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NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The primary authority for the State's accounting and reporting requirements is the Office of Management and Budget. The Office of Management and Budget has adopted the pronouncements of the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are as follows:

A. REPORTING ENTITY

For financial reporting purposes, the State of North Dakota has included all funds, organizations, agencies, boards and commissions that make up its legal entity. The State has also included all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the State to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the State.

As required by accounting principles generally accepted in the United States of America, these financial statements present the State of North Dakota (the primary government) and its component units. The component units are included in the State's reporting entity because of the significance of their operational or financial relationships with the State.

BLENDED COMPONENT UNITS

These component units are entities that are legally separate from the State, but are so intertwined with the State that they are, in substance, the same as the State. They are reported as part of the State and blended into the appropriate fund types.

Building Authority (Debt Service Fund and Capital Projects Fund) - The Building Authority was created by the Legislature as a separate instrumentality of the State. Its purpose is to promote the general welfare of the citizens of the State by providing financing for use by the State in altering, repairing, maintaining or constructing buildings and making any improvements connected to State buildings. The Industrial Commission, which consists of the governor, the attorney general, and the commissioner of agriculture, is the governing board of the Building Authority. The funds and account groups of the Building Authority were audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated August 5, 2004, has been previously issued under a separate cover.

The **North Dakota University System Foundation** is considered a blended component unit. Although it is a legally separate nonprofit 501(c)(3) organization from the North Dakota University System, the North Dakota University System Foundation is reported as if it were part of the primary government because its sole purpose is to support the North Dakota University System. The members of the State Board of Higher Education serve as the Board of Trustees for the North Dakota University System Foundation.

The **NDSU Research Foundation** is considered a blended component unit. Although it is a legally separate, nonprofit 501(c)(3) organization from the North Dakota University System, the NDSU Research Foundation is reported as if it were part of the primary government because its sole purpose is to provide support to NDSU in its missions by enabling NDSU faculty to enhance their involvement in research, technology transfer, and business endeavors. Through linkages with public and private businesses and industries, the Foundation facilitates the commercialization of research technologies developed by NDSU faculty and staff. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated September 30, 2004, has been previously issued under a separate cover.

DISCRETELY PRESENTED COMPONENT UNITS

These component units are entities that are legally separate from the State, but are financially accountable to the State. The component units' columns of government-wide financial statements include the financial data of these entities.

MAJOR COMPONENT UNITS

Comprehensive Health Association (Proprietary Fund Type) - The Association was established by the Legislature with participating membership consisting of those insurance companies, licensed or authorized to do business in the State. It provides low cost access to health insurance coverage for residents of the State who are denied adequate health insurance and are considered uninsurable. The Association is governed by a board of eight members of which five are representatives of the State and is regulated by the State Insurance Department. The Association was audited by other independent auditors for the calendar year ended December 31, 2003, and their report dated February 24, 2004, has been previously issued under a separate cover.

Municipal Bond Bank (Proprietary Fund Type) - The Bond Bank was created by the Legislature as a separate agency of the State. The purpose of the Bond Bank is to make funds available for borrowing by North Dakota political subdivisions through the issuance of its bonds and the purchase of municipal securities of the political subdivisions. The Bond Bank has been granted all powers required in order to accomplish this purpose and is under the control and management of the Industrial Commission. The Fund was audited by other independent auditors for the calendar year ended December 31, 2003, and their report dated January 30, 2004, has been previously issued under a separate cover.

North Dakota Development Fund, Inc. (Proprietary Fund Type) - The Development Fund was established as a statewide nonprofit development corporation with the authority to take equity positions in; to provide loans to; or to use other innovative financing mechanisms to provide capital for new or expanding businesses in North Dakota or relocating businesses to North Dakota. A board of directors consisting of eight members, all of whom are appointed by the governor, manages the corporation. The deputy director of the Department of Commerce (a State agency) is the corporation's chief executive officer. The director of the Department of Commerce (governor-appointed cabinet position) is responsible for developing rules, subject to the approval of the board of directors, necessary to implement the administration of the corporation. The Fund was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated August 13, 2004, has been previously issued under a separate cover.

The **NDSU Research and Technology Park, Inc.** is a nonprofit organization developed to promote an economic environment dedicated to applied research and technology discovery for the benefit of NDSU, its faculty and staff, students, and the citizens of North Dakota. Its facilities are located on the campus of NDSU in Fargo, North Dakota. The organization was established in 1999 and is exempt from federal and state income taxes as it is organized under Section 501(c)(3) of the Internal Revenue Code. The majority of the Park's board of directors (six of nine) consists of people who work in private industry. Vacancies are filled by a majority vote of the board. Officers of NDSU fill three of the nine positions on the Park's board. The president of NDSU serves as president of the board of directors. The status of the Park as a discretely presented component unit is primarily due to the control by the NDSU president over the final building plans for any new building at the Park. This control is based on feedback from the Legislative Budget Section and is required by the land lease between the State Board of Higher Education and the Park, as well as NDUS policy. The Park was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated September 30, 2004, has been previously issued under separate cover.

The **UND Aerospace Foundation** is a North Dakota nonprofit organization organized in 1985 to encourage and develop the University of North Dakota's John D. Odegard School of Aerospace Sciences. The Foundation's principal activities consist of developing and conducting training programs, research and development, and consulting services related to the aerospace industry. The Foundation is managed by a board of directors consisting of five to seven members, including two or more persons who are active in the aerospace industry and/or graduates of UND with an interest in the aerospace industry, elected by the board; a senior manager of the Foundation, elected by the board; the dean of the Odegard School of Aerospace Sciences; and the president of the university. The Foundation benefits the university, financially and otherwise, through its promotion of the Odegard School and its programs and in the sharing of resources. The Foundation is reported as a discretely presented component unit as UND has voting members on the board of directors and because of the extent of the financial relationship between the entities. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated September 15, 2004, has been previously issued under separate cover.

The **Bismarck State College Foundation** is a legally separate, tax-exempt organization providing support and recognition to BSC through a variety of programs. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the college. The Foundation is managed by a 75-member board of directors comprised of leading citizens, both alumni and friends of the college, as well as seven ex-officio members that are officers/employees of BSC. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated August 15, 2004, has been previously issued under separate cover.

Minot State University Development Foundation was incorporated in 1978 exclusively for the benefit of Minot State University (MiSU). Its purpose is to establish, promote and stimulate voluntary financial support for the benefit of the university, especially in the building of endowment and in addressing the long-term priorities of the university. The Foundation is managed by a board of directors comprising 13 voting members, two of whom are ex-officio appointments from the Board of Regents and the Alumni Association, and three ex-officio members who are employees of MiSU. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated October 15, 2004, has been previously issued under separate cover.

North Dakota State University Development Foundation is an incorporated, nonprofit organization developed solely for the benefit of NDSU. The Foundation is approved by the IRS as a charitable, tax-exempt organization and designated by the university as the repository for private giving to the university. Their purpose is to raise, manage, and disburse contributions for the benefit of NDSU. The Foundation is managed by a 61-member board of trustees comprised of leading citizens, both alumni and friends of the university, as well as three ex-officio members: the president of NDSU and the president and vice president of the Alumni Association. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated November 30, 2004, has been previously issued under separate cover.

Alumni Association of the University of North Dakota and UND Foundation - The Alumni Association of the University of North Dakota was incorporated in 1915 for the purpose of (1) keeping classmates in contact with each other, (2) keeping graduates and former students informed of happenings at UND, and (3) involving the graduates, former students, and special friends in the ongoing growth and development of UND. UND Foundation was incorporated in 1978 to replace the Alumni Association Development Fund and is the umbrella organization for alumni and private support for the total University of North Dakota. These two legally separate nonprofit corporations have the same board of directors and the same executive vice president, but different board presidents and vice presidents. The board of directors consists of 21 voting members who are alumni of UND and three ex-officio members that are officers of UND. The Alumni Association and the Foundation were audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated October 1, 2004, has been previously issued under separate cover.

RE Arena, Inc., UND Arena Services, Inc., Arena Holdings Charitable LLC and Affiliates are related organizations with common board of directors and management organized in 2003 for the benefit of UND. These organizations operate and maintain a multipurpose sports and entertainment arena in Grand Forks, ND. The arena is used primarily for UND athletics and activities. UND Sports Facilities, Inc. is the sole member of Arena Holdings Charitable LLC. RE Arena, Inc. conducts the day-to-day operations of the arena as an agent for Arena Holdings. Affiliates of RE Arena market products and services and operate the 2005 World Juniors Hockey Tournament. UND Arena Services, Inc. is the legal manager of Arena Holdings. These organizations were audited by other independent auditors for the fiscal year ended May 31, 2004, and their combined report dated November 15, 2004, has been previously issued under separate cover.

NONMAJOR COMPONENT UNITS

Dickinson State University Foundation, Inc. was organized in 1952 as a nonprofit corporation to provide an avenue through which alumni and friends of the university may contribute financially to the university. Gifts, grants, and bequests to the Foundation benefit present and future students by providing scholarship assistance and the funding of special projects not available through other funding sources. The Foundation is managed by a 26-member board of directors comprised of leading citizens, both alumni and friends of DSU, as well as two ex-officio members that are officers/employees of DSU. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated August 15, 2004, has been previously issued under separate cover.

Lake Region Community College Foundation was established in 1959 to provide a permanent structure through which support for Lake Region State College could be channeled. The work and the resources of the Foundation are managed by a 27-member board of directors elected by the Foundation membership to serve three-year terms. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated October 15, 2004, has been previously issued under separate cover.

Mayville State University Foundation was established to act primarily as a fund-raising organization to supplement the resources that are available to Mayville State University (MaSU). The Foundation is managed by a 29-member board of directors comprised of leading citizens, both alumni and friends of the university, as well as three ex-officio members that are officers/employees of MaSU. The **Comet Athletic Club**, a legally separate nonprofit organization, operates as an entity within the Foundation. The Club's purpose is to promote, support, and encourage interest and participation in MaSU sports. Their financial activity is reflected in the Foundation's financial statements.

Minot State University-Bottineau Development Foundation and Logrollers are separate legal entities that were established to act primarily as fund-raising organizations to supplement the resources that are available to MiSU-B. The Foundation and Logrollers are managed by the same eight-member board of directors comprised of leading citizens, both alumni and friends of the college, as well as one ex-officio member that is an officer of MiSU-B. However, each entity has separate committees that direct each organization's activities. The Foundation and Logrollers were audited by other independent auditors for the fiscal year ended June 30, 2004, and their combined report dated October 15, 2004, has been previously issued under separate cover.

North Dakota State College of Science Foundation was established to act primarily as a fund-raising organization to supplement the resources that are available to NDSCS. The Foundation is managed by a 13-member board of directors comprised of leading citizens, both alumni and friends of the college, as well as three ex-officio members that are officers/employees of NDSCS. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated October 31, 2004, has been previously issued under separate cover.

Valley City State University Foundation was established to support Valley City State University by involving alumni and friends of the university in activities and private giving that meet the university's needs and advance its welfare. The Foundation is managed by a 14-member board of directors comprised of leading citizens, both alumni and friends of the university, and one director each from the Alumni Association, V-500, Booster Board and Regents, as well as two ex-officio members that are officers of VCSU.

Williston State College Foundation was established to act primarily as a fund-raising organization to supplement the resources that are available to WSC. The Foundation is managed by an 11-member board of directors comprised of leading citizens, both alumni and friends of the college. The Foundation was audited by other independent auditors for the fiscal year ended June 30, 2004, and their report dated November 1, 2004, has been previously issued under separate cover.

Complete financial statements for each of these individual component units may be obtained at the entity's administrative offices as follows:

Building Authority
600 E. Boulevard Ave., 14th Floor
Bismarck, ND 58505-0310

North Dakota University System Foundation
600 E. Boulevard Ave., Dept. 215
Bismarck, ND 58505-0230

North Dakota State University Research Foundation
1735 NDSU Research Park Drive
Fargo, ND 58105-5014

Comprehensive Health Association
4510 13th Avenue SW
Fargo, ND 58108

Municipal Bond Bank
700 East Main Avenue
Bismarck, ND 58501

North Dakota Development Fund, Inc.
1833 E. Bismarck Expressway
Bismarck, ND 58504

North Dakota State University Research and Technology Park, Inc.
1735 NDSU Research Park Drive
Fargo, ND 58105-5014

University of North Dakota Aerospace Foundation
PO Box 9023
Grand Forks, ND 58202-9023

Bismarck State College Foundation
PO Box 5587
Bismarck, ND 58506-5587

Minot State University Development Foundation
500 University Avenue West
Minot, ND 58707

North Dakota State University Development Foundation
PO Box 5144
Fargo, ND 58105

Alumni Association of the University of North Dakota
PO Box 8157
Grand Forks, ND 58202

Ralph Engelstad Arena, Inc., UND Arena Services, Inc., Arena Holdings Charitable LLC and Affiliates
One Ralph Engelstad Arena Drive
Grand Forks, ND 58203

Dickinson State University Foundation, Inc.
Dickinson State University
Dickinson, ND 58601

Lake Region Community College Foundation
1801 College Drive North
Devils Lake, ND 58301-1598

Mayville State University Foundation
330 3rd Street NE
Mayville, ND 58257

Minot State University-Bottineau Development Foundation and Logrollers
105 Simrall Boulevard
Bottineau, ND 58318

North Dakota State College of Science Foundation
800 Sixth Street North
Wahpeton, ND 58076-0002

Valley City State University Foundation
101 College Street SW
Valley City, ND 58072

Williston State College Foundation
PO Box 1286
Williston, ND 58802-1286

B. GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Statement of Net Assets and Statement of Activities report information on all non-fiduciary activities of the primary government and its component units. Primary government activities are distinguished between governmental and business-type activities.

Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The Statement of Net Assets presents the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. Net assets restricted by enabling legislation are subject to change by a majority vote of the Legislative Assembly.

Unrestricted net assets consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue.

FUND FINANCIAL STATEMENTS

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

C. MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

The government-wide statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

The State follows the pronouncements of the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard-setting body for establishing accounting principles generally accepted in the United States of America for governmental entities. In accordance with Governmental Accounting Standards Board Statement 20, the State's enterprise funds, with the exception of the Bank of North Dakota, follows all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with GASB pronouncements. The Bank of North Dakota follows all applicable FASB pronouncements unless they conflict with the GASB pronouncements.

Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period.

Major revenues that are determined to be susceptible to accrual include interest, federal grants-in-aid, and taxpayer-assessed taxes such as income, sales, corporate, excise, motor fuel taxes and unemployment compensation contributions. All revenues are determined to be available if collected within one year of fiscal year end. Revenues earned under the terms of reimbursement agreements with other governments or private sources are recorded at the time the related expenditures are made if other eligibility requirements have been met. Sales and use taxes are accrued based upon filings received and an estimate of filings due by June 30. Net income taxes from individuals and corporations are accrued based on current income earned by the taxpayer before June 30. Quarterly filings, withholding statements, and other historical data are used to estimate income. The revenue is accrued net of an allowance for uncollectible taxes. Deferred revenue is recorded for receivables that are measurable but not available at year-end.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to debt service, compensated absences, and claims and judgments, are recorded only when payment is due and payable.

FINANCIAL STATEMENT PRESENTATION

The State reports the following major governmental funds:

The General Fund is the principal operating fund of the State. It is used to account for all financial resources that are not accounted for in other funds. Included are transactions for services such as education, general government, health services, legal and judiciary, natural resources, public safety, regulatory services, agriculture and commerce, and social services.

The Federal Fund accounts for all the financial resources from the federal government.

The School Permanent Trust Fund accounts for moneys belonging to common schools and other public institutions derived from the sale of or leasing of lands owned by the State.

The State reports the following major enterprise funds:

The Bank of North Dakota Fund finances economic development throughout the state, participates in loans with North Dakota financial institutions and holds interest-bearing deposit accounts for state and political subdivisions of North Dakota.

The Housing Finance Agency Fund is authorized to issue bonds to make loans to mortgage lenders for qualified residential mortgage loans and to make mortgage and construction loans for multi-family housing within the State of North Dakota.

The University System Fund accounts for all financial transactions of the colleges and universities that compose the University System of North Dakota.

The Workforce Safety & Insurance Fund is financed entirely by premiums assessed to the employers of North Dakota and provides no-fault medical and disability insurance to all North Dakota employees.

Additionally, the State reports the following fund types:

GOVERNMENTAL FUND TYPES

Special Revenue Funds account for specific revenue sources that are legally restricted to expenditures for specified purposes. Examples include transportation, regulatory, and other activities.

Debt Service Funds account for resources obtained and used for the payment of interest and principal on revenue bonds that are funded primarily through taxes.

Capital Projects Funds account for resources obtained and used for the acquisition, construction or improvement of certain capital facilities (except those financed by non-governmental funds). Such resources are derived principally from proceeds of revenue bonds.

Permanent Funds report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that benefit the government or its citizenry, such as the common schools within the state.

PROPRIETARY FUND TYPES

Enterprise Funds account for those business-like State activities that provide goods/services to the public, financed primarily through user charges. They are also used to account for operations where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability and other purposes. The State's loan programs, Mill and Elevator, and Fair are reported in this type.

Internal Service Funds account for the financing of goods and/or services provided by one department or agency to another department or agency of a government, or to other governments, on a cost-reimbursement basis. These goods and services include motor pool services; printing, reproduction and mailing services; information technology; risk management; and investment administration services. In the government-wide statements, internal service funds are included with governmental activities.

FIDUCIARY FUND TYPES

Pension and Other Employee Benefits Trust Funds account for resources that are required to be held in trust for the members and beneficiaries of the State's defined benefit pension plans, defined contribution plan, deferred compensation plan, flexcomp plan, and other post-employment benefit plans.

Investment Trust Funds account for the transactions, assets, liabilities, and fund equity of the external pool participants (City of Bismarck, ND Association of Counties, and City of Fargo Fargodome RIO Investments). The State Investment Board (SIB) provides administrative services for the external pool participants. SIB issues a publicly available financial report that may be obtained by writing to the Retirement and Investment Office, 1930 Burnt Boat Drive, Bismarck, North Dakota 58503. Investment Trust Funds are accounted for in essentially the same manner as Proprietary Funds.

Private Purpose Trust Funds account for resources of all other trust arrangements in which principal and income benefit individuals, private organizations, or other governments. Examples include student donations and the State's college savings plan.

Agency Funds account for assets held by the State as an agent for other governmental units, or other organizations, and do not involve measurement of results of operations.

D. GENERAL BUDGETARY POLICIES AND PROCEDURES

The State operates through a biennial appropriation that represents departmental appropriations recommended by the governor and presented to the Legislative Assembly at the beginning of each legislative session. The Legislative Assembly enacts the budgets of the various state departments through passage of specific appropriation bills. The governor has line item veto powers over all appropriations subject to legislative override.

Once passed and signed, the appropriation bill becomes the departments' financial plan for the next two years. Changes to the appropriation are limited to Emergency Commission authorization, initiative, allotment, or referendum action. The Emergency Commission can authorize receipt of federal or other moneys not appropriated by the Assembly if the Assembly did not indicate intent to reject the money. The Emergency Commission may authorize pass-through federal funds from one state agency to another. The Emergency Commission may authorize the transfer of expenditure authority between appropriated line items. The Legislature has also passed appropriation laws that authorize directors of certain state agencies to transfer appropriation authority among the various divisions of their specific agency, subject to the Budget Section of the North Dakota Legislative Council's approval. Unexpended appropriations lapse at the end of each biennium, except certain capital expenditures covered under the North Dakota Century Code (NDCC) section 54-44.1-11 and the University System's unexpended general fund appropriation authority.

The State's biennial budget is prepared primarily on a cash basis. The State does not use encumbrance accounting. The legal level of budgetary control is at the agency, appropriation, funding source and expenditure line item level, with administrative controls established at lower levels of detail in certain instances. The State does not formally budget revenues, and it does not budget by fund. The State appropriation is defined through the use of specific expenditure line items. Capital appropriations are generally made at the agency and project level.

