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NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Financial Statements
June 30, 2005 and 2004

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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, 2005 and 2004, 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, 2005 and 2004, and the respective 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, 2005

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, 2005 and 2004. 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, 2005 and 2004 by \$546 and \$556 million, respectively, (presented as "net assets"). Of this amount, \$2.8 and \$3.3 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 \$9.3 million and \$4.9 million, respectively, (1.7% and .9% decrease, respectively) in fiscal years 2005 and 2004.

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 \$546 million as of June 30, 2005, compared to \$556 million as of June 30, 2004.

NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY'S Net Assets		2005	2004
Current Assets		\$ 829,893,123	\$ 959,478,762
Noncurrent Assets		1,846,919,722	1,440,011,843
Capital Assets		4,824,260	6,918,831
Total Assets		\$ 2,681,637,105	\$ 2,406,409,436
Current Liabilities \$		31,260,194	\$ 13,287,321
Noncurrent Liabilities		2,103,905,969	1,837,366,266
Total Liabilities		2,135,166,163	1,850,653,587
Invested in Capital Assets		4,824,260	6,918,831
Restricted		538,896,215	545,548,597
Unrestricted		2,750,467	3,288,421
Total Net Assets		546,470,942	555,755,849
Total Liabilities and Net Assets		\$ 2,681,637,105	\$ 2,406,409,436

The largest portion of the Authority's net assets (98.6% at June 30, 2005 and 98.2% at June 30, 2004) represents resources that are subject to external restrictions on how they may be used. An additional portion (.8% at June 30, 2005 and 1.2% at June 30, 2004) 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 \$9.3million or 1.7% during the year ended June 30, 2005 (decreased by \$4.9 million or .9% during the year ended June 30, 2004).

NORTH CAROLINA STATE EDUCATION ASSISTANCE AUTHORITY'S Changes in Net Assets		2005	2004
REVENUES:			
Operating Revenues:			
Interest Earnings on Loans	\$	88,367,490	\$ 56,126,169
Miscellaneous		<u>3,065,772</u>	<u>3,287,929</u>
Total Operating Revenues		<u>91,433,262</u>	<u>59,414,098</u>
Nonoperating Revenues:			
State Operating Aid		43,649,377	36,356,125
Grants		16,250,168	25,471,113
Investment Earnings		<u>15,341,705</u>	<u>11,008,044</u>
Total Nonoperating Revenues		<u>75,241,250</u>	<u>72,835,282</u>
Total Revenues		<u>166,674,512</u>	<u>132,249,380</u>
EXPENSES:			
Operating Expenses:			
Services		44,595,666	40,912,470
Interest		45,525,994	21,741,328
Borrower Benefits		17,117,740	15,454,401
Student Loan Service Cancellations		10,341,830	10,281,074
Depreciation and Amortization		3,068,673	3,093,368
Other Expenses		<u>1,237,804</u>	<u>1,004,017</u>
Total Operating Expenses		<u>121,887,707</u>	<u>92,486,658</u>
Nonoperating Expenses:			
Grants, Aid and Subsidies		<u>54,071,712</u>	<u>44,678,469</u>
Total Nonoperating Expenses		<u>54,071,712</u>	<u>44,678,469</u>
Total Expenses		<u>175,959,419</u>	<u>137,165,127</u>
CHANGE IN NET ASSETS		(9,284,907)	(4,915,747)
NET ASSETS--Beginning of Year		<u>555,755,849</u>	<u>560,671,596</u>
NET ASSETS--End of Year	\$	<u><u>546,470,942</u></u>	\$ <u><u>555,755,849</u></u>

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

Approximately 53% 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 10% resulted from grants (includes federal and state aid). Approximately 26% of total revenues came from the State of North Carolina for interest earnings on and corpus from 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 worthy and needy residents of North Carolina enrolled at public institutions of higher education in North Carolina. Lastly, an additional 9% 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, approximately 25%, 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 26% of expenses were for interest incurred on bonds issued by the Authority in order to fund federally insured student loans, 31% were for grants and aid distributed for education assistance, 10% were for borrower benefits to students in the Federal Family Education Loan Program, and 6% were for student loan service cancellations related to certain state sponsored loan programs.

