan Revenue Bonds, 2001 Series H (Senior Lien): LIBOR Indexed:				
Due 12-01-12 (Variable Rate)	105,000,000		7,418,133	97,581,867
CP Indexed:				
Due 12-01-12 (Variable Rate)	<u>120,000,000</u>		<u>8,477,867</u>	<u>111,522,133</u>
	<u>225,000,000</u>		<u>15,896,000</u>	<u>209,104,000</u>
Taxable Guaranteed Student Loan Revenue Bonds, 2001 Series I (Senior Lien): LIBOR Indexed:				
Due 12-01-13 (Variable Rate)	100,000,000			100,000,000
CP Indexed:				
Due 12-01-13 (Variable Rate)	<u>100,000,000</u>			<u>100,000,000</u>
	<u>200,000,000</u>			<u>200,000,000</u>
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2001 Series J (Senior Lien): Auction Rate Bonds:				
Due 7-01-31 (Variable Rate)	60,000,000			60,000,000
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2002 Series K (Senior Lien): Auction Rate Bonds:				
Series K-1				
Due 7-01-32 (Variable Rate)	60,000,000			60,000,000
Series K-2				
Due 7-01-32 (Variable Rate)	<u>65,000,000</u>			<u>65,000,000</u>
	<u>125,000,000</u>			<u>125,000,000</u>
Taxable Guaranteed Student Loan Revenue Bonds, 2002 Series L (Senior Lien): Auction Rate Bonds:				
Series L-1				
Due 7-01-32 (Variable Rate)	65,000,000			65,000,000
Series L-2				
Due 7-01-32 (Variable Rate)	<u>70,000,000</u>			<u>70,000,000</u>
	<u>135,000,000</u>			<u>135,000,000</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

7. Noncurrent Liabilities (Continued)

	<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2004</u>
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2003 Series M (Senior Lien): Auction Rate Bonds:				
Series M-1				
Due 7-01-33 (Variable Rate)	\$	\$ 65,000,000	\$	\$ 65,000,000
Series M-2				
Due 7-01-33 (Variable Rate)		65,000,000		65,000,000
Series M-3				
Due 7-01-33 (Variable Rate)		<u>70,000,000</u>		<u>70,000,000</u>
		<u>200,000,000</u>		<u>200,000,000</u>
 Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2003 Series N (Senior Lien): LIBOR Indexed:				
Due 9-01-15 (Variable Rate)		<u>270,000,000</u>		<u>270,000,000</u>
 Total	 \$ <u>1,299,806,000</u>	 \$ <u>470,000,000</u>	 \$ <u>83,838,000</u>	 \$ <u>1,685,968,000</u>

C. Annual Requirements:

The annual requirements to pay principal and interest on bonds outstanding at June 30, 2004 are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 1,000,000	\$ 25,211,978
2006	1,000,000	25,156,978
2007		25,156,978
2008		25,156,978
2009	55,614,000	25,088,851
2010-2014	414,454,000	113,210,041
2015-2019	423,900,000	59,717,912
2020-2024		50,009,000
2025-2029	270,000,000	46,103,000
2030-2034	<u>520,000,000</u>	<u>21,215,100</u>
 Total Requirements	 \$ <u>1,685,968,000</u>	 \$ <u>416,026,816</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2003 and 2002

7. Noncurrent Liabilities (Continued)

The Taxable Guaranteed Student Loan Revenue Bonds, 1995 Series B (Senior Lien) are auction rate bonds due July 1, 2015. The Tax-Exempt Guaranteed Student Loan Revenue Bonds, 1997 Series E (Senior Lien) are auction rate bonds due July 1, 2027. The Taxable Guaranteed Student Loan Revenue Bonds, 1998 Series F (Senior Lien) are auction rate bonds due July 1, 2028. The Taxable Guaranteed Student Loan Revenue Bonds, 2000 Series G (Senior Lien) are LIBOR Indexed Bonds due June 1, 2009. The Taxable Guaranteed Student Loan Revenue Bonds, 2001 Series H (Senior Lien) are LIBOR and CP Indexed Bonds due December 1, 2012. The Taxable Guaranteed Student Loan Revenue Bonds, 2001 Series I (Senior Lien) are LIBOR and CP Indexed Bonds due December 1, 2013. The Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2001 Series J (Senior Lien) are auction rate bonds due July 1, 2031. The Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2002 Series K (Senior Lien) are auction rate bonds due July 1, 2032. The Taxable Guaranteed Student Loan Revenue Bonds, 2002 Series L (Senior Lien) are auction rate bonds due July 1, 2032. The Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2003 Series M (Senior Lien) are auction rate bonds due July 1, 2033. The Taxable Guaranteed Student Loan Revenue Bonds, 2003 Series N (Senior Lien) are LIBOR Indexed Bonds due September 1, 2015. All of the above series have a variable interest rate that changes weekly to quarterly. The annual interest requirements in the schedule above were calculated using the rate in effect on June 30, 2004. Therefore, the debt service interest requirements on the aforementioned series will change on a weekly to quarterly basis throughout the life of the bonds.