North Dakota's Appropriation Act does not present budgets by GAAP fund. Instead, it authorizes General Fund appropriation authority by agency and Other Budgeted Income appropriation authority by agency. Other budgeted income includes all budgeted resources, other than the General Fund, and includes some governmental, proprietary, and fiduciary fund activities.

During 2004, the first year of the 2003-2005 biennium, there were general and federal fund supplemental appropriations of $97,079,415.

E. CASH AND CASH EQUIVALENTS

Cash and cash equivalents for reporting purposes includes cash and short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. This includes investments with original maturity of three months or less. Also cash, as reported, may be under the control of the State Treasurer or by other administrative bodies as determined by law. Cash and cash equivalents are presented on the fund balance sheets as "Cash Deposits at the Bank of North Dakota" and "Cash and Cash Equivalents" to present the unique nature of the relationship between the Bank of North Dakota, an enterprise fund, and other state agencies.

Cash Deposits at the Bank of North Dakota. State agency cash balances, as required by law, are pooled by the State Treasurer and deposited in the Bank of North Dakota, an enterprise fund. These cash balances, in addition to other agency cash deposited at the Bank of North Dakota, are included on the fund balance sheets as "Cash Deposits at the Bank of North Dakota". For purposes of the Government-wide Statement of Net Assets, these amounts have been reclassified to internal balances.

Cash and Cash Equivalents. All cash and cash equivalents, (other than cash deposits at the Bank of North Dakota), as permitted by the North Dakota Century Code, are included on the Government-wide Statement of Net Assets as "Cash and Cash Equivalents".

The State had no cash overdrafts from pooled cash and investments at June 30, 2004.

All interest revenue is allocated to the General Fund unless state law (as outlined in the North Dakota Century Code) requires allocations of interest to other funds.

F. INVESTMENTS

All funds of the State record their investments in accordance with Government Accounting Standards Board (GASB) Statement No. 31, *"Accounting and Financial Reporting for Certain Investments."* Investments are recorded at fair value determined by reference to published market data for publicly traded securities and through the use of independent valuation services and appraisals for other investments. The net change in fair value of investments consists of the realized gains or losses and the unrealized increase or decrease in fair value of investments during the year.

Realized gains and losses on sales of investments are computed based on the difference between the sales price and the original cost of the investment sold. Unrealized increases or decreases are computed based on changes in the fair value of investments between years. Security transactions are currently accounted for on a trade date basis. Interest income is recorded when earned. Dividend income is recorded on the ex-dividend date. Equity investments of the North Dakota Development Fund, Inc. (component unit of the State) are stated at estimated value in absence of a readily ascertainable market value. The Fund's board of directors estimates these values. Among the factors considered by the Fund's Directors in determining the fair value of investments, are the cost of the investment, developments since the acquisition of the investment, the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, and other factors generally pertinent to the valuation of investments. The Fund's Directors, in making their evaluation, have relied on financial data of the investee and, in many instances, on estimates of the investee as to the potential effect of future developments. Total equity investments in the North Dakota Development Fund, Inc. are valued at $1,700,541 at June 30, 2004. All investments are maintained separately by fund.

Purchases of other state funds' debt issues by the Bank of North Dakota have been recorded as normal business transactions if they are the result of arms-length transactions.

Investments are presented on the fund balance sheets as "Investments at the Bank of North Dakota" and "Investments" to present the unique nature of the relationship between the Bank of North Dakota, an enterprise fund, and other state agencies.

Investments at the Bank of North Dakota. State agency investments, primarily certificates of deposits of the Bank of North Dakota, are included on the fund balance sheets as "Investments at the Bank of North Dakota." For purposes of the Government-wide Statement of Net Assets, these amounts have been reclassified to internal balances.

Investments. State agency investments invested at financial institutions other than the Bank of North Dakota are included on the Government-wide Statement of Net Assets as "Investments."

Differences on the Fund Balance Sheets between the assets, "Cash at the Bank of North Dakota" and "Investments at the Bank of North Dakota," and the liability, "Deposits Held For Other Funds," is attributable to timing differences resulting from the Bank of North Dakota having a different fiscal year end than many of the other state agencies.

G. SECURITIES LENDING

GASB Statement No. 28, *"Accounting and Financial Reporting for Securities Lending Transactions,"* establishes accounting and financial reporting standards for securities lending transactions. The standard requires governmental entities to report securities lent as assets in their balance sheets. Cash received as collateral and investments made with that cash must also be reported as assets. The statement also requires the costs of the securities lending transactions to be reported as expenses separately from income received. In addition, the statement requires disclosures about the transactions and collateral related to them.

Securities are loaned versus collateral that may include cash, U.S. government securities, and irrevocable letters of credit. U.S. securities are loaned versus collateral valued at 102 percent of the market value of the securities plus any accrued interest. Non-U.S. securities are loaned versus collateral valued at 105 percent of the market value of the securities plus any accrued interest.

Non-cash collateral cannot be pledged or sold unless the borrower defaults.

All securities loans can be terminated on demand by either the lender or borrower. The average term of overall loans is ninety-eight days; however, the average term of loans for the Land Department is fifty-five days.

Cash open collateral is invested in a short-term investment pool, the Core USA Collateral Section, which had an interest sensitivity of twenty-four days as of this statement date. Cash collateral may also be invested separately in *"term loans,"* in which case the investments match the loan term. These loans can be terminated on demand by either lender or borrower.

There were no significant violations of legal or contractual provisions, and no borrower or lending agent default losses known to the securities lending agent.

There are no dividends or coupon payments owing on the securities lent. Securities lending earnings are credited to participating clients on approximately the fifteenth day of the following month.

Indemnification deals with the situation in which a client's securities are not returned due to the insolvency of a borrower and Northern Trust (custodian of investments) has failed to live up to its contractual responsibilities relating to the lending of those securities. Northern Trust's responsibilities include performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable Department of Labor and Federal Financial Institutions Examination Council regulations concerning securities lending. Northern Trust indemnifies the State if the borrower fails to return the securities (and if the collateral is inadequate to replace the securities lent) or fails to pay income distributions on them.

For securities loaned at year end, the State has no credit risk exposure to borrowers because the amounts the State owes the borrowers exceed the amounts the borrowers owe the State.

H. INTERFUND ACTIVITY AND BALANCES

INTERFUND ACTIVITY

As a general rule, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

In the fund financial statements, transfers represent flows of assets (such as goods or cash) without equivalent flows of assets in return or a requirement for repayment. Residual transfer amounts exist in the Government-wide Statement of Activities due to different fiscal year ends of various agencies included in business-type activities.

INTERFUND BALANCES

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

I. INVENTORIES AND PREPAID ITEMS

Inventories of Governmental Funds are valued at cost and are recognized principally using the average cost method. Generally, the cost of Governmental Funds' inventories is recorded as an expenditure when consumed rather than when purchased.

Inventories of Proprietary Funds consist primarily of grain inventories from the North Dakota Mill and Elevator Association. Grain inventories are valued at the June 30 Minneapolis grain market values less freight costs to Minneapolis. Grain committed to production is valued at cost, and grain committed to sale is valued at net commitment price. Flour, feed and resale inventories are valued at ingredient cost plus manufacturing costs incurred in their production. Proprietary Funds expense the cost of consumable supplies when used.

Generally, inventories of University System Funds are valued at the lower of cost or fair market value. Cost is generally determined on the first in/first out, or moving weighted average method. Inventories consist of food, books, and other merchandise held for resale in auxiliaries and unrestricted physical plant supplies.

Federal fund inventories of commodities and vaccines totaling $2,930,523 are recorded as inventory and deferred revenue on the Government-wide Statement of Net Assets.

The Department of Human Services has approximately $3.0 million in food stamp inventory, which is included in the Federal Fund Inventory.

Prepaid items reflect payments for costs applicable to future accounting periods.

Other government fund inventories and prepaid items are reflected as a reservation of fund balance on the balance sheet.

J. UNAMORTIZED BOND ISSUANCE COSTS

In governmental fund types, issuance costs are recognized in the operating statements when incurred. Bond premiums, discounts and issuance costs for proprietary fund types are deferred and amortized over the term of the bonds using the bonds outstanding method, which approximates the effective interest method. The unamortized discount is shown on the balance sheet as a reduction of the bonds payable, and the amortization is included in the statement of revenues, expenses and changes in fund balance as interest expense.

K. CAPITAL ASSETS

Capital assets, which include land, buildings, equipment, construction in progress and infrastructure assets, are valued at historical cost or at estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair market value on the date of donation. Where necessary, estimates of original cost are derived by factoring price levels from the current period to the time of acquisition. Library books are not capitalized as capital assets except for the University System.

All other capital assets with an original cost of $5,000 ($100,000 or more for infrastructure reported by the Department of Transportation) or more per unit and an estimated useful life in excess of one year are capitalized and reported in the applicable government or business-type activities columns in the government-wide financial statements. Capital asset costs include the purchase price or construction cost, plus the costs necessary to place the asset in its intended location and condition for use. In governmental activities, interest costs on self-constructed assets are not capitalized. In business-type activities, interest costs (if material) on self-constructed assets are also included in the cost. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project with interest earned on invested proceeds over the same period. Capitalized interest is amortized on the straight-line basis over the estimated useful life of the asset. Normal maintenance and repair costs that do not materially add to the value or extend the life of the asset are not capitalized.

Collections of works of art and historical treasures are not capitalized if the following three criteria are met: (1) Held for public exhibition, education, or research in furtherance of public service, rather than financial gain; (2) Protected, kept unencumbered, cared for, and preserved; (3) Subject to organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections. The State's non-capitalized collections include the historical artifacts at the various state museums and historical sites, and monuments and other art throughout the capital grounds. Assets that do not meet all three criteria, or that were capitalized as of June 30, 1999, are capitalized and included in the government-wide financial statements.

Infrastructure consists of major statewide public systems and items attached thereto such as freeways, freeway lighting systems, freeway drainage systems, freeway signs, bridges, bridge lighting systems, and sewer systems. Infrastructure is reported in the applicable governmental or business-type activities columns in the government-wide financial statements. The Department of Transportation uses the first-in first-out method to remove the capitalized cost of a replaced road along with corresponding accumulated depreciation.

Fixed assets in Governmental Funds are recorded as expenditures in the funds used to acquire or construct them in the governmental fund financial statements. Capital assets, along with accumulated depreciation and depreciation expense are reported in the applicable governmental or business-type activities columns in the government-wide financial statements.

Land and construction in progress are not depreciated. With the exception of infrastructure reported by the Department of Transportation (which uses the composite method), other capital assets are depreciated using the straight-line method over the following estimated useful lives:

Assets	Years
Buildings	10-50
Infrastructure	10-50
Furniture, Automobiles, and Equipment	3-20

L. LEASE COMMITMENTS

The State leases land, office facilities, office and computer equipment, and other assets. Leases are classified according to FASB 13. Many of these leases have fiscal funding clauses; however, these clauses have no effect on classifying these leases for accounting purposes. Leases which represent acquisitions are classified as capital leases, and the related assets and liabilities are recorded in the general purpose financial statements at the inception of the lease. Other leases are classified as operating leases with the lease payments recorded as expenditures or expenses during the life of the lease.

M. FEDERAL FUNDS PURCHASED

Federal Funds Purchased represent federal funds borrowed by the Bank of North Dakota from member banks generally on an overnight basis at the federal funds rate.

N. CLAIMS/JUDGMENTS PAYABLE

Claims/Judgments Payable is primarily Workers Compensation Claims Incurred But Not Yet Reported (IBNR) by the claimants as well as claims related to various litigation matters.

O. COMPENSATED ABSENCES

<u>ANNUAL LEAVE</u>

State employees accrue vested annual leave at a variable rate based on years of service. Teachers employed by the State do not receive annual leave. In general, accrued annual leave cannot exceed 30 days at each year end, as set by the agency. The amount of annual leave earned ranges between one and two days per month, and is fixed by the employing unit per section 54-06-14 of the NDCC.

The governmental fund financial statements recognize annual leave when the liability is incurred and payable from available expendable resources. The government-wide financial statements present the cost of accumulated annual leave as a liability. Proprietary and Fiduciary Funds recognize the expense and accrued liability when the annual leave is earned.

<u>SICK LEAVE</u>

The North Dakota Century Code, section 54-06-14, states employees accrue sick leave at the rate of one to a maximum of one and one-half working days per month of employment without limitation on the amount that can be accumulated. Employees vest at ten years of creditable service, at which time the State is liable for ten percent of the employee's accumulated unused sick leave. The governmental fund financial statements recognize sick leave as it is incurred. The government-wide financial statements present the estimated cost of sick leave as a liability after an employee has been employed by the State for six consecutive years.

P. DEPOSITS

The following two liability line items are presented in the Government-wide Statement of Net Assets and/or fund financial statements:

Deposits Held For Other Funds. "Deposits Held For Other Funds" are those deposits held by the Bank of North Dakota for other funds included in the reporting entity and shown on the fund financial statements. For purposes of the Government-wide Statement of Net Assets, these amounts have been reclassified to internal balances.

Other Deposits. "Other Deposits" are those deposits held by the Bank of North Dakota for non-reporting entity third parties. It also includes deposits held for students of the University System.

Differences on the fund balance sheets between the liability "Deposits Held For Other Funds" and the assets "Cash Deposits and Investments at the Bank of North Dakota" are attributable to timing differences resulting from the Bank of North Dakota having a different accounting year end than many other state agencies.

Q. DEFERRED REVENUE

In the government-wide statements and proprietary fund financial statements, deferred revenue is recognized when cash, receivables, or other assets are received prior to their being earned. In the governmental fund statements, deferred revenue is recognized when revenue is unearned or unavailable.

R. REVENUES AND EXPENDITURES/EXPENSES

In the Government-wide Statement of Activities, revenues and expenses are segregated by activity (governmental or business-type), then further by function for governmental activities (e.g., general government, education, health and human services, etc.). Additionally, revenues are classified between program and general revenues. Program revenues include 1) charges to customers or applicants for goods or services, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues, rather than as program revenue. General revenues include all taxes. Certain indirect costs are included in the program expenses reported for individual functions.

In the government-wide financial statements, revenues are reported by source and are further classified as either “general purpose” or “restricted”. General purpose revenues are available to fund any activity accounted for in the fund. Restricted revenues are, either by State law or by outside restriction (e.g., federal grants), available only for specified purposes. Unused restricted revenues at year-end are recorded as reservations of fund balance. When both general purpose and restricted funds are available for use, it is the State’s policy to use restricted resources first.

In the governmental fund financial statements, expenditures are reported by character: “Current,” “Intergovernmental-revenue Sharing,” “Capital Outlay,” or “Debt Service.” Current expenditures are subclassified by function and are for items such as salaries, grants, supplies, and services.

Capital outlay includes expenditures for real property or infrastructure (e.g., highways). Intergovernmental-revenue sharing accounts for the distribution of certain tax revenues that are shared with local units based upon constitutional and statutory requirements. Debt service includes both interest and principal outlays related to bonds and payments on capitalized leases.

Revenues and expenses of proprietary funds are classified as operating or nonoperating and are subclassified by object (e.g., salaries, depreciation, and purchases for resale). Operating revenues consist of sales of goods and services, quasi-external operating transactions with other funds, grant revenues for specific activities that are considered to be operating activities of the grantor, receipts from other agencies for reimbursement of operating transactions, and other miscellaneous revenue that should be classified as operating. Grants that would qualify as an operating activity are those that do not subsidize an existing program, rather they finance a program the agency would otherwise not undertake. For certain loan and investment programs, revenue that would normally be classified as non-operating should be classified as operating. Examples of this would include interest and investment income. All other revenues that do not meet the above criteria should be classified as non-operating.

S. NET ASSETS/FUND BALANCE

The difference between fund assets and liabilities is “Net Assets” on the government-wide, proprietary, and fiduciary fund statements, and “Fund Balance” on governmental fund statements.

T. CHANGE IN ACCOUNTING PRINCIPLE

The State has implemented the Governmental Accounting Standards Board’s Technical Bulletin No. 2004-1, “Tobacco Settlement Recognition and Financial Reporting Entity Issues.” In addition to requirements not applicable to the State, the Technical Bulletin establishes an accrual period for governments to recognize tobacco settlement revenues based on the tobacco companies’ agreement. The effect on the State of implementing this standard is to accrue additional receivables and revenue for estimated tobacco settlement payments for the period January through June 30.

The State has also implemented the Governmental Accounting Standards Board’s Statement No. 39, "Determining Whether Certain Organizations Are Component Units," which is effective for fiscal year June 30, 2004. This statement requires organizations that are separate from the State, and receive or hold resources that are almost entirely for the direct benefit of the State or its component units, be evaluated for inclusion in the State's financial statement as a potential component unit.

The North Dakota State University System's colleges and universities have foundations that are quantitatively significant; therefore, the foundations' resources and activities are reported in these financial statements as component units.

NOTE 2 – RESTATEMENTS

Certain restatements have been made to beginning fund equity for a change in accounting principle discussed previously and for correction of errors. The following changes to beginning fund equity, as previously reported, are summarized in the following table (expressed in thousands):

	Government-wide Governmental Activities	Government-wide Business-type Activities	School Permanent Trust Fund	Nonmajor Governmental Funds	University System
June 30, 2003, fund balances/net assets, as previously reported	$ 2,196,547	$ 1,470,175	$ 587,356	$ 451,262	$ 610,818
Prior period adjustments:					
Change in accounting principles:					
Tobacco settlement	11,536	-	5,191	6,345	-
Correction of errors	(2,269)	185	-	(1,722)	185
June 30, 2003, fund balances/net assets, as restated	$ 2,205,814	$ 1,470,360	$ 592,547	$ 455,885	$ 611,003

	Internal Service Funds	Major Component Units
June 30, 2003, fund balances/net assets, as previously reported	$ 54,951	$ 139,339
Prior period adjustments:		
Changes in accounting principles:		
GASB Statement No. 39	-	207,895
Correction of errors	(547)	-
June 30, 2003, fund balances/net assets, as restated	$ 54,404	$ 347,234

CORRECTION OF ERRORS

The beginning net assets of the Government-wide Business-type Activities and University System were restated by $185,276. There was an error in calculating depreciation and capitalizing special assessments, $(12,474), and a bond payment paid from agency funds in fiscal year 2003, $197,750.

The beginning net assets of the Government-wide Governmental Activities and Commodity Promotion Fund, a nonmajor governmental fund, were restated by $1,722,020. There was an error in recording accounts payable for legal costs of ongoing litigation.

The beginning net assets of the Government-wide Governmental Activities and Risk Management Fund, an internal service fund, were restated by $546,910. There was a $116,279 error for equipment purchased in fiscal year 2003 not capitalized, and contributions received in fiscal year 2003 not correctly reported as deferred revenue $(663,189).

NOTE 3 - DETAILED NOTES ON ACCOUNT BALANCES

A. DEPOSITS

State law generally requires that all State funds be deposited in the Bank of North Dakota. NDCC 21-04-01 provides that public funds belonging to or in the custody of the State shall be deposited in the Bank of North Dakota. Also, NDCC 6-09-07 states, "[a]ll state funds . . . must be deposited in the Bank of North Dakota" or must be deposited in accordance with constitutional and statutory provisions.

The following summary presents the amount of the State's deposits which are fully insured or collateralized with securities held by the State or by its agent in the State's name (Category 1), those deposits which are collateralized with securities held by the pledging financial institution's trust department or agent in the State's name (Category 2) and those deposits which are not collateralized or are collateralized by the pledging financial institution trust or agent, but not in the State's name (Category 3) at June 30, 2004. Funds deposited at the Bank of North Dakota are not credit risked since the Bank is part of the State's reporting entity. The amounts are expressed in thousands:

Primary Government:

	Category 1	Category 2	Category 3	Total Bank Balance	Carrying Amount
Cash Deposits	$ 29,197	$ 951	$ 177,758	$ 207,906	$ 348,929
Certificates of Deposit					
Recorded as Investments	3,111	-	205	3,316	3,316
Total	$ 32,308	$ 951	$ 177,963	$ 211,222	$ 352,245

Major Component Units:

	Category 1	Category 2	Category 3	Total Bank Balance	Carrying Amount
Cash Deposits	$ 3,755	$ -	$ 21,267	$ 25,022	$ 23,896
Certificates of Deposit					
Recorded as Investments	2,010	-	-	2,010	2,010
Total	$ 5,765	$ -	$ 21,267	$ 27,032	$ 25,906

Included in the internal receivable amount in the governmental activities column in the Statement of Net Assets is $450,173,821 of Cash and Investments at the Bank of North Dakota for governmental activities. The internal payable amount in the business-type activities column includes $297,270,498 of deposits the Bank has for governmental activities. Because the Bank has a different fiscal year end, these internal balances do not equal.