The reduction in net assets during the year ended June 30, 2005 is attributable to the accrual of interest income on escheated monies held by the State, which is used by the Authority for providing grants and loans for certain worthy and needy residents of North Carolina enrolled at public institutions of higher education in North Carolina. Interest income for this purpose in 2005 was \$9.1 million less than in 2004. Absent this factor, the net assets of the Authority would have remained approximately the same for the year ended June 30, 2005 as compared to the year ended June 30, 2004.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Authority's investment in capital assets as of June 30, 2005 amounts to \$12 million, net of accumulated depreciation of \$7.2 million, leaving a net book value of \$4.8 million. The Authority's investment in capital assets as of June 30, 2004 amounted to \$12 million, net of accumulated depreciation of \$5.1 million, leaving a net book value of \$6.9 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

There was no gross increase in the Authority's investment in capital assets for the fiscal year 2005. The total gross increase in the Authority's investment in capital assets for the fiscal year 2004 was approximately \$.2 million. The increase during fiscal year 2004 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 \$13.35 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 \$236 million (13.9%) and \$386 million (29.7%) during the fiscal years 2005 and 2004, respectively. Tax-exempt student loan revenue bonds in the amount of \$397 million were issued. Approximately \$161 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 ended June 30, 2006. The Authority issued State of North Carolina State Education Assistance Authority Taxable Guaranteed Student Loan Revenue Bonds 2005 Series P (Senior Lien) dated August 2, 2005 in the amount of \$300,000,000. The Authority anticipates the issuance of State of North Carolina State Education Assistance Authority Guaranteed Student Loan Revenue Bonds, Series 2005-A, in a total amount not to exceed \$550,000,000 (consisting of tax-exempt bonds in an amount not to exceed \$500,000,000 and taxable bonds in an amount not to exceed \$50,000,000) with an expected date of delivery of October 27, 2005. The proceeds from these bonds, net of certain costs of issuance, will be used to fund student loans.

STATEMENTS OF NET ASSETS

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Net Assets
June 30, 2005 and 2004

ASSETS

	2005	2004
CURRENT ASSETS:		
Cash and Cash Equivalents	\$ 3,595,114	\$ 3,475,554
Restricted Cash and Cash Equivalents	228,744,503	273,068,091
Restricted Investments	108,587,874	221,395,657
Receivables:		
Accounts Receivable	2,358,933	1,257,713
Intergovernmental Receivables	14,081,728	5,373,131
Interest Receivable	18,527,366	16,538,166
Due From Component Unit	835,000	520,000
Due from Primary Government	27,255,262	36,356,125
Notes Receivable	424,908,258	400,441,721
Unamortized Bond Issuance Expenses	920,981	885,512
Inventories	3,020	12,925
Prepaid Expense	75,084	154,167
Total Current Assets	829,893,123	959,478,762
NONCURRENT ASSETS:		
Restricted Cash and Cash Equivalents	54,507,860	47,567,852
Restricted Investments	197,260,258	159,285,772
Notes Receivable	1,584,918,326	1,224,119,273
Unamortized Bond Issuance Expenses	10,233,278	9,038,946
Total Noncurrent Assets	1,846,919,722	1,440,011,843
CAPITAL ASSETS:		
Office Furniture and Equipment	209,614	209,614
Data Processing Systems	11,730,331	11,691,932
Other Equipment	125,576	125,576
Accumulated Depreciation	(7,241,261)	(5,108,291)
Net Capital Assets	4,824,260	6,918,831
Total Assets	\$ 2,681,637,105	\$ 2,406,409,436