8. Arbitrage Rebate Payable

The Internal Revenue Code (IRC) and arbitrage regulations issued by the IRS require rebate to the federal government of excess investment earnings on bond proceeds if the yield on those earnings exceeds the effective yield on the related tax-exempt bonds issued. Regulations also exist for calculating rebate earnings in connection with the accounting for bond proceeds, refunding issues, and proceeds that are commingled with other funds for investment purposes. Rebates are payable every five years from date of bond issue or upon maturity of the bonds, whichever is earlier.

Additionally, the IRC and U. S. Treasury Regulations permit issuers of qualified student loan tax-exempt obligations to earn no more than 2.0% above the bond yield on the qualified student loans financed with such tax-exempt obligations. For excess earnings on qualified student loans, issuers may elect to pay such excess to the U.S. Treasury or return such excess to the borrowers of qualified student loans financed by the tax-exempt obligations. The Authority has elected to implement a program of borrower benefits in order to return such excess to borrowers.

The Authority had computations made to determine the liability at June 30, 2004 and 2003. Based on those results, the Authority incurred expense of \$306,511 for the year ended June 30, 2004 and \$5,895 for the year ended June 30, 2003. This expense is determined using the "Future Value" method of determining cumulative arbitrage liability, as set forth in the U.S. Treasury Regulations and is based on cash flows created by investment, sale, maturity of and earnings on gross bond proceeds. As of June 30, 2004 and 2003, the Authority reported \$2,794,468 and \$2,487,957, respectively, arbitrage rebate payable. The Authority's General Resolution requires that funds equal to the amount of the liability be deposited in the Rebate Fund maintained by the Bond Trustee by September 30 of each year.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

9. Pension Plans

A. Retirement Plans:

Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units, and local boards of education. The plan is administered by the North Carolina State Treasurer. Additional detail information about the System can be located in the State of North Carolina's Comprehensive Annual Financial Report.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by North Carolina General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2004, these rates were set at .22% of covered payroll for employers and 6% of covered payroll for members. For the year ended June 30, 2003, the General Assembly required no contribution by employers and 6% of covered payroll for members.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators of the Authority may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the employer contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the years ended June 30, 2004 and 2003, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The Authority assumes no liability other than its contribution.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2004 and 2003

9. Pension Plans (Continued)

For the years ended June 30, 2004 and 2003, the Authority had a total payroll of \$1,622,024 and \$1,576,338, respectively, of which \$1,455,984 and \$1,406,474 was covered under the Teachers' and State Employees' Retirement System and \$159,069 and \$157,967 was covered under the Optional Retirement Program. Total employee contributions for pension benefits under the Teachers' and State Employees' Retirement System for the years ended June 30, 2004 and 2003 were \$87,359 and \$84,388, respectively. Total employee contributions under the Optional Retirement Program for the years ended June 30, 2004 and 2003 were \$9,544 and \$9,478, respectively. Total employer contributions for pension benefits under the Teachers' and State Employees' Retirement System for the year ended June 30, 2004 and 2003 were \$3,203 and \$0, respectively. Total employer contributions under the Optional Retirement Program for the years ended June 30, 2004 and 2003 were \$10,880 and \$10,805, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans:

IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the Authority. The voluntary contributions by employees amounted to \$2,400 for the years ended June 30, 2004 and 2003, respectively.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the Authority. The voluntary contributions by employees amounted to \$1,180 and \$1,690 for the years ended June 30, 2004 and 2003, respectively.

IRC Section 403(b) and 403(b)(7) Plans - Eligible Authority employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the Authority. The voluntary contributions by employees amounted to \$6,264 and \$8,216 for the years ended June 30, 2004 and 2003, respectively.

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10. Other Postemployment Benefits

A. Health Care for Long-Term Disability Beneficiaries and Retirees:

The Authority participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The Authority contributed 3.2% and 2.35% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits for the years ended June 30, 2004 and 2003, respectively. The Authority's total contribution to the Plan was \$51,682 and \$36,764 for the years ended June 30, 2004 and 2003, respectively. The Authority assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's Comprehensive Annual Financial Report.

B. Long-Term Disability:

The Authority participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6 of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. Employer contributions are established in the Appropriations Bill by the General Assembly. The Authority was not required to contribute to the DIPNC for the year ended June 30, 2004. The Authority contributed .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for the year ended June 30, 2003. The Authority's total contribution to the Plan was \$0 and \$8,135 for the years ended June 30, 2004 and 2003, respectively. The Authority assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's Comprehensive Annual Financial Report.

11. Insurance

Physical plant and equipment used by the Authority and reported on the statement of net assets are owned by the State of North Carolina. To provide financial protection for this ownership equity in assets, the State maintains a State Property Fire Insurance Fund as self-insurance against losses which might occur to state-owned property. This fund is administered by the North Carolina Department of Insurance and is maintained without direct cost to individual State agencies. Extended coverage insurance is available at a cost to electing agencies.