B. INVESTMENTS

The investment policies of the State of North Dakota are governed by NDCC 6-09-07, 15-10-12, and 21-04-02, indicating that all public funds must be deposited in the Bank of North Dakota unless there are other constitutional or statutory provisions. If there are no statutory provisions and the funds are invested outside the Bank of North Dakota, the state agency must have the permission of the North Dakota Industrial Commission.

Investments are generally managed by the State Investment Board, the North Dakota Board of University and School Lands, the Bank of North Dakota, and the North Dakota State Treasurer's Office. Management responsibilities and investment instruments as authorized by statute are as follows:

1. State Investment Board (SIB) – NDCC 21-10 designates the SIB with investment responsibilities for the Public Employees' Retirement System, Bonding Fund, Teachers' Fund for Retirement, Fire and Tornado Fund, Workforce Safety & Insurance Fund, and other specific funds. The Century Code states the SIB shall apply the prudent investor rule in investing funds under its supervision.

   The State Investment Board's investment policy allows investment managers to use derivative securities. Managers are specifically permitted to use treasury futures and options, S&P 500 index future options, and currency forwards and futures to hedge portfolio risk, but not to speculate or to leverage the portfolio. Managers may use their discretion to use other derivatives to enhance returns, reduce risk, or facilitate the management of index funds. SIB's policy with respect to these derivatives is that their use may not increase the credit, market, or legal risk level associated with a fully invested portfolio of common stocks or fixed income obligations, depending on the manager's designated role.

2. North Dakota Board of University and Schools Lands – The Century Code states that the Board of University and School Lands shall apply the prudent investor rule in investing its funds. Also, NDCC 15-03-04 allows the Board to invest in first

mortgages on farmlands and improvements thereon in this state to the extent such mortgages are guaranteed or insured by the United States or any instrumentality thereof, or if not so guaranteed or insured, not exceeding in amount 80 percent of the actual value of the property on which the same may be loaned, such value to be determined by competent appraisal.

3. The Bank of North Dakota – NDCC 6-09 authorizes the Bank of North Dakota. The Bank is owned and operated by the State of North Dakota under the supervision of the North Dakota Industrial Commission. The Bank may have investments in anything that any bank lawfully may do, except what is restricted by NDCC 6-09.

4. The North Dakota State Treasurer's Office – The North Dakota Constitution and various sections of the Century Code authorize the State Treasurer to invest all State funds deposited with the State Treasury. However, the State Treasurer must invest the public funds with the Bank of North Dakota unless there is statutory authority to do otherwise. Generally, the State Treasurer pools deposits and invests in money market accounts and Bank of North Dakota certificates of deposit.

5. University System – NDCC 15-55-05 and 15-55-06 govern the investment of proceeds of revenue bonds and revenues pledged to bondholders. Investments governed by a gift instrument are covered under NDCC 15-67-04. Subject to any limitations in the gift instrument, such funds may be invested in any real or personal property deemed advisable by the governing board.

The State's investments are categorized below per GASB Statement Three according to the level of credit risk assumed by the State. <u>Category 1</u> includes investments which are insured or registered, or securities which are held by the State or the State's agent in the State's name. <u>Category 2</u> includes uninsured and unregistered investments, with securities held by the counterparty or their trust department or agent in the State's name. <u>Category 3</u> includes uninsured and unregistered investments, with securities which are held by the counterparty or their trust department or agent, but not in the State's name. The amounts are expressed in thousands:

Primary Government:	Category			
	1	2	3	Fair Value
Equity Securities				
Not on Securities Loan	$ 1,198,032	$ 915	$ 9,977	$ 1,208,924
On Securities Loan	10,108	-	-	10,108
Bonds and Notes				
Not on Securities Loan	834,492	-	32,196	866,688
On Securities Loan	6,741	-	-	6,741
U.S. Government & Agency Issues				
Not on Securities Loan	519,333	222	-	519,555
On Securities Loan	63,067	-	-	63,067
	$ 2,631,773	$ 1,137	$ 42,173	
Investments in Real Estate Pool				179,963
Investments in Unemployment Compensation Pool				54,818
Guaranteed Investment Contract				85,966
Annuities				155
Mutual Funds				1,545,715
Private Equity				119,537
Non-Security Investments				2,000
Held By Brokers/Dealers				4,406
Investments Held By Broker-Dealer Under Securities Loans With Cash Collateral:				
Equity Securities				109,609
Bonds and Notes				127,318
U.S. Government & Agency Issues				281,023
Securities Lending Short-Term Collateral Investment Pool				527,316
Totals				$ 5,712,909

Major Component Units:	Category 1	Category 2	Category 3	Fair Value
Equity Securities	$ 400	$ -	$ 365	$ 765
Bonds and Notes	9,643	-	1,495	11,138
U.S. Government & Agency Issues	106	-	-	106
Obligations of State and Political Subdivisions	1,852	175	171	2,198
	$ 12,001	$ 175	$ 2,031	
Guaranteed Investment Contract				98,971
Non-Security Investments				196,346
Held By Brokers/Dealers				190,994
Investments in Real Estate				15,240
Totals				$ 515,758

There were no violations of statutory authority or contractual provisions for investments during the year ended June 30, 2004.

C. REVERSE REPURCHASE AGREEMENTS

State statutes permit the State to enter into reverse repurchase agreements, that is, the sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. All sales of investments under these agreements are for fixed terms. In investing the proceeds of these agreements, State policy is for the term to maturity of the investment to be the same as the term of the agreement. Such matching existed at year end. These agreements are secured by Fed book-entry securities held in the State's name. At June 30, 2004, the State had reverse repurchase agreements of $20,500,000 included in securities lending collateral on the statement of net assets. The highest month end balance for the previous year was $37,000,000, with an average daily balance of $14,216,000. The weighted average interest rate as of year end was .80 percent. The weighted average interest rate paid during the year was .99 percent. The fair value of these securities at June 30, 2004, was $20,500,000.

D. RECEIVABLES

Receivables at June 30, 2004, consist of the following (expressed in thousands):

	General	Federal	School Permanent Trust Fund	Other Governmental Funds	Bank of North Dakota	Housing Finance	University System
Receivables:							
Accounts	$ 3,640	$ 5,759	$ 5,191	$ 28,619	$ -	$ 504	$ 12,891
Less Allowance	(465)	-	-	(7,531)	-	-	(855)
Taxes	134,395	-	220	50,328	-	-	-
Less Allowance	(9,823)	-	-	(5,985)	-	-	-
Interest	3	-	4,670	1,839	15,105	2,771	10
Less Allowance	-	-	-	(624)	-	-	-
Current Loans and Notes	115	-	839	75,846	224,853	9,851	6,197
Less Allowance	(20)	-	-	(4,288)	-	-	(460)
Noncurrent Loans and Notes	-	-	23,181	-	1,121,596	493,315	40,442
Less Allowance	-	-	-	-	(25,334)	-	(3,009)
Net Receivables	$ 127,845	$ 5,759	$ 34,101	$ 138,204	$ 1,336,220	$ 506,441	$ 55,216

	Workforce Safety & Insurance	Other Enterprise Funds	Internal Service Funds	Fiduciary Funds	Major Component Units	Total
Receivables (continued):						
Accounts	$ 23,388	$ 42,263	$ 61	$ 7,437	$ 6,290	$ 136,043
Less Allowance	(4,500)	(5,027)	-	-	-	(18,378)
Taxes	-	-	-	10,535	-	195,478
Less Allowance	-	-	-	(421)	-	(16,229)
Interest	7,619	5,780	53	9,411	3,474	50,735
Less Allowance	-	-	-	-	-	(624)
Current Loans and Notes	-	39,475	-	-	2,289	359,465
Less Allowance	-	(23)	-	-	-	(4,791)
Noncurrent Loans and Notes	-	142,886	-	-	10,166	1,831,586
Less Allowance	-	(1,639)	-	-	(6,561)	(36,543)
Net Receivables	$ 26,507	$ 223,715	$ 114	$ 26,962	$ 15,658	$ 2,496,742

E. INTERFUND ACCOUNTS AND TRANSFERS

DUE FROM OTHER FUNDS/DUE TO OTHER FUNDS

Interfund balances at June 30, 2004, consist of the following (expressed in thousands):

Due To General Fund From:	
Federal Fund	$ 53,997
Nonmajor Governmental Funds	7,945
Nonmajor Enterprise Funds	26,259
All Others	1,852
Total Due To General Fund	$ 90,053

Due To Federal Fund From:	
General Fund	$ 3,120
Nonmajor Governmental Funds	7,333
All Others	1,849
Total Due To Federal Fund	$ 12,302

Due To Internal Service Funds From:	
Nonmajor Governmental Funds	$ 2,472
All Others	1,754
Total Due To Internal Service Funds	$ 4,226

Due To School Permanent Trust Fund From:	
Nonmajor Enterprise Funds	$ 4,364
All Others	1,190
Total Due To School Permanent Trust Fund	$ 5,554

Included in the Nonmajor Enterprise Funds is an advance from the Developmentally Disabled Fund for $2,983,227. This is not expected to be repaid within one year.

Due To Nonmajor Governmental Funds From:	
General Fund	$ 2,966
Federal Fund	17,501
All Others	2,310
Total Due To Nonmajor Governmental Funds	$ 22,777

Due To Bank of North Dakota From:	
General Fund	$ 4,775
University System	10,985
Housing Finance	17,977
Nonmajor Enterprise Funds	13,025
All Others	150
Total Due To Bank of North Dakota	$ 46,912

$10,164,854 from the University System and $13,107,000 from the Mill and Elevator are the result of loans made by the bank. The University System is not expected to be repaid within one year, and the Mill and Elevator is a short-term loan.

Due To University System From:	
General Fund	$ 3,946
Nonmajor Governmental Funds	2,573
All Others	352
Total Due To University System	$ 6,871

Due To All Other Funds From:	
All Other	$ 417

Included in this category are all other enterprise funds, component units, and fiduciary funds.

These balances are a result of a time lag between the dates that (1) services are provided and goods received or reimbursable expenditures occur, (2) the payments are made, (3) the transactions are entered into the accounting system, and (4) because of transactions occurring between funds with a fiscal year other than June 30, 2004.

A reconciliation of Due From's and Due To's is presented below (expressed in thousands):

Due From's		$ 189,112
Differences:		
Bank of ND/General Fund	16,785	
Housing Finance/Bank of ND	(4,886)	
Bank of ND/Mill & Elevator	(3,500)	
University System/Bank of ND	71	
Internal Service Funds/Bank of ND	3,958	
Job Service/Bank of ND	434	
Student Loan Trust/Bank of ND	(8)	
Developmentally Disabled Loan Fund/ School Permanent Trust Fund	(950)	
Emergency Management/Bank of ND	(3,442)	
Guaranteed Student Loan/Bank of ND	453	
Bank of ND/Governmental Agencies	(124)	
Total Differences		8,791
Due To's		$ 197,903

In addition, the total Internal Receivables and Internal Payables on the Government-wide Statement of Net Assets does not equal due to activity occurring between funds that have different fiscal year ends.

INTERFUND TRANSFERS

A summary of interfund transfers for the fiscal year ended June 30, 2004, follows (expressed in thousands):

	Transfers In					
	General	Federal	Non-major Governmental	University System	Non-major Enterprise	Total
Transfers Out						
General	$ -	$ 16	$ 11,239	$ 208,957	$ 1,346	$ 221,558
Federal	1	-	29,927	-	-	29,928
School Permanent Trust Fund	-	-	30,789	1,499	-	32,288
Non-major Governmental	38,154	106	31,933	5,338	1,033	76,564
Bank of North Dakota	24,909	-	75	-	300	25,284
Housing Finance	-	-	25	-	24	49
University System	-	34	6,025	-	-	6,059
Non-major Enterprise	31,194	-	381	356	4,123	36,054
Total	$ 94,258	$ 156	$ 110,394	$ 216,150	$ 6,826	$ 427,784

(Transfers In do not agree to the statements due to the timing differences noted below.)

Transfers are used for the following purposes:

- Move general fund appropriation amounts to certain agencies.
- Move revenues from the fund that statute requires to collect them to the fund authorized to spend them.
- Move certain excess revenues collected in other funds to the general fund.
- Move receipts restricted for debt service from the funds collected to the debt service funds as payments become due, and move capital project funds paying the construction costs.

For the year ended June 30, 2004, transfers of excess profits of $30.0 million were made from the Bank of North Dakota as well as legislatively-mandated transfers of $26.3 million, $18.0 million, and $1.5 million from Student Loan Trust, North Dakota Health Care Trust Fund and Bonding Fund, respectively, to the General Fund.

A reconciliation of Transfers In and Transfers Out is presented below (expressed in thousands):

Transfers In		$ 430,705
Differences:		
General Fund/Bank of ND	(5,091)	
General Fund/Developmentally Disabled Loan Fund	2,004	
Human Services/ Developmentally Disabled Loan Fund	379	
Industrial Commission/Bank of ND	37	
Beginning Farmer/Ag PACE	(250)	
Total Differences		(2,921)
Transfers Out		$ 427,784

The above timing differences of $2,920,859 result from transactions between agencies that have different fiscal year ends. This difference is also the total net transfers on the Government-wide Statement of Activities.

F. CAPITAL ASSETS

PRIMARY GOVERNMENT:

The following is a summary of capital assets during the fiscal year (expressed in thousands):

Description	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004
Governmental Activities:				
Capital Assets Not Being Depreciated				
Land	$ 39,973	$ 3,396	$ (89)	$ 43,280
Construction in Progress	174,396	90,558	(57,886)	207,068
Total Capital Assets Not Being Depreciated	214,369	93,954	(57,975)	250,348
Capital Assets Being Depreciated:				
Buildings and Improvements	337,303	18,731	(1,932)	354,102
Equipment	189,058	20,946	(19,462)	190,542
Infrastructure	2,834,637	66,739	(118)	2,901,258
Total Capital Assets Being Depreciated	3,360,998	106,416	(21,512)	3,445,902
Less Accumulated Depreciation for:				
Buildings and Improvements	(141,569)	(8,226)	1,623	(148,172)
Equipment	(97,960)	(15,249)	14,671	(98,538)
Infrastructure	(2,176,534)	(122,713)	78	(2,299,169)
Total Accumulated Deprecation	(2,416,063)	(146,188)	16,372	(2,545,879)
Total Capital Assets Being Depreciated, Net	944,935	(39,772)	(5,140)	900,023
Governmental Activities Capital Assets, Net	$ 1,159,304	$ 54,182	$ (63,115)	$ 1,150,371

Description	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004
Business-Type Activities:				
Capital Assets Not Being Depreciated				
Land	$ 16,989	$ 1,583	$ (7)	$ 18,565
Construction in Progress	35,623	26,713	(31,280)	31,056
Total Capital Assets Not Being Depreciated	52,612	28,296	(31,287)	49,621
Capital Assets Being Depreciated:				
Buildings and Improvements	626,121	62,524	(704)	687,941
Equipment	296,529	28,445	(9,253)	315,721
Infrastructure	135,849	2,879	(623)	138,105
Total Capital Assets Being Depreciated	1,058,499	93,848	(10,580)	1,141,767
Less Accumulated Depreciation for:				
Buildings and Improvements	(294,281)	(15,852)	484	(309,649)
Equipment	(180,406)	(19,890)	7,262	(193,034)
Infrastructure	(45,008)	(3,554)	400	(48,162)
Total Accumulated Deprecation	(519,695)	(39,296)	8,146	(550,845)
Total Capital Assets Being Depreciated, Net	538,804	54,552	(2,434)	590,922
Business-Type Activities Capital Assets, Net	$ 591,416	$ 82,848	$ (33,721)	$ 640,543

Description	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004
Major Component Units:				
Capital Assets Not Being Depreciated				
Land	$ 2,241	$ 1,228	$ (375)	$ 3,094
Construction in Progress	49	4,768	(49)	4,768
Total Capital Assets Not Being Depreciated	2,290	5,996	(424)	7,862
Capital Assets Being Depreciated:				
Buildings and Improvements	3,581	103,480	-	107,061
Equipment	13,069	2,051	(232)	14,888
Infrastructure	1,100	65	(508)	657
Total Capital Assets Being Depreciated	17,750	105,596	(740)	122,606
Less Accumulated Depreciation for:				
Buildings and Improvements	(406)	(2,776)	-	(3,182)
Equipment	(2,231)	(1,427)	76	(3,582)
Infrastructure	(64)	(43)	-	(107)
Total Accumulated Deprecation	(2,701)	(4,246)	76	(6,871)
Total Capital Assets Being Depreciated, Net	15,049	101,350	(664)	115,735
Business-Type Activities Capital Assets, Net	$ 17,339	$ 107,346	$ (1,088)	$ 123,597

Beginning capital asset balances were adjusted for certain reclassifications.

Depreciation expense was charged to functions/programs of the primary government as follows (expressed in thousands):

Governmental Activities:	
General Government	$ 3,446
Education	296
Health and Human Services	6,337
Regulatory	123
Public Safety & Corrections	4,923
Agriculture and Commerce	121
Natural Resources	3,681
Transportation	127,261
Total Governmental Activities Depreciation Expense	$ 146,188

Construction In Progress is composed of the following (expressed in thousands):

Project Description:

Governmental Activities	Amount Authorized	Amount Expended Through June 30, 2004	Balance Authorized
Corrections	$ 3,031	$ 525	$ 2,506
Job Service	437	437	-
Adjutant General	3,653	669	2,984
Department of Transportation	211,602	188,681	22,921
Human Services	2,838	1,901	937
Game and Fish	972	32	940
Health Department	5,884	4,120	1,764
ConnectND Software System	19,940	10,703	9,237
Total Governmental Activities	$ 248,357	$ 207,068	$ 41,289

Business-Type Activities	Amount Authorized	Amount Expended Through June 30, 2004	Balance Authorized
Mill and Elevator	$ 895	$ 292	603
University System	98,855	30,764	68,091
Total Business-Type Activities	$ 99,750	$ 31,056	$ 68,694

Major Component Units	Amount Authorized	Amount Expended Through June 30, 2004	Balance Authorized
RE Arena, Inc.	$ 7,800	$ 4,768	$ 3,032

G. OPERATING LEASES

PAYMENTS ON OPERATING LEASES

The State is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore, the resulting expenditures are recognized as incurred. Lease expenditures for the year ended June 30, 2004, amounted to $9,038,047 for governmental activities and $6,050,111 for business-type activities.

Future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2004, for all fund types are as follows (expressed in thousands):

Year Ending June 30	Governmental Activities	Business-type Activities
2005	$ 7,031	$ 5,180
2006	1,792	2,339
2007	1,195	1,825
2008	762	920
2009	496	361
2010-2014	1,342	969
2015-2019	119	-
Total Minimum Lease Payments	$ 12,737	$ 11,594

H. CAPITAL LEASES

The State is obligated under certain leases accounted for as capital leases. In the government-wide and proprietary fund statements, capital assets and a corresponding liability are recorded at the inception of the lease. The liability is reduced by payments of principal, with a portion of the payment allocated to interest expense. For capital leases in governmental funds, other financing sources and expenditures are recorded at lease inception. Lease payments are recorded as debt service expenditures.