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

LIABILITIES AND NET ASSETS

	<u>2005</u>	<u>2004</u>
CURRENT LIABILITIES:		
Accounts Payable and Accrued Liabilities:		
Accounts Payable	\$ 532,050	\$ 490,796
Accrued Payroll	66,710	62,838
Intergovernmental Payables	10,386	18,822
Due to IRC Section 529 Plan Participants	16,383,329	7,282,819
Interest Payable	13,258,895	4,423,538
Bonds Payable	1,000,000	1,000,000
Accrued Vacation Leave	8,824	8,508
Total Current Liabilities	<u>31,260,194</u>	<u>13,287,321</u>
NONCURRENT LIABILITIES:		
Due to IRC Section 529 Plan Participants	180,361,705	149,416,868
Bonds Payable	1,920,562,000	1,684,968,000
Arbitrage Rebate Payable	2,801,638	2,794,468
Accrued Vacation Leave	180,626	186,930
Total Noncurrent Liabilities	<u>2,103,905,969</u>	<u>1,837,366,266</u>
Total Liabilities	<u>2,135,166,163</u>	<u>1,850,653,587</u>
NET ASSETS:		
Invested in Capital Assets, net of Related Debt	4,824,260	6,918,831
Restricted for Educational Assistance Programs	538,896,215	545,548,597
Unrestricted	2,750,467	3,288,421
Total Net Assets	<u>546,470,942</u>	<u>555,755,849</u>
Total Liabilities and Net Assets	<u>\$ 2,681,637,105</u>	<u>\$ 2,406,409,436</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Revenues, Expenses and Changes in Net Assets
For The Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
OPERATING REVENUES:		
Interest Earnings on Loans	\$ 88,367,490	\$ 56,126,169
Miscellaneous	3,065,772	3,287,929
Total Operating Revenues	<u>91,433,262</u>	<u>59,414,098</u>
OPERATING EXPENSES:		
Personal Services	2,064,889	1,986,202
Supplies and Materials	58,114	45,339
Services	42,530,777	38,926,268
Interest	45,525,994	21,741,328
Depreciation and Amortization	3,068,673	3,093,368
Borrower Benefits	17,117,740	15,454,401
Student Loan Service Cancellations	10,341,830	10,281,074
Other Expenses	1,179,690	958,678
Total Operating Expenses	<u>121,887,707</u>	<u>92,486,658</u>
Operating Loss	<u>(30,454,445)</u>	<u>(33,072,560)</u>
NONOPERATING REVENUES (EXPENSES):		
State Operating Aid	43,649,377	36,356,125
Noncapital Grants	10,391,485	19,473,745
Federal Grants	5,858,683	5,997,368
Investment Earnings	15,341,705	11,008,044
Grants, Aid and Subsidies	(54,071,712)	(44,678,469)
Total Nonoperating Revenues (Expenses)	<u>21,169,538</u>	<u>28,156,813</u>
Change in Net Assets	(9,284,907)	(4,915,747)
NET ASSETS--Beginning of Year	<u>555,755,849</u>	<u>560,671,596</u>
NET ASSETS--End of Year	<u>\$ 546,470,942</u>	<u>\$ 555,755,849</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, 2005 and 2004

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from Customers	\$ 205,525	\$ 1,015,408
Collection of Loans from Students	600,687,917	589,660,762
Payments to Employees and Fringe Benefits	(2,067,005)	(1,949,227)
Payments to Vendors and Suppliers	5,378,825	23,143,813
Loans Issued to Students	(925,183,313)	(845,229,494)
Payments of Operating Interest Expense	(45,525,994)	(21,741,328)
Net Cash Used by Operating Activities	(366,504,045)	(255,100,066)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from Sale of Bonds	396,650,000	470,000,000
Repayment of Bond Principal	(161,056,000)	(83,838,000)
Bond Issuance Costs	(2,165,504)	(2,418,166)
State Operating Aid	43,649,377	36,356,125
Noncapital Grants	10,391,485	19,473,745
Federal Grants	5,858,683	5,997,368
Grants, Aid and Subsidies	(54,071,712)	(44,678,469)
Net Cash Provided by Noncapital Financing Activities	239,256,329	400,892,603
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of Fixed Assets	(38,399)	(252,737)
Net Cash Used by Capital and Related Financing Activities	(38,399)	(252,737)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the Sale and Maturities of Non-State Treasurer Investments	1,329,140,753	1,758,725,331
Redemptions from the State Treasurer Long-Term Investment Pool		14,660,000
Interest on Investments	11,688,918	12,298,951
Purchase of Non-State Treasurer Investments	(1,250,807,576)	(1,872,236,689)
Net Cash Provided (Used) by Investing Activities	90,022,095	(86,552,407)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(37,264,020)	58,987,393
CASH AND CASH EQUIVALENTS--Beginning of Year	324,111,497	265,124,104
CASH AND CASH EQUIVALENTS--End of Year	\$ 286,847,477	\$ 324,111,497

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Statements of Cash Flows
For The Years Ended June 30, 2005 and 2004

	2005	2004
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:		
Operating Loss	\$ (30,454,445)	\$ (33,072,560)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation and Amortization	3,068,673	3,093,368
Student Loan Principal Repayments	501,858,224	523,212,937
Student Loans Issued	(886,488,188)	(811,289,697)
Student Loan Cancellations and Write-offs	9,206,202	10,428,156
Allowances and Uncollectible Accounts	1,256,000	(106,500)
Capitalized Interest and Other	(11,097,828)	(8,120,235)
(Increase) Decrease in Assets:		
Accounts Receivable	(1,101,220)	(547,515)
Intergovernmental Receivables	(8,708,597)	(1,284,794)
Investment Earnings Receivable	(1,836,293)	(302,654)
Due from Component Unit	(315,000)	(172,008)
Due from Primary Government	9,100,863	34,450
Inventories	9,905	7,635
Prepaid Expense	79,083	(84,232)
Increase (Decrease) in Liabilities:		
Accounts Payable	8,883,781	1,601,517
Accrued Payroll	3,872	6,848
Intergovernmental Payables	(8,436)	(15,464)
Due to IRC Section 529 Plan Participants	40,045,347	61,480,555
Accrued Vacation Leave	(5,988)	30,127
	\$ (366,504,045)	\$ (255,100,066)
Net Cash Used by Operating Activities		
 SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:		
Cash Paid During the Year for Interest	\$ 35,921,150	\$ 19,813,504
 NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Noncash Distributions from State Treasurer		
Long-Term Investment Pool	\$ 2,257,494	\$ 3,160,468
Write-up (down) of Investments to Fair Market Value	\$ 1,242,386	\$ (4,868,857)

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

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

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, 2005 and 2004, 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. Millennium Teacher Scholarship Program
13. Paul Douglas Teacher Scholarship Program
14. Golden LEAF Scholars Program
15. North Carolina National College Savings Program
16. Alternative Loan and Collection Programs
17. State Budget Code 66011
18. Operating Funds

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, 2005 and 2004

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, 2005 and 2004. 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, as well as cash on deposit and money market accounts with trustees/custodians. 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. Additional information regarding cash and cash equivalents is provided in Note 2.

E. Investments:

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

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

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.

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

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.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

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, 2005 and 2004

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:

Deposits include cash and cash equivalents 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 \$286,847,477 at June 30, 2005 and \$324,111,497 at June 30, 2004. The Authority's portion of the Cash and Investment Pool and Budget Code Cash at June 30, 2005 and 2004 was \$257,459,671 and \$312,804,435, 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 and bank balance of the Authority's deposits not with the State Treasurer at June 30, 2005 and 2004 was \$29,387,806 and \$11,307,062, respectively. Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2005, the Authority's bank balance was exposed to custodial credit risk as follows:

Uninsured and Collateral Held by Bank	\$ 24,417,409
Uninsured and Collateral Held by Pledging Bank's Agent but not in Authority's Name	<u>4,970,397</u>
Total	<u>\$ 29,387,806</u>

North Carolina General Statutes 147.69.1(c) and 147-69.2, which are applicable to the Authority, 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.