The schedule below lists the future minimum lease payments under these capital leases and the present value of the net minimum lease payments at June 30, 2004 (expressed in thousands):

Year Ending June 30	Governmental Activities	Business-type Activities	Fiduciary Funds	Major Component Units
2005	$ 436	$ 6,468	$ 4	$ 126
2006	423	5,612	2	126
2007	326	3,882	1	126
2008	31	3,583	-	126
2009	1	3,578	-	126
2010-2014	-	10,169	-	632
2015-2019	-	5,335	-	632
2020-2024	-	5,228	-	632
2025-2029	-	2,124	-	632
2030-2034	-	-	-	632
Total Minimum Lease Payments	1,217	45,979	7	3,790
Less: Amount Representing Interest	(85)	(11,849)	-	(1,790)
Present Value of Future Minimum Lease Payments	$ 1,132	$ 34,130	$ 7	$ 2,000

The historical costs of assets acquired under capital leases, and included as capital assets on the government-wide statement of net assets at June 30, 2004, is as follows (expressed in thousands):

	Governmental Activities	Business-Type Activities	Major Component Units
Infrastructure	$ -	$ 1,160	$ -
Buildings	-	36,998	-
Equipment	1,809	22,101	2,000
Less: Accumulated Depreciation	(552)	(10,481)	-
Total	$ 1,257	$ 49,778	$ 2,000

I. LONG-TERM DEBT

Debt authorized is generally limited by the state constitution. The Constitution of North Dakota provides that the State may issue or guarantee the payment of bonds, provided that all bonds in excess of $2 million are: (1) secured by first mortgage upon property and no further indebtedness may be incurred by the State unless evidenced by a bond issue; (2) authorized by law; (3) for a certain purpose; (4) provisioned to pay the interest semiannually; and (5) the principal is paid within 30 years. Additionally, the law authorizing the bond issue must specifically appropriate the provisions to the payment of the principal and interest of the bond.

BONDS AND NOTES PAYABLE

Bonds payable at June 30, 2004, consisted of bonds issued by the State and are accounted for by the respective state agencies in the government-wide financial statements that issued the bonds.

1. REVENUE BONDS

Current state statutes empower certain state agencies to issue bonds as part of their activities. This debt is not backed by the full faith and credit of the State of North Dakota. The principal and interest on such bonds shall be payable only from the applicable agency's program income.

Primary Government

BUILDING AUTHORITY

The 2002 Series C Bonds have interest payable semiannually on February 15 and August 15 of each year. The 1998 Series A, B, and C Bonds, the 2000 Series A Bonds, the 2001 Series A Bonds, the 2002 Series A, B and D Bonds, and the 2003 Series A, B, and C Bonds have interest payable semiannually on June 1 and December 1 of each year. The bonds of each series are subject to optional and/or extraordinary optional redemption prior to maturity upon the occurrence of certain events. The bonds are independently secured by the funds, certain mortgaged property, and all rights, titles, and interests of the Building Authority as lessor, including all basic rent payments, investment earnings on the funds and any other income derived by the Building Authority with respect to the lease.

All the bond agreements require the establishment and maintenance of reserve funds to be used for debt service payments if amounts in the bond funds are insufficient to make payments. Reserve funds are also required for any positive arbitrage due to the federal government.

Lignite Research

The Industrial Commission is authorized by NDCC 54-17.5 (the "Act") to provide funds and financial assistance to qualified persons for projects related to the clean use of lignite in order to insure economic growth, maintain and enhance development of North Dakota lignite and general welfare in North Dakota. The Industrial Commission is authorized and has established a program to issue and sell North Dakota Lignite Research Bonds to provide funds for the purpose stated in the Act. As of June 30, 2004, there were $16 million of authorized and $8,825,000 issued through the Lignite Research Fund. The Commission's intention is not to issue any bonds in the future.

The 1995 Series A Bonds have interest payable on May 15 and November 15 of each year. The bonds maturing on November 15, 2005, are subject to mandatory redemption equal to 100% of par plus accrued interest at various amounts in 2005. The bonds are also subject to extraordinary redemption upon the occurrence of certain events. Proceeds of the bonds are being used to provide a grant for funding of construction of an anhydrous ammonia plant.

Water Commission

The Water Commission is authorized by Senate Bill No. 2188 from the 1999 Legislative Session to issue bonds to finance various flood control and pipeline projects throughout the state of North Dakota. Authorized and unissued bonds totaled $60,257,958 at June 30, 2004. Water development projects that will benefit from the financing are as follows:

Statewide Water Development Projects	$ 60,000,000
Southwest Pipeline Project	257,958

Interest is payable semiannually on January 1 and July 1 of each year for the Series 1997 A and Series 2000 A Term Bonds, March 1 and September 1 of each year for the Series 1998 A Bonds, and February 1 and August 1 for the Series 2000 A Serial Bonds. Interest is payable annually on July 1 of each year for all other series bonds. The bonds of each series are subject to optional and/or extraordinary optional redemption prior to maturity at the option of the Water Commission or the occurrence of certain events. All redemption prices are at par plus accrued interest.

State Fair

Interest on the 2001 Series Bonds is payable semi-annually on June 1 and December 1 of each year. The bonds maturing on December 1, 2011, are not subject to optional redemption prior to maturity, except under extraordinary circumstances.

Student Loan Trust

The Series C Bonds are zero coupon bonds with interest accruing monthly and the face value payable at maturity. These bonds were issued to refund a portion of the 1979 Series A and 1984 Series A Bonds and to provide funds for the acquisition of student loans from the Bank of North Dakota.

The proceeds of the 1996 Series B Bonds were used to refund the July 1, 1996, principal maturity of the 1988 Series A and B, 1989 Series B, and 1992 Series A Bonds. Interest is payable semiannually on January 1 and July 1 of each year. The 1996 Series B Bonds are variable rate bonds initially issued as auction rate certificates. The rate of interest will be determined each 35-day period. The maximum rate of interest is 12% per annum. Details of the terms and provisions of the auction rate bonds are outlined in Schedule A of the First Supplemental Resolution to the State of North Dakota Student Loan Revenue Bonds Second General Bond Resolution. Under certain conditions, the Industrial Commission may call for early redemption of the 1996 Series B Bonds at 100% of the principal amount plus accrued interest to date of redemption.

The proceeds of the 1996 Series D Bonds were used to finance the acquisition of supplemental loans. These bonds are subject to redemption prior to maturity at the option of the Industrial Commission on July 1, 2006, at 100% of the principal amount plus accrued interest to date of redemption.

Interest is payable semiannually on January 1 and July 1 of each year for the 1997 Series B Bonds.

The proceeds of the Series 1997 Bonds were used to refund the current maturities of the 1988 Series A and B, 1989 Series B and 1992 Series A Bonds on July 1, 1997, and to current refund and redeem the remainder of the 1988 Series A Bonds at a redemption price of 103% on August 1, 1997.

The 1997 Series B Bonds are variable rate bonds initially issued as auction rate certificates. The rate of interest will be determined each 35-day period. The maximum rate of interest is 12% per annum. Details of the terms and provisions of the auction rate bonds are outlined in Schedule A of the Second Supplemental Resolution to the State of North Dakota Student Loan Revenue Bonds Second General Bond Resolution. Under certain conditions, the Industrial Commission may call for an early redemption of the 1997 Series B Bonds at a redemption price equal to 100% of the principal amount plus accrued interest to date of redemption. The 1997 Series B Bonds are subject to mandatory redemption prior to maturity at a redemption price equal to 100% of the principal amount of $11,600,000, plus accrued interest, on January 1, 2006.

Interest on the 1998 Series B Bonds is payable semiannually on June 1 and December 1 of each year. The proceeds of the Series 1998 Bonds were used to refund the current maturities of the 1988 Series B Bonds and the 1989 Series B Bonds on July 1, 1998, and to call $32,670,000 of the 1989 Series A and B Bonds at a redemption price of 103% on August 1, 1998. The 1998 Series B Bonds are variable rate bonds initially issued as auction rate certificates. The rate of interest will be determined each 35-day period. The maximum rate of interest is 12% per annum. Details of the terms and provisions of the auction rate bonds are outlined in Schedule A of the Second Supplemental Resolution to the State of North Dakota Student Loan Revenue Bonds Second General Bond Resolution. Under certain conditions, the Industrial Commission may call for early redemption of the 1998 Series B Bonds at a redemption price equal to 100% of the principal amount plus accrued interest to date of redemption.

The 2000 Series A Bonds are variable rate bonds initially issued as auction rate certificates. Interest is payable semiannually on June 1 and December 1 of each year. The maximum rate of interest is 12% per annum. The proceeds of the Series 2000 Bonds were used to provide funds for the acquisition of student loans from the Bank of North Dakota. Details of the terms and provisions of the auction rate bonds are outlined in Schedule A of the Second Supplemental Resolution to the State of North Dakota Student Loan Revenue Bonds Second General Bond Resolution. The 2000 Series B Bonds are fixed rate bonds. Under certain conditions, the Industrial Commission may call for early redemption of the 2000 Series A and B Bonds at a redemption price equal to 100% of the principal amount plus accrued interest to date of redemption.

Interest is payable semiannually on June 1 and December 1 of each year. The 2004 Series A Bonds are variable rate bonds. The rate of interest is determined based on the one-month LIBOR plus .7%. The maximum rate of interest is 12% per annum. Details of the terms and provisions of the variable rate bonds are outlined in Section 2.4 of the Second Supplemental Resolution to the State of North Dakota Student Loan Revenue Bonds First General Bond Resolution. The Series 2004 Bonds are subject to redemption prior to maturity at the option of the Commission from any source of funds, in whole or in part, on any date at a redemption price equal to 100% of the principal amount plus accrued interest to date of redemption.

Housing Finance

Housing Finance Bonds were issued to provide financing to purchase mortgage loans to finance multifamily housing projects. The bonds are the direct obligation of the Housing Finance Agency and are secured by the mortgage loans purchased under the applicable resolutions; the revenues, prepayments, insurance and foreclosure proceeds received related to the mortgage loans; and certain funds and accounts established pursuant to the applicable bond resolution. The term bonds of all bond series have mandatory sinking fund requirements starting in 1998.

Major Component Units

Municipal Bond Bank

The bonds of the Municipal Bond Bank were issued to provide financing to purchase municipal securities in order to provide local political subdivisions with funds to finance local projects. The bonds are direct obligations of the Municipal Bond Bank and are secured by municipal securities purchased under the applicable resolutions, interest earnings and certain accounts established pursuant to the applicable bond resolutions.

Revenue Bonds outstanding (expressed in thousands):

Fund Type/Fund	Maturities	Interest Rates	Balance 6/30/04
Primary Government			
Governmental:			
Building Authority	2005-2023	2.00 – 5.60	$ 91,451
Lignite Research	2005-2006	5.75	2,860
Water Commission	2005-2042	2.50 – 6.00	46,112
Information Technology Department	2006-2014	4.28	5,961
Proprietary:			
State Fair	2005-2011	3.25 – 4.60	1,924
Student Loan Trust	2006-2036	1.27 – 7.25	125,388
Housing Finance:			
Multi-Family	2005-2024	5.05 – 6.85	10,018
Single-Family	2005-2036	1.45 – 7.00	575,514
University System:			
VCSU—Valley City	2005-2033	4.30 – 7.25	3,737
Williston State College	2005-2019	0 – 4.75	1,299
Lake Region State College	2005-2017	3.00 – 5.125	1,050
UND—Grand Forks	2005-2034	0 – 4.80	43,771
NDSU—Fargo	2005-2032	0 – 5.60	46,817
NDSCS—Wahpeton	2005-2016	0 – 5.50	2,437
MiSU–Minot	2005-2013	3.00 – 4.75	4,266
MiSU—Bottineau	2005-2012	4.30 – 6.90	192
MaSU—Mayville	2005-2018	3.00 – 5.38	3,277
DSU—Dickinson	2005-2019	4.30 – 5.90	1,208
BSC—Bismarck	2005-2009	4.00 – 6.10	438
NDUS – Univ. Sys. State Office	2006-2014	4.28	14,200
Total Revenue Bonds Payable— Primary Government			$ 981,920
Major Component Units			
Proprietary:			
Municipal Bond Bank	2005-2028	2.00 – 10.00	$ 158,901
NDSU Development Foundation	2005-2019	5.19	1,630
Arena Holdings Charitable LLC	2005-2031	2.50 – 3.93	7,500
UND Foundation	2005-2027	2.02 –5.95	12,938
Total Revenue Bonds Payable— Major Component Units			$ 180,969

Debt service requirements to maturity on revenue bond issues for the fiscal years ending June 30 are summarized below (expressed in thousands):

Primary Government:

Governmental Activities

Fiscal Year	Principal	Interest
2005	$ 7,960	$ 6,880
2006	10,621	6,542
2007	9,041	6,089
2008	10,264	5,659
2009	10,195	5,187
2010-2014	40,954	19,350
2015-2019	32,316	10,454
2020-2024	17,720	3,482
2025-2029	3,021	1,383
2030-2034	1,592	847
2035-2039	1,816	424
2040-2044	740	80
Bond Premium	1,018	(1,018)
Deferred Amount On Refunding	(874)	874
Total	$ 146,384	$ 66,233

Business-type Activities

Fiscal Year	Principal	Interest
2005	$ 14,550	$ 34,826
2006	62,577	34,955
2007	19,875	33,570
2008	20,118	32,703
2009	20,908	31,835
2010-2014	116,639	143,871
2015-2019	106,045	116,064
2020-2024	114,855	88,752
2025-2029	173,855	52,466
2030-2034	97,050	17,245
2035-2039	89,589	1,747
Less Bond Discount	(263)	263
Deferred Amount On Refinancing	(90)	90
Accrued Interest At Maturity On Zero Coupon Bonds	(172)	172
Total	$ 835,536	$ 588,559

Major Component Units

Fiscal Year	Principal	Interest
2005	$ 9,020	$ 7,913
2006	9,786	7,682
2007	10,063	7,187
2008	10,286	6,675
2009	10,480	6,197
2010-2014	53,503	23,916
2015-2019	50,608	12,054
2020-2024	22,313	3,038
2025-2029	4,409	416
2030-2034	305	10
Bond Premium	196	(196)
Total	$ 180,969	$ 74,892

2. NOTES PAYABLE

The following is a schedule of notes payable outstanding at June 30, 2004 (expressed in thousands):

Fund Type/Fund	Maturities	Interest Rates	Balance 6/30/04
Primary Government			
Governmental:			
Job Service North Dakota	2006	3.57-5.68	$ 651
Information Technology Department	2004	4.18-6.64	434
Department of Corrections	2005 – 2015	4.59	462
Department of Human Services	2005 – 2014	4.24	3,909
Proprietary:			
Bank of North Dakota--Short Term (1)	2005	1.04	125,000
Bank of North Dakota--Long Term	2005 - 2022	2.98 – 7.35	400,795
University Systems	2005-2019	4.09-5.52	9,458

Major Component Units

Municipal Bond Bank (2)	2019	2.84	6,460
UND Aerospace Foundation	2005-2009	3.425-4.00	4,210
MiSU Development Foundation	2005-2008	6.00	30
NDSU Development Foundation	2005-2013	2.77 – 4.25	3,029
UND Foundation	2005-2012	1.98 – 4.31	873

(1) The Bank of North Dakota issued short-term debt to fund loans on a short-term basis.
(2) The Municipal Bond Bank note payable is to the Bank of North Dakota, part of the primary government.

Debt service requirements to maturity for notes payable for the fiscal years ending June 30 are summarized below (expressed in thousands):

Primary Government:

Governmental Activities

Fiscal Year	Principal	Interest
2005	$ 993	$ 256
2006	816	195
2007	363	160
2008	395	142
2009	415	124
2010 – 2014	2,453	328
2015 – 2019	21	-
Total	$ 5,456	$ 1,205

Business-type Activities

Fiscal Year	Principal	Interest
2005	$ 148,957	$ 22,809
2006	64,904	20,834
2007	24,538	17,912
2008	15,960	16,873
2009	96,306	12,054
2010-2014	103,826	41,834
2015-2019	56,162	19,858
2020-2024	24,600	3,658
Total	$ 535,253	$ 155,832

Major Component Units

Fiscal Year	Principal	Interest
2005	$ 3,780	$ 330
2006	641	295
2007	1,352	247
2008	1,826	213
2009	400	152
2010-2014	1,738	890
2015-2019	4,120	339
2020-2024	745	10
Total	$ 14,602	$ 2,476

Changes in General Long-Term Liabilities

Changes in Long-Term Liabilities for the year ended June 30, 2004, are summarized as follows (expressed in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Governmental Activities:					
Notes Payable	$ 5,671	$ 4,804	$ (5,020)	$ 5,455	$ 992
Bonds Payable	146,795	7,461	(7,872)	146,384	7,960
Capital Leases Payable	2,240	277	(1,385)	1,132	404
Intergovernmental Payable	617	72	(21)	668	41
Compensated Absences	28,382	18,780	(18,476)	28,686	1,367
Claims/Judgments Payable	5,863	2,587	(2,391)	6,059	3,180
Total Long-Term Liabilities	$ 189,568	$ 33,981	$ (35,165)	$ 188,384	$ 13,944

Business-Type Activities:					
Notes Payable—Short-Term	$ 25,000	$ 1,190,000	$(1,090,000)	$ 125,000	$ 125,000
Notes Payable—Long-Term	402,683	23,567	(15,997)	410,253	23,957
Bonds Payable	886,185	145,388	(196,038)	835,535	14,550
Capital Leases Payable	31,798	9,318	(6,986)	34,130	4,934
Intergovernmental Payable	12,610	12,036	(13,582)	11,064	1,164
Compensated Absences	18,879	2,474	(1,174)	20,179	1,597
Claims/Judgments Payable	579,317	134,883	(109,399)	604,801	70,558
Total Long-Term Liabilities	$ 1,956,472	$ 1,517,666	$(1,433,176)	$ 2,040,962	$ 241,760

Major Component Units:					
Notes Payable	$ 15,281	$ 4,000	$ (4,679)	$ 14,602	$ 3,780
Bonds Payable	149,608	60,645	(29,284)	180,969	8,285
Capital Leases Payable	-	2,000	-	2,000	32
Intergovernmental Payable	1,405	83	(759)	729	22
Total Long-Term Liabilities	$ 166,294	$ 66,728	$ (34,722)	$ 198,300	$ 12,119

Internal service funds predominately serve the governmental funds. Accordingly, long-term liabilities for them are included as part of the above totals for governmental activities. At year end, $1,248,482 of internal service fund compensated absences and $5,058,957 of claims and judgments are included in the above amounts. Other governmental activities compensated absences generally have been liquidated by the General Fund (57%), the Highway Fund (16%), the Federal Fund (20%), and other various funds. Other governmental activities claims and judgments are generally liquidated by the Insurance Regulatory Trust Fund (78%), Highway Fund (21%), and the Petroleum Release Compensation Fund (1%).

3. DEFEASED DEBT

Primary Government

Building Authority

On July 18, 2002, the Building Authority issued $16,425,000 Lease Revenue Refunding Bonds, 2002 Series D. The proceeds of the issue were used for an advance refunding of 1995 Series A. The net proceeds were deposited in an irrevocable trust with an escrow agent to provide for all the future debt service payments on the refunded bonds. The reacquisition price exceeded the net carrying amount of the old debt by $999,000. This amount is netted against the new debt and amortized over the life of the refunded debt, which is the same as the life of the new debt issued. The current refunding was undertaken to reduce total debt service payments over the next fifteen years by $561,000 and resulted in an economic gain of $478,000. As of June 30, 2004, $13,840,000 of bonds outstanding is considered defeased and the liability for those bonds is not reflected on the State's financial statements.

Housing Finance

Previous to July 1, 1999, Housing Finance defeased certain general obligation bonds by placing bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the State's financial statements. At June 30, 2004, $6,900,000 of bonds outstanding are considered defeased.

University System

Mayville State University

On July 1, 1998, Mayville State University issued $695,000 of Student Center Refunding Revenue Bonds (Series 1998) with an average interest rate of 4.40%. These bonds were used to advance refund $640,000 of outstanding 1989 Student Center Revenue Bonds (with an average interest rate of 7.40%). The net proceeds of $666,673 (after payment of $28,327 in underwriting fees, insurance, and other issuance costs) were used to purchase U.S. Government Securities. Those securities are deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1989 Student Center Revenue Bonds. As a result, the 1989 bonds are considered to be defeased and the liability for those bonds has been removed from the statement of net assets. The principal amount outstanding as of June 30, 2004, of the original bonds refunded by the advance refunding of 1998 totaled $350,000.

Minot State University

On June 2, 1992, Minot State University placed the proceeds of the $2,620,000 Student Housing Revenue Refunding Bonds of 1992 in an irrevocable trust with an escrow agent to provide for future debt service payments of the existing revenue bonds. The purpose of the 1992 Bonds was to refund in advance of maturity the 1966 Student Union Construction and Refunding Bonds and the 1985 Student Housing Revenue Bonds. As a result, the trust account assets and the liabilities for the defeased bonds are not included in the State's financial statements.

The principal amount outstanding as of June 30, 2004, of the original bonds refunded (considered defeased) by the advance refunding total $100,000.

University of North Dakota

On January 1, 1998, the University of North Dakota issued $22.6 million of Housing and Auxiliary Facilities Improvement and Refunding Revenue Bonds (Series 1998 A) with an average interest rate of 4.70%. These bonds were used to advance refund $20.4 million of outstanding 1988 Series A and B Housing and Auxiliary Facilities Refunding Revenue Bonds (with an average interest rate of 7.50%) and to provide $450,000 for parking lot construction at the Rural Technology Center. The principal amount outstanding as of June 30, 2004, of the original bonds refunded by the advanced refunding of 1998 totaled $15,005,000.

Housing and Auxiliary Facilities Revenue Bonds Series I and Series J, which were included in the advance refunding of 1984 as described above, were originally issued in 1975 for the purpose of advance refunding certain outstanding bonds of the university. The principal amount outstanding as of June 30, 2004, of the original bonds refunded by the advance refunding of 1975 totaled $555,000.

All of the refunded bonds are considered "defeased" and have debt service needs covered by U.S. Government securities which are held in a special trust administered by the Bank of North Dakota. As such, neither the assets of the trust nor the related bonds payable are included in the accompanying statement of net assets.

Certificates of Participation totaling $20,450,000 were originally issued by UND in 1990 to: (1) reimburse the University for certain expenses incurred for capital improvements; (2) refinance the costs of certain equipment; and (3) finance the acquisition of certain equipment and real property, to fund a reserve, and to pay the costs of issuance. Subsequent to this issuance, the 1991 North Dakota Legislature, in House Bill 1003, directed the University to retire those certificates originally issued for the acquisition of certain equipment and real property and to fund a reserve. Therefore, in December 1991, $6,025,000 in certificates were defeased. The principal amount outstanding as of June 30, 2004, of the defeased certificates totals $2,375,000.

North Dakota State University

The North Dakota State University, pursuant to resolutions adopted by the Board of Higher Education on November 7, 1985, issued $4,833,813 of Housing and Auxiliary Facilities Revenue Refunding Bonds (Series 1985) on December 30, 1985. The purpose of issuing Series 1985 bonds was to refund in advance of maturity the outstanding advanced refunded bonds, which consisted of all bonds outstanding as of December 30, 1985, totaling $7,675,000. The Series 1985 Bonds do not pay the holder interest but were sold at a discount so that principal payments will yield a return to maturity from 8.20% to 9.70%. All of the refunded bonds are considered "defeased" in accordance with Financial Accounting Standards Board Statement No. 76. As such, neither the assets of the trust nor the related bonds payable are included in the accompanying statement of net assets. The principal amount outstanding as of June 30, 2004, of the original bonds refunded by the advance refunding total $1,045,000.

North Dakota State College of Science

On June 20, 2001, North Dakota State College of Science issued $2,785,000 of Housing and Auxiliary Facilities Improvement and Refunding Revenue Bonds (Series 2001) with an average interest rate of 4.92%. These bonds were used to (1) refund, defease and discharge outstanding North Dakota State School of Science Married Student Housing Revenue Bonds 1970 at 7.0% and 7.25%, Dormitory Revenue Bonds of 1970 at 7.25% and Dormitory Revenue Bonds of 1972 at 6.3%. Funds were deposited in a trust account with an escrow agent to provide for all future debt service payments for the above bonds; (2) finance the cost of the construction of the parking lot and related improvements at the College; and (3) to pay certain costs associated with the issuance of the Series 2001 bonds.

As a result of this issue, trust account assets and liabilities for the defeased bonds are not included in the State's financial statements. The project costs for the parking lot and related improvements were set at $1,000,000. The principal amount outstanding as of June 30, 2004, of the original bonds refunded is $1,335,000.

Component Units

Municipal Bond Bank Bonds

On December 16, 2003, the Bond Bank issued $20,455,000 of revenue bonds (Series 2003 B SRF Bonds) with an average interest rate of 4.71 percent. The net proceeds were deposited in an irrevocable trust with an escrow agent to provide for all the future debt service payments on the refunded bonds. As of December 31, 2003, $19,740,000 of bonds outstanding is considered defeased and the liability has been removed from the balance sheet. The reacquisition price exceeded the net carrying amount of the old debt by $2,129,000. This amount is being netted against the new debt and amortized over the life of the refunded debt, which is the same as the life of the new debt issued. This advance refunding was undertaken to reduce total debt service payments over the next 14 years by $1,066,000 and resulted in an economic gain of $842,000.

J. ARBITRAGE REBATE PAYABLE

Arbitrage as it applies to government financing refers to the ability of state governments to obtain funds at a tax-exempt rate of interest and to then invest those funds in investments which earn a higher yield, resulting in a profit to the issuer.

The arbitrage rebate rules require that any earnings from the investment of the tax-exempt bond proceeds which exceed the yield on the bonds be remitted to the federal government.

The State has an arbitrage rebate payable to the federal government of approximately $5,802,248 at June 30, 2004. These amounts are reported in the Government-wide and Proprietary Fund Type financial statements as an intergovernmental payable.

NOTE 4 - RETIREMENT SYSTEMS

A. DESCRIPTION OF PLANS

The State of North Dakota administers four major retirement systems: North Dakota Public Employees' Retirement System, North Dakota Highway Patrolmen's Retirement System, Retirement Plan for the Employees of Job Service North Dakota and the Teachers' Fund for Retirement. The State also administers the North Dakota Defined Contribution Retirement Plan, which was established January 1, 2000. These retirement systems have implemented Governmental Accounting Standards Boards Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and Statement No. 27, Accounting for Pensions by State and Local Governmental Employers. Certain state employees may also participate in a privately administered retirement system: Teachers' Insurance Annuity Association. The following is a brief description of each plan. More detailed information can be found in the plan agreements and the related legislation.

NORTH DAKOTA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (PERS)

The North Dakota Public Employees' Retirement System (PERS) is a cost-sharing multiple-employer defined benefit pension plan covering substantially all employees of the State of North Dakota, its agencies, and various participating political subdivisions (Main System). It also covers Supreme and district court judges, the National Guard Security Officers and Firefighters, and as of August 1, 2004, peace officers and correctional officers employed by political subdivisions. It is not subject to the provisions of the Employee Retirement Security Act of 1974. PERS issues a publicly available financial report that may be obtained by writing to North Dakota Public Employees Retirement System, 400 East Broadway, Suite 505, Bismarck, North Dakota 58501.

At June 30, 2004, the number of participating local political subdivisions in PERS was:

Cities and Park Districts	68
Counties	44
School Districts	100
Other	57
Total Participating Local Political Subdivisions	269

Death and disability benefits are set by statute. If an active employee dies with less than five years (three years of service for the Main System and National Guard/Law Enforcement) of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of service for the Main System and National Guard/Law Enforcement, the surviving spouse will be entitled to a single payment refund, life-time monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, or 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred or monthly payments in an amount equal to the employees' accrued 100% joint and survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the employee's accumulated pension benefits are paid, the balance will be payable to the surviving spouse's designated beneficiary.

For judges only, the death benefit is changed to the greater of (i) lump sum payment of accumulated contributions, and (ii) 100% of the member's accrued benefit (not reduced on account of age), payable for the spouse's lifetime.

Eligible employees who become totally disabled after a minimum of 180 days of service receive monthly disability benefits that are equal to 25% of their final average salary with a minimum benefit of $100. To qualify under this section, the employee has to become disabled during the period of eligible employment and apply for benefits within one year of termination. The definition for "disabled" is set by the Board in the North Dakota Administrative Code.

For Judges only, the disability benefit formula is changed to 70% of final average salary minus social security and workers compensation benefits.

Pension benefits are set by statute. The System has no provisions or policies with respect to automatic and ad hoc post-retirement benefit increases. Employees are entitled to unreduced monthly pension benefits beginning when the sum of age and years of credited service equals or exceeds 85 or at normal retirement age (65), equal to 2.00% of their average monthly salary, using the highest 36 months out of the last 120 months of service, for each year of service. The plan permits early retirement at ages 55-64, with three or more years of service for the Main System and National Guard/Law Enforcement, and five or more years of service for the Supreme and district court judges. The monthly pension benefit for Supreme and district court judges at normal retirement age (65) is equal to a percentage of average monthly salary using the highest 36 consecutive months out of the last 120 months of service. The percentage is equal to 3.5% of final average monthly salary multiplied by the first 10 years of service, plus 2.80% of final average monthly salary times the second 10 years of service, plus 1.25% of final average monthly salary times years of service in excess of 20 years. The judicial retirement formula is only applied to eligible judicial service. Non-judicial service benefits are calculated using the 2.00% multiplier. The monthly pension benefit for National Guard/Law Enforcement at normal retirement age (55) is equal to 2.00 percent of their average monthly salary, using the highest 36 months out of the last 120 months of service, for each year of service.

Employees may elect to receive the pension benefits in the form of a single life, joint and survivor, level social security or term-certain annuity. Employees may elect to receive the value of their accumulated contributions, plus interest, as a lump sum distribution upon retirement or termination, or they may elect to receive their benefits in the form of an annuity. For each member electing an annuity, total payment will not be less than the employee's accumulated contributions plus interest.

The System is funded by employee contributions (set by statute) of 4% of regular compensation, with the exception of Supreme and district court judges' contributions, which are established at 5% of total compensation. During the 1983-1985 biennium, the State implemented the employer pickup provision of the IRS code, whereby a portion or all of the required employee contributions are made by the employer. The State is paying the full employee contribution with the exception of the Supreme and district court judges, in which the State is paying 4 of the 5% contribution. Some of the political subdivisions are paying all or part of the employee contributions. Employer contributions of 4.12% of covered compensation are set by statute. The employer contribution rate for the Supreme and district court judges is also set by statute at 14.52%, and the contribution rate for the National Guard/Law Enforcement is set by the Board at 8.33% for the National Guard, 8.31% for Law Enforcement with previous service, and 6.43% for Law Enforcement without previous service. The required contributions are determined using an entry age normal actuarial funding method.

Except for Supreme and district court judges, the employees' account balance includes the vested employer contributions equal to the employee's contributions to an eligible deferred compensation plan.

The minimum member contribution is $25, and the maximum may not exceed certain parameters based upon years of service.

The North Dakota Retirement Board was created by the State Legislature and is the governing authority of PERS. Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code.

<u>NORTH DAKOTA HIGHWAY PATROLMEN'S RETIREMENT SYSTEM (NDHPRS)</u>

The North Dakota Highway Patrolmen's Retirement System is a single-employer defined benefit pension plan covering substantially all sworn officers of the Highway Patrol of the State of North Dakota. It is not subject to the provisions of the Employee Retirement Income Security Act of 1974. NDHPRS issues a publicly available financial report that may be obtained by writing to North Dakota Public Employees Retirement System, 400 East Broadway, Suite 505, Bismarck, North Dakota 58501.

Death and disability benefits are set by statute. If an active employee dies with less than 10 years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than 10 years of credited service, the surviving spouse, if any, will be entitled to a single payment refund, life-time monthly payments in an amount equal to 50 percent of the employee's accrued normal retirement benefit, or 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 55 the day before death occurred. If the surviving spouse dies before the employee's accumulated pension benefits are paid, the balance will be payable to any designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days service receive monthly disability benefits that are up to 70 percent of their final average salary, reduced by workers compensation with a minimum benefit of $100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled and apply for benefits within one year of termination.

Pension benefits are set by statute. The System has no provisions or policies with respect to automatic and ad hoc post-retirement benefit increases. Employees are entitled to unreduced pension benefits after a minimum of 10 years of service upon attainment of age 55 or when the sum of age and years of credited service equals or exceeds 80. The annual pension benefit is equal to a percentage of average monthly salary using the highest 36 consecutive months out of the last 120 months of service. The percentage is equal to the sum of the first 25 years of service multiplied by 3.60% and 1.75% multiplied by years of service in excess of 25, if any. The plan permits early retirement at ages 50-54, with ten or more years of service.

The System is funded by employee contributions of 10.30% (of which the State is paying 4%) of total compensation and an employer contribution of 16.70%. The required contributions are determined using an entry age normal cost method. The North Dakota Retirement Board was created by the State Legislature and is the governing authority of NDHPRS. Benefit and contribution provisions are administered in accordance with chapter 39-03 of the North Dakota Century Code.

REFUNDS OF MEMBER CONTRIBUTIONS

Upon termination, if an employee is not vested (is not 65 or does not have five years of service [three years of service for the Main System and National Guard/Law Enforcement] credited for PERS, or is not 60 or does not have ten years of service credited for NDHPRS), they will receive the accumulated employee contributions plus interest. If an employee has vested, they have the option of applying for a refund or can remain as a terminated vested participant. If an employee of the PERS terminated and withdrew their accumulated employee contribution and is subsequently re-employed, they have the option of repurchasing their prior service.

RETIREMENT PLAN FOR THE EMPLOYEES OF JOB SERVICE NORTH DAKOTA (JSND)

The retirement plan for employees of Job Service North Dakota is a single-employer defined benefit public employee retirement plan administered by PERS. The plan is established under NDCC 52-11-01 with benefit provisions established through the plan document, as amended. This plan document, as amended, is authorized by the Plan Administrator, who is the Executive Director of the agency.

On August 1, 2003, the administrative authority and the net assets of the Retirement Plan for Employees of Job Service North Dakota were transferred from the agency to the Public Employees Retirement System Board. This action was based on the passage of House Bill 1064 by the Fifty-eighth Legislative Assembly of North Dakota. The Retirement Plan for Employees of Job Service has an Actuarial Valuation Report produced annually. Requests to obtain or review this report should be addressed to the Executive Director, NDPERS, 400 East Broadway, Suite 505, Bismarck, North Dakota 58501.

Participation in the plan is limited to employees participating in the plan as of September 30, 1980. Employees were vested in the program after the completion of five years of credited service.

The plan provides retirement, disability and death benefits. If the death of a participant occurs prior to their annuity starting date, the surviving spouse who has been married at least two years prior to the participant's death or, if married less than two years is a parent of a child of this marriage, then the spouse shall receive monthly benefits. The amount is the greater of the benefit had the participant retired on the day before they died and elected the Contingent Annuitant Option with 55% of their retirement benefit continued to their spouse or 55% of the smaller of 40% of the deceased participant's average monthly earnings or the deceased participant's normal retirement benefit obtained by increasing their credited service by the period of time between their date of death, and the date they would have attained age 60. Upon remarriage of the surviving spouse before age 60, the death benefit will cease.

If a participant becomes totally disabled, they will be eligible for a monthly disability benefit which shall be equal to the greater of 40% of the participant's average annual earnings or the accrued benefit determined as of their date of disability.

Employees are entitled to annual pension benefits beginning at normal retirement age (65). Employees may elect an optional retirement eligibility at age 62 with 5 years of credited service, at age 60 with 20 years of credited service, or at age 55 with 30 years of credited service. Pension benefits are calculated based on the final average earnings (basic monthly earnings averaged over the highest three consecutive years of basic earnings) of the employee multiplied by the sum of:

- 1.5% times years of credited service up to 5 plus;
- 1.75% times years of credited service between 6 and 10 plus;
- 2.0% times years of credited service in excess of 10.

The System is funded by employee contributions of 7% of retirement wages (of which 4% is paid by the employer in lieu of salary increases). The required employer contributions are determined using the frozen initial liability actuarial cost method. Benefit and contribution provisions of the JSND are administered in accordance with chapter 52-11 of the North Dakota Century Code. Effective July 1, 1999, the "scheduled contribution" will be zero as long as the Plan's actuarial value of assets exceeds the actuarial present value of projected benefits.

TEACHERS' FUND FOR RETIREMENT (TFFR)

The North Dakota Teachers' Fund for Retirement is a cost-sharing multiple-employer defined benefit pension plan covering employees for all public and certain college, State and non-public teachers of the State who meet certain requirements of age, period of productive service and employment. TFFR provides for pension, survivor and disability benefits. Teachers' Fund for Retirement issues a publicly available financial report that may be obtained by writing to the Retirement and Investment Office, 1930 Burnt Boat Drive, Bismarck, North Dakota 58503.

At June 30, 2004, the number of participating employer units in TFFR was:

Type	Number
Special Education Units	19
Vocational Education Units	4
Public School Districts	211
County Superintendents	15
Other	17
Total	266

A member is entitled to receive full benefits when three or more years of credited service as a teacher in North Dakota have accumulated, the member is no longer employed as a teacher and has reached age 65, or the sum of age and years of service credit equals or exceeds 85. TFFR permits early retirement from ages 55 to 64, with benefits actuarially reduced by 6% per year for every year the member's retirement age is less than 65 years or the date as of which age plus service equal 85. In either case, benefits may not exceed the maximum benefits specified in Section 415 of the Internal Revenue Code.

Pension benefits paid by TFFR are determined by NDCC 15-39.1-10. Monthly benefits under TFFR are equal to the three highest annual salaries earned divided by 36 months and multiplied by 2.00% times the number of service credits earned. Retirees may elect payment of benefits in the form of a single life annuity, 100% or 50% joint and survivor annuity, ten- or twenty-year term certain annuity, partial lump sum option, or level income with Social Security benefits. Members may also qualify for benefits calculated under other formulas and may be eligible for legislative increases in monthly benefits.

Survivor benefits may be paid to a member's designated beneficiary. If a member's death occurs before retirement, the benefit options available are determined by the member's vesting status prior to death. If a member's death occurs after retirement, the death benefit received by the beneficiary (if any) is based on the retirement plan the member selected at retirement.

An active member is eligible to receive disability benefits when: (a) a total disability lasting twelve months or more does not allow the continuation of teaching, (b) the member has accumulated one year of credited service in North Dakota, and (c) the Board of Trustees of TFFR has determined eligibility based upon medical evidence. The amount of the disability benefit is computed by the retirement formula in NDCC 15-39.1-10 without consideration of age and assuming the member has a minimum of 20 years of credited service. There is no actuarial reduction for reason of disability retirement.

Assessments and contributions paid to TFFR are set by NDCC 15-39.1-09. Every eligible teacher in the state of North Dakota is required to be a member of TFFR and is assessed at a rate of 7.75% of salary as defined by NDCC 15-39.1-04. Every governmental body employing a teacher must also pay into TFFR a sum equal to 7.75% of the teacher's salary.

A vested member who terminates covered employment may elect a refund of assessments paid or defer payment until eligible for pension benefits. A nonvested member who terminates covered employment must claim a refund of assessments paid unless that member submits a valid waiver of this refund to the Board of Trustees of TFFR. Refunded members forfeit all service credits under TFFR. These service credits may be repurchased upon return to covered employment under certain circumstances, as defined by the NDCC.

The following table summarizes membership information by plan at the actuarial valuation date:

	PERS	NDHPRS	JSND	TFFR
Retirees and Beneficiaries Currently Receiving Benefits:	5,634	90	213	5,373
Special Prior Service Retirees:	74	-	-	-
Terminated Employees:				
Vested	986	2	5	1,346
Nonvested	3,133	3	-	175
Total Terminated Employees	4,119	5	5	1,521
Active Employees:				
Vested	13,402	65	60	8,658
Nonvested	4,234	67	-	1,168
Total Active Employees	17,636	132	60	9,826
Date of Annual Valuation	July 1, 2004	July 1, 2004	July 1, 2004	July 1, 2004

The above table includes retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSET MATTERS

BASIS OF ACCOUNTING

The public employee retirement systems described above are considered part of the State of North Dakota's reporting entity and are included in the State's financial statements as pension trust funds. The financial statements of these systems are prepared using the accrual basis of accounting. Employee contributions are recognized as revenues in the period in which they are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contribution. Benefits and refunds are recognized when due and payable in accordance with the terms of the plans.