The financial statements and disclosures for the State Treasurer's Investment Pool are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

2. Deposits and Investments (Continued)

B. Investments:

Investments totaled \$305,848,132 at June 30, 2005 and \$380,681,429 at June 30, 2004. The Authority's portion of the State Treasurer's Long-Term Investment Pool at June 30, 2005 and 2004 was \$37,634,451 and \$34,134,571, respectively. The Authority's investments not with the State Treasurer as of June 30, 2005 and 2004 totaled \$268,213,681 and \$346,546,858, respectively.

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.

Non-Pooled Investments – The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2005, for the Authority's non-pooled investments. Interest rate risk is defined by GASB Statement No. 40 as the risk a government may face should interest rate variances affect the fair value of investments. The Authority does not have a formal investment policy that addresses interest rate risk.

	Total	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More Than 10
Investments Subject to Interest Rate Risk:					
U.S. Treasuries	\$ 10,448,387	\$	\$	\$ 6,528,789	\$ 3,919,598
Repurchase Agreements	8,422,712				8,422,712
Mutual Bond Funds	<u>15,584,292</u>			<u>15,584,292</u>	
Total Investments Subject to Interest Rate Risk	<u>34,455,391</u>	\$ <u> </u>	\$ <u> </u>	\$ <u>22,113,081</u>	\$ <u>12,341,310</u>
Investments Not Subject to Interest Rate Risk:					
Investment Agreements	100,165,162				
Other Mutual Funds	101,885,048				
Domestic Stocks	16,425,176				
Other: Insurance					
Investment Contracts	<u>15,282,904</u>				
Total Investments Not Subject to Interest Rate Risk	<u>233,758,290</u>				
Total Non-Pooled Investments	\$ <u>268,213,681</u>				

Credit Risk: The Authority has formally adopted investment policies for credit risk stating that certain investment obligations shall bear one of the two highest ratings by nationally recognized rating services. As of June 30, 2005, the Authority's non-pooled investments were rated as follows:

	Fair Value	AAA	Unrated
Repurchase Agreements	\$ 8,422,712	\$	\$ 8,422,712
Mutual Bond Funds	15,584,292	10,603,292	4,981,000

Rating Agency: Standard & Poor's

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

2. Deposits and Investments (Continued)

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority does not have a formal policy that addresses custodial credit risk. The Authority's non-pooled investments were exposed to custodial credit risk as follows:

	<u>Total</u>	<u>Held by Counterparty</u>	<u>Held by Counterparty's Trust Dept or Agent Not in Authority's Name</u>	<u>All Other Investments</u>
Investments Categorized:				
U.S. Treasuries	\$ 10,448,387	\$	\$	\$ 10,448,387
Repurchase Agreements	8,422,712		8,422,712	
Domestic Stocks	<u>16,425,176</u>		<u>16,425,176</u>	
Total Categorized	<u>35,296,275</u>	<u>\$</u>	<u>\$ 24,847,888</u>	<u>\$ 10,448,387</u>
Investments Not Categorized:				
Investment Agreements	100,165,162			
Mutual Bond Funds	15,584,292			
Other Mutual Funds	101,885,048			
Insurance Investment Contracts	<u>15,282,904</u>			
Total Not Categorized	<u>232,917,406</u>			
Total Non-Pooled Investments	<u>\$ 268,213,681</u>			

Concentration of Credit Risk: The Authority places no limit on the amount that may be invested in any one issuer. More than 5% of the Authority's non-pooled investments are in Trinity Funding, FSA Capital Management, and MetLife Funding. These investments are 30%, 7%, and 6%, respectively, of the Authority's non-pooled investments.