METHOD USED TO DETERMINE EMPLOYER CONTRIBUTIONS

Employer contributions for the PERS and NDHPRS were determined by an actuarial formula identified as entry age normal cost method. The formula determines the amount of contributions necessary to fund: (a) the current service cost, which represents the estimated amount necessary to pay for benefits earned by employees during the current service year and, (b) the prior service cost, which represents the amount necessary to pay for benefits earned prior to the effective date of the plan.

METHOD USED TO VALUE INVESTMENTS

Investments are recorded at fair value determined by reference to published market data for publicly traded securities and through the use of independent valuation services and appraisals for other investments. The net increase in fair value of investments consists of the realized gains or losses and the unrealized increase or decrease in fair value of investments during the year. Realized gains and losses on sales of investments are computed based on the difference between the sales price and the original cost of the investment. Unrealized increases or decreases are computed based on changes in the fair value of investments between years. Security transactions are accounted for on a trade date basis. Interest income is recognized when earned. Dividend income is recorded on the ex-dividend date.

During the current year, there were no investments in the stock or bonds of any commercial or industrial organization whose fair value represented five percent or more of the net assets available for benefits. Additionally, there were no securities of the employers or related parties included in the assets of the pension trust funds.

Investments of PERS and NDHPRS are commingled and invested. Earnings on the investments and expenses relating to administering the plans are allocated to each plan based upon their percentage of ownership or number of participants.

On March 14, 1994, the Plan Administrator/Trustee for the Retirement Plan for Employees of Job Service North Dakota entered into an investment management agreement with the North Dakota State Investment Board. This agreement provided for investment management services for pension fund assets.

C. FUNDING STATUS AND PROGRESS

The actuarial methods and assumptions together with the schedule of funding progress is presented by the retirement systems in their separately presented financial reports based upon the actuary reports generated by the studies conducted by the Segal Company and Gabriel, Roeder, Smith and Company. The actuarial value of assets is based on a five-year smoothed fair value basis. Under this method, realized and unrealized gains and losses on investments are smoothed over five years. Below is listed the various actuarial methods and significant assumptions used to determine the annual required contributions, together with the schedule of funding progress.

	PERS NDHPRS	JSND	TFFR
Valuation Date	July 1, 2004	July 1, 2004	July 1, 2004
Actuarial Cost Method	Entry Age Normal	Frozen Entry Age**	Entry Age Normal
Amortization Method	Level Percent Open	Level Dollar Closed	Level Payment Open
Remaining Amortization Period	20 years	15 years	20 years
Asset Valuation Method	5-year smoothed market	5-year smoothed market	5-year smoothed market
Actuarial Assumptions:			
Investment rate of return	8.0%	8.0%	8.0%
Projected salary increase	4.5%*	5.0%	4.0% to 13.0%
Includes inflation at	4.5%	5.0%	3.0%
Post retirement cost-of-living adjustment	None	5.0%	None

* Inflation together with wage increases attributable to seniority, merit and “standard of living” increases.

** As of July 1, 2004, the actuarial value of assets exceeds the present value of projected benefits; therefore, the unfunded actuarial accrued liability is currently zero.

Schedule Of Funding Progress
(Dollars In Millions)

Actuarial Valuation Date	Actuarial Value Of Plan Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL) (Funded Excess)	Funded Ratio	Annual Covered Payroll	UAAL (Funded Excess) As A Percentage Of Annual Covered Payroll
PERS						
July 1, 1999	$ 917.0	$ 842.7	$ (74.3)	108.8%	$ 397.7	(18.7)%
July 1, 2000	1,027.0	891.9	(135.1)	115.1%	409.0	(33.0)%
July 1, 2001	1,115.3	1,008.6	(106.7)	110.6%	433.3	(24.6)%
July 1, 2002	1,150.0	1,103.5	(46.5)	104.2%	461.3	(10.1)%
July 1, 2003	1,166.5	1,188.8	22.3	98.1%	479.5	4.7%
July 1, 2004	1,196.5	1,272.9	76.4	94.0%	501.0	15.3%
NDHPRS						
July 1, 1999	$ 32.0	$ 32.2	$ .2	99.4%	$ 4.5	4.4%
July 1, 2000	35.9	34.0	(1.9)	105.6%	4.7	(40.4)%
July 1, 2001	38.8	38.1	(0.7)	101.8%	4.9	(14.3)%
July 1, 2002	39.5	40.5	1.0	97.4%	5.1	19.6%
July 1, 2003	39.6	42.4	2.8	93.4%	5.4	51.9%
July 1, 2004	40.0	44.5	4.5	89.9%	5.4	83.3%
JSND						
July 1, 1999	$ 66.6	N/A*	$ -	N/A	$ 4.0	0.0%
July 1, 2000	71.0	N/A	-	N/A	3.7	0.0%
July 1, 2001	70.8	N/A	-	N/A	3.5	0.0%
July 1, 2002	67.6	N/A	-	N/A	3.2	0.0%
July 1, 2003	66.0	N/A	-	N/A	2.9	0.0%
July 1, 2004	67.5	N/A	-	N/A	2.5	0.0%
TFFR						
July 1, 1999	$ 1,053.1	$ 1,188.4	$ 135.3	88.6%	$ 314.6	43.0%
July 1, 2000	1,308.5	1,287.9	(20.6)	101.6%	323.0	(6.4)%
July 1, 2001	1,414.7	1,467.7	53.0	96.4%	342.2	15.5%
July 1, 2002	1,443.5	1,575.8	132.3	91.6%	348.1	38.0%
July 1, 2003	1,438.4	1,690.3	251.9	85.1%	367.9	68.5%
July 1, 2004	1,445.6	1,800.4	354.8	80.3%	376.5	94.2%

*The Frozen Initial Liability method does not directly identify an Actuarial Accrued Liability.

D. CONTRIBUTIONS REQUIRED AND CONTRIBUTIONS MADE

Employer contribution rates for PERS and NDHPRS are set by state statute using the entry age normal actuarial cost method. This method produces an employer contribution rate consisting of (1) an amount for normal cost, (2) an amount for amortization of the unfunded accrued liability over a period of 20 years for PERS and NDHPRS, and (3) the amount necessary to provide for operating expenses. Contribution rates for the Job Service Retirement Plan are established in the plan document, as amended, actuarially determined using the frozen initial liability actuarial cost method.

The contribution rate is not actuarially determined for TFFR; it is set by statutory law under the North Dakota Century Code 15-39.1-09. It is required that every eligible teacher be a member of the Fund and assessed at a rate of 7.75 percent of gross salary and that every governmental body employing a teacher pay into the plan a sum equal to 7.75 percent of the teacher's salary.

The following schedule presents, by retirement system, annual required contributions and the percentage contributed:

Schedule of Employer Contributions

	Annual Required Contribution	Percentage Contributed
PERS		
2002	$ 16,811,296	100.0%
2003	20,644,235	93.0%
2004	26,704,376	74.0%
TFFR		
2002	$ 27,243,542	100.0%
2003	28,850,725	100.0%
2004	29,635,584	86.7%

For NDHPRS and JSND, sole employer plans, the following schedule represents the annual pension costs and net pension obligations for the year ended June 30, 2004:

	NDHPRS	JSND
Annual required contributions	$ 940,629	$ -
Interest on net pension obligations	(71,944)	(133,787)
Adjustment to annual required contributions	62,763	137,546
Annual pension costs	931,448	3,759
Contributions made	844,241	-
Increase in net pension obligations	87,207	3,759
Net pension obligations, beginning of year	(899,304)	(1,672,335)
(Assets in excess of) net pension obligations, end of year	$ (812,097)	$ (1,668,576)

The following schedule presents the annual pension costs, the percentages contributed, and the net pension obligations:

	Annual Pension Costs (APC)	Percentage of APC Contributed	Net Pension Obligations
NDHPRS			
2002	$ 591,235	138%	(806,653)
2003	748,658	111%	(899,304)
2004	940,629	90%	(812,097)
JSND			
2002	$ 3,776	0%	(1,676,102)
2003	3,767	0%	(1,672,335)
2004	3,759	0%	(1,668,576)

E. DEFINED CONTRIBUTION PLAN

The North Dakota Defined Contribution Retirement Plan was established on January 1, 2000, and is administered in accordance with chapter 54-52.6 of the North Dakota Century Code. The Defined Contribution Plan covers state employees who are in positions not classified by the central personnel division of the State. Employees of the judicial branch or the Board of Higher Education and state institutions under the jurisdiction of the Board of

Higher Education are not eligible to participate in the Defined Contribution Plan. The Defined Contribution Plan had 295 participants as of June 30, 2004.

Upon the death of a participating employee or former participating employee, the vested account balance of that deceased participant is available to the participant's designated beneficiary(ies). An employee who becomes totally and permanently disabled while employed by the State is eligible to receive a distribution of the vested account balance. To qualify under this section, the employee must meet the criteria established by the System for being totally disabled.

Employees are entitled to their vested account balance. A participating employee is immediately 100% vested in the employee's contributions. A participating employee vests in the employer contributions made on the employee's behalf as follows:

Upon completion of two years of service	50%
Upon completion of three years of service	75%
Upon completion of four years of service	100%

Employees may elect to receive their account balance in a lump sum, lump sum direct rollover, or periodic distribution.

Contributions are set by state statute and are a percentage of salaries and wages. Employee contributions are established at 4%, and employer contributions are established at 4.12% of regular compensation. Employer and employee contributions totaled $498,224 and $483,713 respectively, for the fiscal year ended June 30, 2004.

The Board, or vendors contracted by the Board, have exclusive authority to invest and manage the assets of the Defined Contribution Retirement Plan. State statute allows each participating employee to direct the investment of the individual's employer and employee contributions and earnings to one or more investment options within the available categories of investment as established by the Board. The following investments represent 5% or more of net plan assets at June 30, 2004:

Fidelity Managed Income Portfolio Mutual Fund	21.57%
Fidelity Growth Company Mutual Fund	13.51%
Fidelity Freedom 2020 Mutual Fund	10.63%
Fidelity Equity Income	7.30%
Fidelity Spartan U.S. Equity Index	6.60%
PIMCO Total Return Admin. Mutual Fund	5.00%
Fidelity Diversified International Mutual Fund	7.14%

F. TEACHERS' INSURANCE ANNUITY ASSOCIATION

The Teachers' Insurance and Annuity Association (TIAA-CREF), a privately-administered defined contribution retirement plan, provides individual retirement fund contracts for eligible employees as defined by the Board of Higher Education in its approved TIAA-CREF retirement resolution. All benefits vest immediately to the participant. Further information can be obtained by writing to TIAA-CREF, Denver Regional Office, 1700 Broadway, Suite 770, Denver, Colorado 80290 or by calling 800-842-2009.

Employees are eligible for retirement benefits after attaining the age of 65, which is payable periodically for life. All benefits vest immediately to the participant. The plan requires employee and employer contributions be based on a classification system and years of service based on the schedule shown below.

Employment Class	Years Of Service	By The Participant	By The Institution	Total
I and III	0 thru 10	1.50%	9.50%	11.00%
	over 10	2.00%	10.00%	12.00%
II	0 thru 2	0.50%	4.50%	5.00%
	3 thru 10	1.50%	9.50%	11.00%
	over 10	2.00%	10.00%	12.00%
IV	0	1.00%	9.00%	10.00%

Plan contributions are made on a tax-deferred basis in accordance with section 414(h)(2) of the Internal Revenue Code. All contributions are applied as premiums to retirement annuity contracts owned by the participant. The State has no further liability once annual contributions are made. The State contributed $17,962,691 to TIAA-CREF during the fiscal year ending June 30, 2004.

NOTE 5 - POST-RETIREMENT BENEFITS

The Retiree Health Insurance Credit Fund is administered by the North Dakota Retirement Board (the Board) to provide members receiving retirement benefits from the Public Employees Retirement System (which includes judges retired under NDCC 27-17), the Highway Patrolmen's Retirement System, the Defined Contribution Retirement Plan, and the Retirement Plan for employees of Job Service North Dakota a credit toward their monthly health insurance premium under the state health plan based upon the member's years of credited service. The Retiree Health Insurance Credit Fund is advance-funded on an actuarially determined basis.

The employer contribution for the Public Employees Retirement System, the Highway Patrolmen's Retirement System, and the Defined Contribution

Retirement Plan is set by state statute on an actuarially determined basis at one percent of covered compensation. The employer contribution for the Supreme and district court judges is one percent of covered compensation in order to extend this benefit to judges retired under NDCC 27-17. The employer contribution for non-teaching employees of the Office of the Superintendent of Public Instruction is 3.1 percent of covered compensation beginning in the month following the transfer under chapter 54-92-02.13 of the North Dakota Century Code and continuing thereafter for a period of eight years. Job Service North Dakota reimburses the Retiree Health Insurance Credit Fund monthly for credit received by members of the retirement program for employees of Job Service North Dakota. Employees participating in the retirement plan as part-time/temporary members are required to contribute one percent of their covered compensation to the Retiree Health Insurance Credit Fund. Employees purchasing previous service credit are also required to make an employee contribution to the Fund.

Retiree health benefits are set by state statute. There are no provisions or policies with respect to automatic and ad hoc post-retirement benefit increases. Employees who are receiving monthly retirement benefits from the Public Employees Retirement System (which includes judges retired under NDCC 27-17), the Highway Patrolmen's Retirement System, the Defined Contribution Retirement Plan, or the Retirement Plan for employees of Job Service North Dakota, are eligible to receive credit toward their monthly health insurance premium under the state health plan. The benefits are equal to $4.50 for each of the employee's years of credited service not to exceed the premium in effect for selected coverage. Total Job Service expenditures for their pay-as-you-go plan was $207,779 for the period ending June 30, 2004. The number of employees from Job Service using the credit was 154 at June 30, 2004. The retiree health benefit is also available for early retirement with reduced benefits.

Death and disability benefits are set by state statute. An employee receiving disability benefits, or the spouse of a deceased annuitant receiving a surviving spouse benefit, are eligible to receive a credit toward their monthly health insurance premium under the state health plan. The benefits are equal to $4.50 for each of the employee's or deceased employee's years of credited service, not to exceed the premium in effect for selected coverage.

Actuarial valuations of the Fund were done as of June 30, 2004. The actuarial cost method used is the Projected Unit Actuarial Credit Cost Method. The significant actuarial assumptions used to determine funding requirements are (a) a rate of return on the investment of present and future assets of 8.0 percent, (b) inflation at 4.50 percent per annum, (c) pre- and post-mortality life expectancies of participants based upon 1983 Group Annuity Mortality Tables and the PBGC's Disabled Life Mortality Tables, (d) rates of withdrawal from active service before retirement for reasons other than death, rates of disability, and expected retirement ages developed on the basis of actual plan experience, and (e) administrative expenses of $65,000 per year. Plan assets are valued, for actuarial purposes, using a five-year smoothed market method.

The following are the changes in actuarial assumptions, asset method and plan experience and the effect on the employee's contribution rates expressed as a percent of covered payroll, and the dollar effect on the actuarial accrued liability:

	As a Percentage of Covered Payroll	Dollar Effect
Changes in plan experience during the year	(.01)%	$ (51,852)

Employer contributions totaling $4,854,949 were made for the year ended June 30, 2004. The actuarially required employer contribution of $5,139,793 for the year ended June 30, 2004, is 0.99 percent of the covered payroll and reflects the fact that the statutory rate of one percent is sufficient to cover future costs of the Fund. At June 30, 2004, the cost of benefits incurred for the fund was $4,063,395.

Employee membership is as follows:

Retirees receiving benefit	3,607
Active participants	18,017
Total Membership	21,624

According to the Projected Unit Credit Cost Method, the actuarial accrued liability and the unfunded actuarial accrued liability of the Retiree Health Insurance Credit Fund are as follows:

Actuarial accrued liability	$ 74,589,006
Net assets available for benefits, at actuarial value	(28,949,717)
"Unfunded" accrued liability	$ 45,639,287

The fair value of the net assets available for benefits at June 30, 2004, is $30,163,400.

NOTE 6 - DEFERRED COMPENSATION PLAN

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits them to defer a portion of their current salary until future years. Participation in the plan is optional. The deferred compensation is not available to the employees until termination, retirement, death or unforeseeable emergency.

All compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property or rights, are held in trust for the exclusive use of the employee or their beneficiary.

The related assets of the plan, held in trust, are reported at fair value as follows (expressed in thousands):

Plan Participation By:	
State of North Dakota	$ 11,684
Other Jurisdictions	2,605
Total Value	$ 14,289

NOTE 7 - PERS UNIFORM GROUP INSURANCE PROGRAM

The PERS Uniform Group Insurance Program, an enterprise fund, contracts with Blue Cross Blue Shield of North Dakota (BCBS) to provide health care insurance to the employees of the State of North Dakota, or any of its political subdivisions, institutions, departments or agencies. The contract provides for an accounting of premiums paid and claims incurred during the biennium. In accordance with the term of the contract for the 2001-2003 biennium, the system is to deposit a total of $3 million with BCBS. These surplus funds are to be used to pay any claims in excess of the premiums collected. At the end of the contract period, the system receives the remaining surplus funds plus interest. This amount will be determined as of June 30, 2005. The System has entered into a similar contract with BCBS for the 2003-2005 biennium. The accumulated surplus and other invested funds in the amount of $3,267,756 are shown as cash on the state's financial statements. These funds are being held by BCBS.

Similarly, the PERS Uniform Group Insurance Program contracts with ReliaStar Life Insurance Company to provide life insurance to the employees of the State of North Dakota or any of its political subdivisions, institutions, departments or agencies. The contract provides for an accounting of premiums paid and claims incurred during the biennium, with any surplus shared according to a formula outlined in the contract.

NOTE 8 - SEGMENT INFORMATION

North Dakota Housing Finance Agency maintains three separate funds which account for general agency operations and provide loans to finance construction of rental residential housing and single-family ownership. The three funds are accounted for in a single fund, but investors in the multi-family and home ownership bonds rely solely on the revenue generated by the mortgage loans and assets acquired for repayment. Segment information for the year ended June 30, 2004, was as follows (expressed in thousands):

	Multi-family Bond Funds	Home-Ownership Bond Funds
Condensed Statement of Net Assets		
Current assets – other	$ 2,194	$ 154,914
Noncurrent assets – other	8,372	499,315
Total Assets	10,566	654,229
Current liabilities – other	478	27,206
Noncurrent liabilities – other	9,703	581,951
Total Liabilities	10,181	609,157
Net assets – restricted	385	45,072
Total Net Assets	$ 385	$ 45,072
Condensed Statement of Revenues, Expenses and Change in Fund Net Assets		
Operating revenues	$ 663	$ 36,661
Operating expenses	667	33,797
Operating income (loss)	(4)	2,864
Change in net assets	(4)	2,864
Total net assets, beginning of year	389	39,825
Total net assets, end of year	385	45,072

	Multi-family Bond Funds	Home-Ownership Bond Funds
Condensed Statement of Cash Flows		
Net cash from operating activities	2,390	79,686
Net cash used for noncapital financing activities	(889)	(106,685)
Net cash from investing activities	246	1
Net change in cash and cash equivalents	1,747	(26,998)
Cash and cash equivalents, beginning of year	403	165,030
Cash and cash equivalents, end of year	2,150	138,032

NOTE 9 - MAJOR COMPONENT UNIT TRANSACTIONS

NORTH DAKOTA STATE UNIVERSITY AND NDSU RESEARCH AND TECHNOLOGY PARK, INC.

On December 30, 1999, North Dakota State University, through the State of North Dakota and North Dakota State Board of Higher Education, entered into a ground lease, whereby the NDSU Research and Technology Park, Inc. leases 40 acres of land for $1 per year for the next seventy-five years.