Foreign Currency Risk: Foreign currency risk is defined by GASB Statement No. 40 as the risk that changes in exchange rates will adversely affect the fair value of an investment. The Authority has formally adopted investment policies for foreign currency risk stating that foreign investments must be dominated in U.S. dollars or the securities must be traded solely on an exchange based in the United States. The Authority's exposure to foreign currency risk for their non-pooled investments is as follows:

<u>Investment Type</u>	<u>Currency Denomination</u>	<u>Carrying Value (U.S. Dollars)</u>
Other Mutual Funds:		
Seligman International Growth	Various	\$ 7,783,686
Seligman Emerging Markets	Various	4,296,334
Evergreen International Equity I	Various	<u>1,766,676</u>
Total		<u>\$ 13,846,696</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

3. Receivables

The gross student loan receivables and related allowances for service cancellations and doubtful accounts at June 30, 2005 were:

	<u>Total</u>	<u>Current</u>	<u>Noncurrent</u>
Gross Student Loan Receivables	\$ 2,049,775,584	\$ 434,012,700	\$ 1,615,762,884
Less: Allowance for Service Cancellations and Doubtful Accounts	<u>39,949,000</u>	<u>9,104,442</u>	<u>30,844,558</u>
Net Receivables	\$ <u>2,009,826,584</u>	\$ <u>424,908,258</u>	\$ <u>1,584,918,326</u>

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>

4. Capital Assets

A summary of changes in capital assets for the year ended June 30, 2005 is presented as follows:

	<u>Balance July 1, 2004</u>	<u>Additions</u>	<u>Balance June 30, 2005</u>
Capital Assets:			
Office Furniture and Equipment	\$ 209,614	\$	\$ 209,614
Data Processing Systems	11,691,932	38,399	11,730,331
Other Equipment	<u>125,576</u>	<u></u>	<u>125,576</u>
Total Capital Assets	<u>12,027,122</u>	<u>38,399</u>	<u>12,065,521</u>
Less Accumulated Depreciation for:			
Office Furniture and Equipment	178,428	5,968	184,396
Data Processing Systems	4,817,377	2,121,708	6,939,085
Other Equipment	<u>112,486</u>	<u>5,294</u>	<u>117,780</u>
Total Accumulated Depreciation	<u>5,108,291</u>	<u>2,132,970</u>	<u>7,241,261</u>
Net Capital Assets	\$ <u>6,918,831</u>	\$ <u>(2,094,571)</u>	\$ <u>4,824,260</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

4. Capital Assets (Continued)

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>

5. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities at June 30, 2005 and 2004 were as follows:

	2005	2004
Accounts Payable	\$ 532,050	\$ 490,796
Accrued Payroll	66,710	62,838
Intergovernmental Payables	<u>10,386</u>	<u>18,822</u>
	<u>\$ 609,146</u>	<u>\$ 572,456</u>

6. Revolving Line of Credit

On September 15, 2004, the Authority agreed to reimburse the College Foundation, Inc. for principal, interest, unused commitment fees, and other fees due and payable under certain agreements between the Foundation and Branch Banking & Trust concerning a line of credit for which the Authority is designated as guarantor. The sole purpose of the line of credit is to provide funds for education loans in the event that the Authority is unable to remit amounts requested by the Foundation for education loans in time for scheduled disbursements. The line of credit expires on September 15, 2006.

Interest accrues on the line of credit at a variable rate based on the 30-day LIBOR rate plus 1%, adjusted monthly. In addition, there is an unused fee of 0.125% per annum on the average daily amount of the unused commitment under the line of credit.

As of June 30, 2005, no disbursements have been made from this line of credit. During the year ended June 30, 2005, unused fees of \$15,226 were incurred by the Foundation and subsequently reimbursed by the Authority.