On November 1, 2000, NDSU Research and Technology Park, Inc. (RTP) entered into a $6.5 million lease agreement with the City of Fargo to finance the construction of laboratory and research facilities and all equipment and furnishings located on Lot 1, Block 2, Research and Technology Park First Addition to the City of Fargo (Research Building #1). Article IV, Section 4.12 of that agreement assigned to NDSU all of NDSU Research and Technology Park's obligations under the lease, including but not limited to the payment of all basic rent and additional rent, maintenance of all insurance required under the lease, and restrictions of use of the project set forth in the lease. Under the terms of Exhibit B, Assignment of Lease to the aforementioned lease agreement, ". . . that upon payment of all the Bonds, title to the Facility will revert to the Company." (Company is defined in the lease as NDSU Research and Technology Park, Inc.) Because of the lease assignment, NDSU accounted for this as a capital lease in fiscal year 2002. Beginning in fiscal year 2003, NDSU converted the classification of the debt to bonds payable.

ON August 1, 2002, essentially the same legal and financial structure used to construct Research Building #1 was used to construct a second research building. The new lease agreement was for $20,450,000. NDSU is reporting the related assets and debt in its fiscal year 2004 financial statements.

The audited financial statements for fiscal years 2003 and 2004 of the RTP report these transactions as an operating lease and report the related capital assets and related debt as assets and debt of RTP. Since the RTP is a discretely presented component unit of the University System and the component unit and the University System are reporting the same assets and debt for Research Buildings 1 and 2, fiscal year 2004 beginning balances are restated and an elimination entry is made to ending balances in the component unit's consolidating financial statements to avoid duplication.

NDSU and RTP have entered into an operating agreement, whereby NDSU leases Research Building #1 for an annual rent of $628,943 and Research Building #2 for $165,370 (through June 2005, then annual rent of $1,525,963 through July 2013) plus utilities and insurance. Total payments under these agreements in fiscal year 2004 were approximately $1,047,405. These agreements are subject to funding and legislative appropriations. A receivable from NDSU for $282,432 is recorded at June 30, 2004, for amounts due under these agreements.

NORTH DAKOTA STATE UNIVERSITY AND NDSU DEVELOPMENT FOUNDATION

NDSU Equine Science Center

Effective January 1, 2003, NDSU and the NDSU Development Foundation entered into a ten-year lease agreement with an option for an additional ten-year term to facilitate the building of an Equine Science Center. Under the agreement, NDSU will pay rent to NDSU Development Foundation for use of the premises. The amount of the rent is tied to the debt service retirement plus necessary insurance and taxes incurred by the Development Foundation. NDSU paid the Development Foundation $178,576 in fiscal year 2004 and has a payable of $11,678 at June 30, 2004, under this agreement.

As of June 30, 2004, construction of the facility was complete, and the facility is included in capital assets and the debt is included in long-term liabilities on the financial reports of the NDSU Development Foundation. NDSU has also recorded a capital asset and a capital lease payable of $4,355,000 as of June 30, 2004. Since the Development Foundation is a discretely presented component unit of the North Dakota University System, and the component unit and the University System are reporting the same assets and debt for the Equine Center, an elimination entry is made to ending balances in the component unit's consolidating financial statements to avoid duplication.

UNIVERSITY OF NORTH DAKOTA AND UND AEROSPACE FOUNDATION

The Foundation reimbursed UND for salaries, building rent, aircraft rental, and goods and services under an operating agreement aggregating approximately $2,225,579 in fiscal year 2004. This operating agreement has no specific term and is intended to memorialize various operating agreements, rate structures, duties, and obligations each party has to the other. The Foundation also reimbursed UND for air service and hangar, CRJ, 360-degree tower, and aircraft rental of $941,356. These expense reimbursements represent actual costs incurred.

UNIVERSITY OF NORTH DAKOTA AND RE ARENA, INC.

RE Arena, Inc. manages, operates, and maintains an arena known as the Ralph Engelstad Arena, which was constructed in 2001 for the benefit of UND athletics. On July 1, 2003, UND and RE Arena, Inc., entered into a usage agreement with regards to the arena that sets forth facility usage, fees and services, and net income disposition. This agreement expired on June 30, 2004, but a similar agreement was signed effective July 1, 2004. In accordance with this agreement, UND will control all ticket revenue from UND athletic events held in the arena, UND and RE Arena, Inc. will jointly utilized UND marketing staff, and UND agrees to pay RE Arena, Inc. a stated amount of the ticket revenue from hockey, football, and men's and women's basketball events. Revenue and expenses from all other UND events held at the arena will be negotiated on an event-by-event basis. Per this agreement, UND paid approximately $1.37 million to RE Arena, Inc. in fiscal year 2004 for event ticket revenue. Also per the agreement, RE Arena, Inc. will annually fund a reserve for extraordinary repairs, maintenance, and building improvements in an amount up to $350,000. And, on an annual basis, RE Arena, Inc. will remit to UND the net income after adding back depreciation, amortization, the funded reserve and capital expenditures for the fiscal year.

In addition, RE Arena, Inc. may contract with UND for materials and personnel in the service and utility areas and will reimburse UND based on separate agreements. As of June 30, 2004, RE Arena, Inc. has a payable to UND of $260,078 for these expenditures.

UNIVERSITY OF NORTH DAKOTA AND UNIVERSITY OF NORTH DAKOTA FOUNDATION

The University of North Dakota Foundation issued through Wells Fargo Brokerage Services, LLC, tax-exempt lease revenue bonds on October 24, 2003, of $4,400,000 to finance the land purchase and construction of the Minot Family Practice Center. The center is a component of the School of Medicine & Health Sciences at UND. Interest only is due on a semi-annual basis at a variable rate of interest with a maturity date of December 15, 2018. The initial interest rate was 1.95 percent. Effective June 15, 2004, the interest rate was reset at 2.02 percent. The Foundation may pay down principal in increments of $100,000 on interest payment dates without penalty. A total of $100,000 in principal was retired in fiscal year 2004.

On July 1, 2002, UND Foundation issued lease revenue bonds of $8,595,000 on behalf of UND to 1) finance the construction of an office building for EERC, 2) renovate the current EERC building, 3) finance capitalized interest, and 4) pay cost of issuance of the bonds. UND and UND Foundation also entered into a lease agreement on July 1, 2002, whereby the foundation leases certain property to UND and UND will pay the Foundation basic rents which will be sufficient to cover principal and interest on the lease revenue bonds when due. The bonds bear an interest rate of 2 to 5.13 percent and mature in 2027. The lease revenue bond has a balance of $8,370,000 at June 30, 2004. The Foundation's financial statements include this transaction as a receivable from UND and a long-term liability. UND's financial statements include the capitalized asset and a long-term liability due to UND Foundation.

UND leases office space to the UND Foundation at a cost of $1 per year and provides some administrative services, computer services, utilities and maintenance at no cost as a partial in-kind reimbursement for services rendered by the Foundation. Lease on the office, dated November 1, 1979, has a term of five years remaining. At June 30, 2004, due to timing of receipts and payments, the UND Foundation recorded a payable of $536,698 to UND, which was paid in full in July.

NOTE 10 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

BANK OF NORTH DAKOTA

The State, through the Bank of North Dakota, is a party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit and financial standby letters of credit. Those instruments involve varying degrees of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the State has in particular classes of off-balance-sheet financial instruments.

The State's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and financial standby letters of credit is represented by the contractual amount of those instruments. The State uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

		Contract Amount (in thousands)
Commitments to extend credit	$	237,582
Financial standby letters of credit		124,636
	$	362,218

Commitments to extend credit are agreements to lend as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The State evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained by the State upon extension of credit is based on management's credit evaluation of the customer. Collateral held may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Financial standby letters of credit are conditional commitments issued by the State to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The likelihood of funding any of these letters of credit is considered to be remote.

NORTH DAKOTA HOUSING FINANCE AGENCY

In the normal course of business, the Agency makes various commitments that are not reflected in the financial statements. These include commitments to extend credit and the debt reduction required when related loan acquisition funds are not drawn down within prescribed time frames set by the specific bond resolution.

Commitments to extend credit are agreements to fund loans as long as there is no violation of any condition established in the contracts. Commitments require the payment of a reservation fee and generally have a fixed expiration date. Commitments to extend credit total $28,864,000 at June 30, 2004. The Agency does not anticipate any material losses as a result of these commitments.

The bond resolutions require that the funds in the loan acquisition accounts be expended within 42 months of the related bond delivery date. Any remaining funds must be used for debt reduction. The loan acquisition funds totaled $32,866,000 at June 30, 2004.

MUNICIPAL BOND BANK

In the normal course of business, the Bond Bank (a component unit) makes various commitments that are not reflected in the financial statements. These commitments include commitments to extend credit of $26,721,000 at December 31, 2003.

COMMUNITY WATER FACILITY LOAN FUND

The Fund is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Commitments to extend credit totaled $661,700 as of December 31, 2003.

NOTE 11 - INTEREST RATE SWAP

NORTH DAKOTA HOUSING FINANCE AGENCY

As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance, the Agency entered into several interest rate swaps in connection with various variable-rate housing bond series. The intention of these swaps was to effectively change the Agency's interest rate on the bonds to a fixed rate.

The bonds and the related swap agreements have a stated maturity date, and the swap's notional amounts match the amount of variable-rate bonds. Under the swaps, the Agency pays the counterparty a fixed payment and receives a variable payment computed as a percent of the London Interbank Offered Rate (LIBOR) plus a fixed percentage. On the other hand, the bond's variable-rate coupons are determined by the remarketing agent. If, for any reason, the remarketing agent fails to act, the rate shall be the lesser of (i) the TBMA (Bond Market Association) Index plus 0.25% or (ii) the Maximum rate as defined within the applicable series resolution. The Agency did not disburse any funds to enter into these swap agreements.

As of June 30, 2004, the Agency is exposed to credit risk on the swaps that have a positive fair value, which total $468,309. Of the swaps with negative fair value, the Agency is not exposed to credit risk. However, the swap exposes the Agency to basis risk should the relationship between LIBOR and TBMA converge, changing the synthetic rate on the bonds. The swap counterparty has guaranteed all payments and is rated AA+/AA-/AA by Moody's Investor Services, Standard & Poor's, and Fitch, respectively. To mitigate potential credit risk, the counterparty has entered into a Credit Support Agreement with Citigroup Global Marketing as a credit enhancement.

Due to the difference among the variable rate indices, the swaps had a net negative fair value of $1,109,537 as of June 30, 2004. The swap's negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating a lower synthetic fixed interest rate. Because the coupons on the government's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. All valuations are as of the valuation date indicated. Mid-Market or indicative unwind valuations may be derived from broker quotations or from proprietary models that take into consideration estimates about relevant present and future market conditions as well as the size and liquidity of the position and any related actual or potential hedging transactions. Valuations based on other models or different assumptions may yield different results.

As noted above, the swap exposes the Agency to basis risk should the relationship between LIBOR and the actual variable rates converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate and the synthetic rate as of June 30, 2004. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized.

The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedule to the Master Agreement includes an "additional termination event." That is, the swap may be terminated if counterparty's credit quality rating falls below "A3" as issued by Moody's Investors Service or "A-" as issued by Fitch Ratings or Standard & Poor's. The swap may be terminated at any time by the Agency or the counterparty with 30 days' written notice up to limits specified in the swap agreement. If the swap or swaps were terminated, the variable-rate bonds would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the Agency would be liable to the counterparty for payment equal to the swap's fair value, but in the event the fair value is positive, the counterparty would be liable to the Agency.

1.	Bond Series	2002 B	2002 B	2003 A	2003 A
2.	Issuance Date	8/28/02	8/28/02	5/14/03	5/14/03
3	Maturity Date	1/1/34	7/1/11	7/1/34	1/1/12
4.	Notional Amount	$ 17,595,000	$ 6,120,000	$ 14,120,000	$ 8,355,000
5.	Variable-rate Bonds	$ 17,595,000	$ 6,120,000	$ 14,120,000	$ 8,355,000
6.	Fixed Rate	4.470%	2.940%	4.035%	2.463%
7.	LIBOR Percentage	68.70%	70.60%	62.50%	62.50%
8.	Additional Percentage	0.00%	0.00%	0.44%	0.44%
9.	Bonds Variable-rate	1.10000%	1.10000%	1.11000%	1.11000%
10.	Fair Value	$ (645,453)	$ (91,308)	$ 103,749	$ 111,455
11.	Percentage of LIBOR	0.94033%	0.96634%	1.29547%	1.29547%
12.	Synthetic Rate	4.62967%	3.07366%	3.84953%	2.27538%
13.	Actual Synthetic Rate	4.70040%	3.15130%	3.89757%	2.32603%

1.	Bond Series	2003 B	2003 B	2004 B	2004 B
2.	Issuance Date	8/27/03	8/27/03	4/1/04	4/1/04
3	Maturity Date	1/1/12	7/1/34	1/1/13	7/1/35
4.	Notional Amount	$ 8,190,000	$14,205,000	$ 11,735,000	$12,990,000
5.	Variable-rate Bonds	$ 8,190,000	$14,205,000	$ 11,735,000	$12,990,000
6.	Fixed Rate	3.155%	4.530%	2.620%	3.980%
7.	LIBOR Percentage	64.00%	64.00%	63.00%	63.00%
8.	Additional Percentage	0.365%	0.365%	0.34%	0.34%
9.	Bonds Variable-rate	1.11000%	1.11000%	1.11000%	1.11000%
10.	Fair Value	$ (124,603)	$ (716,482)	$ 180,483	$ 72,622
11.	Percentage of LIBOR	1.24100%	1.24100%	1.20231%	1.20231%
12.	Synthetic Rate	3.02400%	4.39900%	2.52769%	3.88769%
13.	Actual Synthetic Rate	3.11563%	4.49063%	2.66663%	4.02663%

Using rates as of June 30, 2004, debt service requirements of the variable-rate debt and new swap payments are as follows. Interest calculations were based on rates as of June 30, 2004. As rates vary, variable-rate bond interest payments and net swap payments will vary. (Expressed in thousands.)

	Variable-Rate Bond			
Fiscal Year Ending June 30	Principal	Interest	Interest Rate Swap, Net	Total
2005	$ 1,750	$ 1,023	$ 2,362	$ 5,135
2006	3,395	992	2,316	6,703
2007	4,995	940	2,242	8,177
2008	5,410	880	2,157	8,447
2009	5,165	822	2,074	8,061
2010-2014	14,080	3,458	9,449	26,987
2015-2019	-	3,261	9,180	12,441
2020-2024	1,335	3,252	9,154	13,741
2025-2029	22,955	2,536	7,124	32,615
2030-2034	29,040	1,058	2,956	33,054
2035-2039	5,580	15	39	5,634
	$ 93,705	$ 18,237	$ 49,053	$ 160,995

NOTE 12 – SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Most of the State's business is with customers within the state. Concentrations of credit are present in the construction and operation of community water facilities, developmentally disabled facilities, loans to students for post-secondary education, single-family and multifamily mortgage loans, and the agricultural industry. Due to the pervasive nature of agriculture in the economy of the state, all loans, regardless of type, are impacted by agriculture.

NOTE 13 – RISK MANAGEMENT

Several funds accumulate assets to cover risks that the State may incur. Specifically, the State assumes a portion or substantially all risks associated with the following:

THE STATE FIRE AND TORNADO FUND

The State Fire and Tornado Fund, an Enterprise Fund, is financed by premiums charged to the participating funds of the State. All monies collected must be paid into the fund for use only for the purpose outlined in NDCC 26.1-22.02.

All losses occasioned by the hazards provided for in the North Dakota Century Code must be paid out of the fund, with the fund being reimbursed by a third-party insurance carrier for all losses in excess of $1,000,000 per occurrence. The limit of liability of such reinsurance contract is no less than $1,000,000 during each twelve month period.

STATE BONDING FUND

The State Bonding Fund, an Enterprise Fund, is financed by premiums charged to each State agency for the bonding of public employees and public officials.

FLEET SERVICES

Fleet Services, an Internal Service Fund, represents the State's fleet of automobiles and is administered by the Department of Transportation. The State is self-insured for substantially all automobile insurance (e.g., comprehensive, collision), with the exception of liability, which is provided by the State's Risk Management Fund (RMF). State agencies are charged premiums to cover Fleet Service's RMF assessment and to pay for those losses which are not covered by RMF. These premium charges are factored into the fees agencies are charged when renting the cars.

WORKFORCE SAFETY & INSURANCE

Workforce Safety & Insurance (WSI), an Enterprise Fund, is a State insurance fund and a "no fault" insurance system, covering the State's employers and employees. WSI is financed by premiums assessed to employers. The rate of such premiums is periodically adjusted to assure the solvency of WSI. The premiums are available primarily for the payment of claims to employees injured in the course of employment. During fiscal year 2003, a total of $105,131,905 in claims was recognized. Incurred but not reported claims of $604,100,000 have been accrued as a liability based primarily upon actuarial estimates.

RISK MANAGEMENT FUND

Due to the loss of sovereign immunity, the 1995 Legislature established the Risk Management Fund

(RMF) to pay money damages for tort claims for which the State is liable. The statutory liability of the State is limited to a total of $250,000 per person and $1,000,000 per occurrence. The State purchases commercial insurance for claims in excess of coverage provided by the Fund and continues to transfer liabilities for medical malpractice and aviation to private insurance carriers. Settlements have not exceeded insurance coverage in any of the past three fiscal years.

Revenues to the RMF are generated from contributions required from state agencies, boards and commissions, and the University System. The need for and amount of funding is determined using a projected cost allocation approach. The premise of this plan is that the agencies with greater expected loss costs should contribute more to the funding of the RMF than those agencies with lessor costs. The underlying logic is that contributions should roughly equal loss costs plus the expenses of administering the program over the long term.

The RMF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Unpaid claim liabilities are based on an actuarial study of the outstanding loss reserve need for the fund and a forecast of ultimate loss and loss expense. These liabilities were determined on an undiscounted expected level of ultimate loss. Because actual claims liabilities are affected by complex factors including inflation, changes in legal doctrines, and unanticipated damage awards, the process used in computing claims liabilities does not necessarily result in exact amounts. Claims liabilities will be re-evaluated periodically to take in consideration settled claims, the frequency of claims, and other economic and social factors.

The following table presents the changes in claims liabilities balance for the fiscal years ending June 30, 2003, and June 30, 2004:

Fiscal Year	Beginning Balance	Current Year Claims and Changes In Estimates	Claims Payments	Ending Balance
2003	$ 2,537,631	$ 1,210,045	$ 765,415	$ 2,982,261
2004	2,982,261	547,972	769,932	2,760,301

The Risk Management Workers Compensation Program (WCP) was established to consolidate all state entities under one workers compensation account, allowing for transitional duty between entities. The statutory liability of the fund is limited to $100,000 per claim with Workforce Safety & Insurance, providing excess insurance for claims which exceed the $100,000 cap. WCP pays separately for this coverage. Since the inception of WCP on July 1, 2001, five claims exceeded coverage by $315,854.

Revenues to WCP are generated from contributions required from state agencies, boards, commissions, and the University System. The amount contributed from each agency is actuarially determined by Workforce Safety & Insurance and based upon the number of employees, the type of work done, and claims history of each entity. Each entity also pays a deductible of $250 per claim.

The WCP liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities are affected by complex factors including inflation, changes in legal doctrine, and unanticipated damage awards, the process used in computing claims liabilities does not necessarily result in exact amounts. Claims liabilities will be re-evaluated periodically to take into consideration settled claims, the frequency of claims, and other economic and social factors. An actual study was performed for Workforce Safety & Insurance. The liability estimates are based on that study.

The following table presents the changes in claims liabilities balance for the fiscal year ending June 30, 2004:

Fiscal Year	Beginning Balance	Current Year Claims and Changes in Estimates	Claims Payments	Ending Balance
2003	$ 491,170	$ 1,864,658	$ 1,009,070	$ 1,346,758
2004	1,346,758	2,368,743	1,416,845	2,298,656

NOTE 14 – PUBLIC ENTITY RISK POOLS

A. GENERAL

FIRE AND TORNADO AND BONDING FUND

The Fire and Tornado Fund provides property insurance to state agencies, political subdivisions, the International Peace Garden and the winter show. The Fire and Tornado Fund has issued 1,087 policies to participating entities for a total building and content coverage of $5.7 billion. The Bonding Fund is used to provide fidelity bonding of public employees and officials. The Fund has issued 2,922 policies to participating entities. The total coverage for the Bonding Fund is $580.7 million. If the assets of these funds were exhausted, fund participants would not be responsible for the funds' liabilities.