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

7. Noncurrent Liabilities

A. Changes in Noncurrent Liabilities:

A summary of changes in noncurrent liabilities for the year ended June 30, 2005 is presented as follows:

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005	Current Portion
Bonds Payable	\$ 1,685,968,000	\$ 396,650,000	\$ 161,056,000	\$ 1,921,562,000	\$ 1,000,000
Accrued Vacation Leave	195,438	2,520	8,508	189,450	8,824
Arbitrage Rebate Payable	2,794,468	7,170		2,801,638	
Due to IRC Section 529 Plan Participants	<u>156,699,687</u>	<u>53,280,747</u>	<u>13,235,400</u>	<u>196,745,034</u>	<u>16,383,329</u>
Total Noncurrent Liabilities	<u>\$ 1,845,657,593</u>	<u>\$ 449,940,437</u>	<u>\$ 174,299,908</u>	<u>\$ 2,121,298,122</u>	<u>\$ 17,392,153</u>

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

	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004	Current Portion
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>

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:

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 1995 Series A (Subordinate Lien):				
Serial Bonds:				
Due 7-01-04 (5.40%)	\$ 1,000,000	\$	\$ 1,000,000	\$ 0
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>14,350,000</u>		<u>1,000,000</u>	<u>13,350,000</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

7. Noncurrent Liabilities (Continued)

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2005</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> </u>	<u> </u>	<u>120,000,000</u>
	<u>240,000,000</u>	<u> </u>	<u> </u>	<u>240,000,000</u>
Taxable Guaranteed Student Loan Revenue Bonds, 2000 Series G (Senior Lien): LIBOR Indexed: Due 6-01-09 (Variable Rate)	55,614,000		55,614,000	0
Taxable Guaranteed Student Loan Revenue Bonds, 2001 Series H (Senior Lien): LIBOR Indexed: Due 12-01-12 (Variable Rate)	97,581,867		48,739,600	48,842,267
CP Indexed: Due 12-01-12 (Variable Rate)	<u>111,522,133</u>	<u> </u>	<u>55,702,400</u>	<u>55,819,733</u>
	<u>209,104,000</u>	<u> </u>	<u>104,442,000</u>	<u>104,662,000</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

7. Noncurrent Liabilities (Continued)

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2005</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> </u>	<u> </u>	<u>100,000,000</u>
	<u>200,000,000</u>	<u> </u>	<u> </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> </u>	<u> </u>	<u>65,000,000</u>
	<u>125,000,000</u>	<u> </u>	<u> </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> </u>	<u> </u>	<u>70,000,000</u>
	<u>135,000,000</u>	<u> </u>	<u> </u>	<u>135,000,000</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> </u>	<u> </u>	<u>70,000,000</u>
	<u>200,000,000</u>	<u> </u>	<u> </u>	<u>200,000,000</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

7. Noncurrent Liabilities (Continued)

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2005</u>
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2003 Series N (Senior Lien): LIBOR Indexed:				
Due 9-01-15 (Variable Rate)	\$ 270,000,000	\$	\$	\$ 270,000,000
Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2004 Series O (Senior Lien): Auction Rate Bonds:				
Series O-1				
Due 7-01-34 (Variable Rate)		82,000,000		82,000,000
Series O-2				
Due 7-01-34 (Variable Rate)		82,000,000		82,000,000
Series O-3				
Due 7-01-34 (Variable Rate)		82,650,000		82,650,000
Series O-4				
Due 7-01-34 (Variable Rate)		75,000,000		75,000,000
Series O-5				
Due 7-01-34 (Variable Rate)		<u>75,000,000</u>		<u>75,000,000</u>
		<u>396,650,000</u>		<u>396,650,000</u>
 Total	 <u>\$ 1,685,968,000</u>	 <u>\$ 396,650,000</u>	 <u>\$ 161,056,000</u>	 <u>\$ 1,921,562,000</u>

C. Annual Requirements:

The annual requirements to pay principal and interest on bonds outstanding at June 30, 2005 are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 1,000,000	\$ 60,912,007
2007		60,912,007
2008		60,912,007
2009		60,912,007
2010		60,912,007
2011-2015	310,012,000	281,614,020
2016-2020	423,900,000	174,971,050
2021-2025		171,804,050
2026-2030	270,000,000	153,324,050
2031-2035	<u>916,650,000</u>	<u>77,533,340</u>
 Total Requirements	 <u>\$ 1,921,562,000</u>	 <u>\$ 1,163,806,545</u>

NORTH CAROLINA
STATE EDUCATION ASSISTANCE AUTHORITY
Notes To Financial Statements
June 30, 2005 and 2004

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, 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. The Tax-Exempt Guaranteed Student Loan Revenue Bonds, 2004 Series O (Senior Lien) are auction rate bonds due July 1, 2034. 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, 2005. 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, 2005 and 2004. Based on those results, the Authority incurred expense of \$7,170 for the year ended June 30, 2005 and \$306,511 for the year ended June 30, 2004. 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, 2005 and 2004, the Authority reported \$2,801,638 and \$2,794,468, 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.

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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.

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, 2005, these rates were set at 2.17% of covered payroll for employers and 6% of covered payroll for members. 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.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

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, 2005 and 2004, 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.

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9. Pension Plans (Continued)

For the years ended June 30, 2005 and 2004, the Authority had a total payroll of \$1,705,265 and \$1,622,024, respectively, of which \$1,525,152 and \$1,455,984 was covered under the Teachers' and State Employees' Retirement System and \$180,113 and \$159,069 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, 2005 and 2004 were \$91,509 and \$87,359, respectively. Total employee contributions under the Optional Retirement Program for the years ended June 30, 2005 and 2004 were \$10,807 and \$9,544, respectively. Total employer contributions for pension benefits under the Teachers' and State Employees' Retirement System for the year ended June 30, 2005 and 2004 were \$33,096 and \$3,203, respectively. Total employer contributions under the Optional Retirement Program for the years ended June 30, 2005 and 2004 were \$12,320 and \$10,880, 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 \$5,400 and \$2,400 for the years ended June 30, 2005 and 2004, 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 \$14,380 and \$1,180 for the years ended June 30, 2005 and 2004, 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 \$6,676 and \$6,264 for the years ended June 30, 2005 and 2004, 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% 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, 2005 and 2004. The Authority's total contribution to the Plan was \$54,568 and \$51,682 for the years ended June 30, 2005 and 2004, 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. The Authority contributed .445% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for the year ended June 30, 2005. The Authority was not required to contribute to the DIPNC for the year ended June 30, 2004. The Authority's total contribution to the Plan was \$7,588 and \$0 for the years ended June 30, 2005 and 2004, 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.

12. Change in Financial Accounting and Reporting

For the fiscal year ended June 30, 2005, the Authority implemented Governmental Accounting Standards Board Statement No. 40, Deposit and Investment Risk Disclosures. This statement establishes and modifies disclosure requirements related to investment risks: credit risk, interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.

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13. Subsequent Events

The Authority issued State of North Carolina State Education Assistance Authority Taxable Guaranteed Student Loan Revenue Bonds 2005 Series P (Senior Lien) dated August 2, 2005 in the amount of \$300,000,000. The Authority anticipates the issuance of State of North Carolina State Education Assistance Authority Guaranteed Student Loan Revenue Bonds, Series 2005-A, in a total amount not to exceed \$550,000,000 (consisting of tax-exempt bonds in an amount not to exceed \$500,000,000 and taxable bonds in an amount not to exceed \$50,000,000) with an expected date of delivery of October 27, 2005. The proceeds from these bonds, net of certain costs of issuance, will be used to fund student loans.