The Fire and Tornado and Bonding Fund are accounted for on the accrual basis. The Fire and Tornado Fund establishes claim liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims incurred but not reported. The Bonding Fund establishes claim liabilities based on actual judgments obtained against the fund but not paid prior to fiscal year end. Liabilities for incurred but not reported losses have not been established as they are not expected to be material amounts. Neither fund incurred any acquisition costs which should have been capitalized, nor were any liabilities recognized that were discounted. Investment income was not considered in determining the existence of premium deficiencies.

The Fire and Tornado Fund uses reinsurance agreements to reduce its exposure to large losses on all types of its insured events. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Fund as direct insurer of the risks that are reinsured. The Fire and Tornado Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by reinsurers.

WORKFORCE SAFETY & INSURANCE

Workforce Safety & Insurance (WSI), an Enterprise Fund, is a state insurance fund and a "no fault" insurance system covering the State's employers and employees. At June 30, 2004, coverage extended to the following employers:

Annual Premium	
$125 - $5,000	16,366
$5,001 - $50,000	2,507
$50,001 - $100,000	211
Over $100,000	156
Total Employers	19,240

WSI is financed by premiums assessed to the employers of North Dakota. The premiums are available primarily for the payment of claims to employees injured in the course of employment.

The operations of WSI are accounted for on the accrual basis. Liability for incurred but not reported and incomplete claims and claims expense is estimated by WSI's actuary. The estimate is developed by WSI's actuary, taking into consideration past experience of WSI in paying claims, and general conditions of the environment in which WSI operates. The liability includes estimates of costs to settle individual claims which have been reported, plus a provision for losses incurred but not yet reported and includes the effects of inflation and other societal and economic factors. WSI records the liability at a discounted amount.

As adjustments to this estimated liability become necessary, such adjustments are reflected in current operations. Management believes the estimated liability for losses and loss adjustment expense is sufficient to cover the ultimate net cost of incurred claims, but such reserves are necessarily based on estimates and the ultimate liability may be greater or less than the amounts estimated.

For the year ended June 30, 2004, the actuary presented an estimate in the form of a range to emphasize the uncertainty for the estimated liability of WSI. These ranges are as follows (expressed in thousands):

	Low	Expected Value	High
Full Value Basis (undiscounted)	$ 990,000	$ 1,098,000	$ 1,265,000
Discounted at 6% rate	*	604,100	695,000

*Not computed by actuary.

WSI has adjusted the estimated liability for unpaid loss and loss adjustment expense to the actuary's six percent discounted expected value of $604.1 million at June 30, 2004.

The June 30, 2003, liability of $577.5 million was also recorded at the discounted rate of six percent.

While management has recorded amounts that fall within the ranges of estimated liabilities as computed under actuarial assumptions, the high level of uncertainty indicates that actual losses and expenses could be materially higher than the recorded estimated liability.

WSI did not incur any acquisition costs which should have been capitalized at June 30, 2004.

B. RECONCILIATION OF CLAIMS LIABILITIES

The following is a reconciliation of total claims liabilities, including an analysis of changes in aggregate liabilities for claims and claim adjustment expenses for the current fiscal year and the prior year (expressed in thousands):

	Fire And Tornado		Bonding		Workforce Safety & Ins	
	2004	2003	2004	2003	2004	2003
Unpaid claims and claims adjustment expenses at the beginning of the year	$ 1,451	$ 7,069	$ 366	$ 126	$ 577,500	$ 500,800
Incurred claims and claims adjustment expenses:						
Provision for current fiscal year	135	(2,523)	254	259	102,850	92,605
Change in provision for prior fiscal year	-	-	-	-	31,645	133,442
Payments and claims and adjustment expenses attributable to:						
Current fiscal year insured events	227	3,974	85	107	(20,379)	(18,586)
Prior fiscal years' insured events	(1,451)	(7,069)	(366)	(126)	(65,216)	(60,761)
Total Payments	(1,224)	(3,095)	(281)	(19)	(85,595)	(79,347)
Change in provision for discount	-	-	-	-	(22,300)	(70,000)
Total unpaid claims and claims adjustment expenses at the end of the year	$ 362	$ 1,451	$ 339	$ 366	$ 604,100	$ 577,500

NOTE 15 – SCHOOL PERMANENT TRUST FUND

State law permits the permanent fund to use one-tenth of the realized gains and losses in the current and previous years to be included in its calculation of income available for distribution in the current year. When determining the amount of distribution from any of the permanent educational trusts, the board of the permanent fund must consider both preservation of trust corpus and its ability to produce income for future years and the demands for distribution of current income. Any realized gains and losses that are spent must be spent for the purposes for which the trust was established.

Any income in excess of the amount of distribution for the current year can be acted on in one of three ways by the board of the permanent fund:

1. Distribute to the fund beneficiary all or a portion of the income in excess of the previous fiscal year's distribution;
2. Retain for distribution in future years all of a portion of the income in excess of the preceding fiscal year's distribution in an amount not to exceed $10 million; or
3. Add to the permanent fund all or a portion of the income in excess of the preceding fiscal year's distribution.

At June 30, 2004, realized gains and losses available for distribution in the current year totaled $8,971,463 for the permanent educational trusts. This amount is included in Reserved Fund Balances—Undistributed Revenue in the governmental funds balance sheet.

NOTE 16 – BANK OF NORTH DAKOTA

GASB Statement No. 34 requires assets and liabilities of enterprise funds be presented in a classified format to distinguish between current and long-term assets and liabilities. The Bank of North Dakota is the only government-owned bank in the United States. Banks do not present a classified balance sheet because current assets are not matched with current liabilities. Presentation of a classified balance sheet would give the false impression that there is a liquidity problem at the bank. Presentation of a classified balance sheet for the Bank of North Dakota would be misleading to the extent that the financial statements may be materially misstated. Therefore, the balance sheet of the Bank of North Dakota presents assets and liabilities in order of their relative liquidity, rather than in a classified format.

NOTE 17 - COMMITMENTS AND CONTINGENCIES

A. LONG-TERM COMMITMENTS

BANK OF NORTH DAKOTA

The 2003 North Dakota Legislature passed Senate Bill 2022, which included the statewide water development goals. In connection with these goals, the bill provides that a line of credit-contingent appropriation be made. If determined necessary by the State Water Commission, the Bank of North Dakota shall extend a line of credit, not to exceed $25,000,000 or so much of the sum as may be necessary, to the State Water Commission for the purpose of interim financing until bonds are issued under NDCC chapters 61-02 and 61-02.1 for the biennium beginning July 1, 2003, and ending June 30, 2005. As of December 31, 2003, Bank of North Dakota has not funded and has not committed to fund any amount under the line of credit.

The 2003 North Dakota Legislature passed House Bill 1321, which provides that the Bank of North Dakota may guarantee the loan of money by banks, credit unions, lending institutions that are part of the farm credit system, and savings and loan associations in this state to eligible persons for the purchase of agricultural real estate or the restructuring of agricultural real estate loans, provided the transactions do not exceed a loan-to-value ratio of 80%, and further provided that no single loan exceeds $400,000. The Bank of North Dakota may have no more than $5,000,000 in outstanding loan guarantees under this program. The Bank of North Dakota may guarantee up to 75% of the amount of principal due the lender. The guarantee term may not exceed five years. As of December 31, 2003, the Bank of North Dakota has not guaranteed or committed to guarantee any loans under this program.

The 2001 North Dakota Legislature passed Senate Bill 2349, which amended the Beginning Entrepreneur Loan Guarantee Program. The program provides that the Bank of North Dakota enters into an agreement with a lender that in the event of default by a beginning entrepreneur under a note and mortgage or other loan or financing agreement, the Bank of North Dakota shall pay the lender the amount agreed upon, which is 85 percent of the amount of principal due the lender on a loan at the time the claim is approved. A lender may apply to the Bank of North Dakota for a loan guarantee for a loan of up to $100,000. The term of the loan guarantee may not exceed five years. The Bank may provide guarantees totaling $3,400,000. As of December 31, 2003, the Bank has provided guarantees totaling $1,346,000 and has guarantee commitments of $32,000 included in commitments to extend credit.

STUDENT LOAN TRUST

The 2003 North Dakota Legislature also passed Senate Bill 2335, which permits the Bank of North Dakota to request from the Commission a transfer from the Trust to reimburse the Bank of North Dakota for any losses incurred from investments in North Dakota alternative and venture capital investments and early-stage capital funds up to $5,000,000. As of June 30, 2004, approximately $75,000 has been funded.

PACE FUNDS

The 2003 North Dakota Legislature passed House Bill 1021, Section 9, which provides that the Bank of North Dakota shall transfer $800,000 from the Agricultural PACE Fund to the main NDSU research center. The transfer may not be made until $1,000,000 of federal funds and $1,000,000 of special funds from private contributions have been collected for the establishment of a beef systems center of excellence.

RETIREMENT AND INVESTMENT OFFICE (RIO)

The North Dakota Retirement and Investment Office has entered into two contracts to implement a new pension administration software system for the North Dakota Teachers' Fund for Retirement. The contracts commenced March 1, 2004, and terminate June 30, 2005, and September 30, 2005. The approximate costs under these contracts for implementation of the new software is $1,707,875. RIO has budgeted $2.0 million for the implementation of this system. Other costs of the system not under contract include support from the Information Technology Department and other miscellaneous costs totaling $292,125. Fees paid under these contracts total $480,864 as of June 30, 2004.

INDUSTRIAL COMMISSION

In September of 2001, the Industrial Commission, as part of the Lignite Research, Marketing and Development Program—Vision 21, entered into a contract with Montana-Dakota Utilities/Westmoreland Power, Inc. (MDU) for a total of $10,000,000. The contract authorizes payments over a period of years based on completion of the required research and the construction of a new lignite-fired power plant in North Dakota. Payments made on the contract total $1,125,000. The contract contains a provision for payback to the Industrial Commission of $4.5 million over twenty years if new power plants are built and become operational. Total commitments under the contract would be reduced by $7,650,000 if the power plant is not constructed. In addition, the Commission entered into a contract on November 1, 2001, with Great Northern Power Development L.P. totaling $673,250. Payments totaling $464,226 have been made. On June 18, 2003, the Commission approved the issuance of a Phase II feasibility matching contract in the amount of $687,500. The Phase II contract is currently being negotiated.

The Commission also has various significant commitments at June 30, 2004, for the purchase of various types of services and other goods totaling $3,801,778.

MILL AND ELEVATOR

The Mill has entered into futures contracts for spring wheat to lock in a price for a future delivery or settlement period. These contracts are entered into to protect the Mill against price fluctuations of the commodity and are not reflected on the face of the financial statements. The price protection is needed to cover any long or short positions compared to flour sales. All trades are completed using two different national brokerage firms on the Minneapolis Grain Exchange. The following table shows the Mill's futures positions at June 30, 2004. One contract equals 5,000 bushels.

Futures Positions:

Month	Contracts Long	Contracts Short	Avg. Price	Fair Value
September	9	-	$ 3.883	$ 3.885
December	-	202	4.158	3.970

As of June 30, 2004, the Mill had commitments to purchase 1,671,247 bushels of spring wheat and 121,387 bushels of durum.

STATE COURTS

As of June 30, 2004, the state courts had significant commitments of $1,995,708. The majority of the amount consists of indigent defense contracts with law firms around the state to provide legal services for eligible indigent persons at all stages of proceedings as specified in the contracts.

JOB SERVICE NORTH DAKOTA

As of June 30, 2004, Job Service has commitments to pay $558,336 for purchase orders and contracts awarded for goods and services to be provided in future periods.

BUILDING AUTHORITY

The Authority has committed funds to complete various construction and modernization programs at June 30, 2004, totaling $14,428,000.

The Legislature authorized the Authority to issue bonds for the State Historical Society to renovate historic site interpretive centers if they decide to proceed with the project prior to June 30, 2005. The amount authorized for financing this project is $2,000,000.

MUNICIPAL BOND BANK

On April 1, 1997, a Standby Bond Purchase Agreement was executed with the Central Dakota Irrigation District, a political subdivision. Should the District experience financial difficulties, the Bond Bank will purchase Central Dakota Irrigation District's Refunding Improvement Bonds (warrants) in an aggregate principal amount not less than the outstanding principal amount of the warrants plus accrued interest on the warrants. The original amount of the warrants issued April 1, 1997, was $3,270,000.

INFORMATION TECHNOLOGY DEPARTMENT

ITD has entered into a contract with Maximus to facilitate the implementation of PeopleSoft software for the ConnectND project. Remaining estimated payments for the 2003-2005 biennium are $3,905,250.

DEPARTMENT OF HUMAN SERVICES

As of June 30, 2004, the Department of Human Services had significant commitments for the purchase of various types of services totaling $27,105,631.

PUBLIC SERVICE COMMISSION

As of June 30, 2004, the Public Service Commission had significant commitments of $1,042,643. This amount consists primarily of contractor charges associated with the Abandoned Mine Lands.

AERONAUTICS COMMISSION

As of June 30, 2004, the Aeronautics Commission had significant commitments of $1,152,000. This amount consists of grants to political subdivisions for maintenance and improvements of their airports.

DAIRY PRODUCTS PROMOTION COMMISSION

As of June 30, 2004, the Dairy Products Commission had significant commitments of $225,000. This amount consists of a contract with Midwest Dairy Association to implement and administer programs intended to contribute to the betterment of North Dakota dairy farmers and the State's dairy industry. The contract also provides the Commission with administrative, financial, and reporting services.

NORTH DAKOTA SOYBEAN COUNCIL

As of June 30, 2004, the North Dakota Soybean Council had significant commitments of $659,160. This amount mainly consists of grants for the research and development of soybeans.

STATE WATER COMMISSION

As of June 30, 2004, the State Water Commission had long-term commitments of $68,647,572 for various water projects.

NORTH DAKOTA DEPARTMENT OF TRANSPORTATION

At June 30, 2004, the North Dakota Department of Transportation (Special Revenue Fund) had non-construction contract commitments of approximately $10.6 million of which $8.1 million represents federal programs which are cost reimbursable.

Construction commitments at June 30, 2004, totaled approximately $173.6 million, of which $146.0 million represents federal programs which are cost reimbursable. These commitments will be funded with future appropriations as work is performed.

UNIVERSITY SYSTEMS

Contracts for the construction of various projects on behalf of the University System have been let as follows (expressed in thousands):

	Original Issue	Paid To Date	Amount To Be Paid
BSC	$ 148	$ 57	$ 91
DSU	4,790	1,373	3,417
MaSU	3,531	3,010	521
MiSU	88	-	88
MiSU-B	111	53	58
NDSCS	421	95	326
NDSU	9,249	719	8,530
UND	18,636	14,702	3,934
VCSU	2,612	1,973	639
WSC	5,625	5,564	61

NORTH DAKOTA DEVELOPMENT FUND

The board of directors has approved equity investments, loans, grants, and guaranty of collections at June 30, 2004, for which funds have not been disbursed or written agreements entered into in the amount of $4,619,000.

OTHER CONSTRUCTION COMMITMENTS

Health Department	$ 1,085
Human Services	937
Corrections	455
Adjutant General	2,984
Game and Fish	40
Transportation	22,654

B. LITIGATION

The estimated loss in all of the litigation against the State in which a loss to the State is probable is estimated at zero. Litigation that is reasonably possible to result in an unfavorable outcome is estimated at $100,000 to $10,000,000.

The estimated gain in all the litigation brought by the State in which a gain is probable is estimated at $4,552,154. This amount was not accrued in these financial statements.

In November 1998, the North Dakota Attorney General joined forty-five other states and five territories in a settlement agreement against the nation's largest tobacco manufacturer. The Master Settlement Agreement includes base payments to states totaling $220.6 billion for the next 25 years, and continues in perpetuity. North Dakota's share of the settlement is expected to be $866 million over the next 25 years. The amount of the annual payment is subject to a number of modifications, including adjustments for inflation and usage volumes. Some of the adjustments may result in increases in the payments (inflation, for example), or other adjustments will likely cause decreases in the payments (e.g., volume adjustments). The net effect of these adjustments on future payments is unclear.

The State had not settled any cases before June 30, 2004, in which the settlement had not been paid as of June 30, 2004.

C. QUESTIONED COSTS

The State receives federal financial assistance which is subject to review and audit by the Office of the State Auditor and the federal government. This assistance is generally conditioned upon compliance with certain laws and regulations. Disallowed and questioned costs relating to federal assistance could become a liability to the State. The State estimates that the ultimate disallowances pertaining to federal assistance, if any, will be immaterial to its overall financial condition.

The single audit of the State of North Dakota for the two year period ending June 30, 2002, was completed in March of 2003. As a result of this audit, approximately $300,000 of identifiable questioned costs were noted. Also, there were several findings which had potentially significant, unknown, questioned costs. The State is cooperating with the federal government to resolve the findings and is optimistic these findings will not have a material impact on the State.

The 2003-2004 single audit will be issued sometime in March 2005. It is anticipated there will be potential questioned costs against the State as a result of this audit. The State does not believe the results of the audit will have a material impact.

NOTE 18 - SUBSEQUENT EVENTS

HOUSING FINANCE AGENCY

Subsequent to June 30, 2004, the Agency began the process for the issuance of 2004 Series C Housing Finance Program Bonds. The 2004 Series C bond issuance will be in the amount of $60,000,000. The 1993 AB Multi-Family bond issue of $1,783,000 was repaid on July 1, 2004.

HEALTH DEPARTMENT

The State reached an agreement in July 2004 with Burlington Northern and Santa Fe Railway Company (BNSF) to settle the lawsuit relating to the fuel contamination in downtown Mandan, North Dakota. The agreement, which was approved by the Mandan City Commission, settled claims by the North Dakota Department of Health and the City of Mandan alleging violations of North Dakota's hazardous waste and water pollution laws.

Under the settlement, BNSF agrees to pay $29 million, of which $26.5 million will be placed in trust, and transfer property to the City of Mandan valued at $1.25 million. The settlement addresses BNSF's continued responsibility for the contamination in the Mandan Railyard and the State's right to bring future enforcement actions for any new contamination.

The financial reporting implications of the trust funds have not been determined.

WORKFORCE SAFETY & INSURANCE

At its November 17, 2004, quarterly meeting, the Workforce Safety & Insurance (WSI) board of directors unanimously approved a five percent discount for WSI's unpaid loss and loss adjusting expense liability. This is a reduction from the current rate of six percent.

The change was applied prospectively and resulted in a $55.1 million increase in the liability and expense accounts.

WATER COMMISSION

Subsequent to June 30, 2004, the Commission issued the remaining authorized but unissued 2003 A Series Bonds for the Southwest Pipeline, totaling $257,958.

MUNICIPAL BOND BANK

Subsequent to year end, the Industrial Commission approved the issuance of two separate bond series: (1) $11,790,000 State Revolving Fund Program Bonds, Series 2004 A; and (2) $880,000 Capital Financing Program Bonds, Series 2004 A. These bonds are for the express purpose of providing funds to political subdivisions for use in connection with various improvement, construction, and refinancing projects. The interest rates vary on these bonds from 2.00% to 4.75%, with maturity ranging from October 1, 2004, to October 1, 2021.

STUDENT LOAN TRUST

On July 1, 2004, the Trust purchased $2,194,000 of student loans from the Bank of North Dakota.

NORTH DAKOTA STATE UNIVERSITY

In August 2004, NDSU issued $10.3 million in revenue bonds to finance the construction of the Bison Court Apartments. The revenue bonds will be repaid with auxiliary revenues.

NOTE 19 – NEW PRONOUNCEMENT

In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. This statement addresses common deposit and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also should be disclosed. This statement is effective for financial periods beginning after June 15, 2004. The State is planning to implement the new reporting requirements for the fiscal year 2004-05 financial statements.