



State of North Carolina

Department of State Treasurer

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*State and Local Government Finance Division
and the Local Government Commission*

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Memorandum No. 1106

August 29, 2008

TO: Local Government Officials and Certified Public Accountants

FROM: Sharon Edmundson, Director
Fiscal Management Section

SUBJECT: North Carolina State Education Assistance Authority Securities and Disclosures for June 30, 2008

This memo is to those local governments (and their auditors) who hold investments in the NC State Education Assistance Authority (NCSEAA) in their portfolio at June 30, 2008. Due to changing market conditions, additional disclosures on these investments will be required. NCSEAA bonds were issued as auction rate bonds with 15 to 30 year maturities and interest rate reset dates every 7, 28 or 35 days. At those intervals the bonds could be redeemed at par, and as such were considered liquid investments. They **were and continue to be allowable** investments under G.S. 159-30(c)(3). On February 12th of this year the auctions for these bonds began to fail such that the investments became illiquid with no secondary market. Some units had material amounts of their portfolios invested in these instruments; others had nominal amounts. Any unit with a material amount of investments in the NCSEAA will be required to make the additional disclosures. We do not have a complete list of the local governments that held these investments but estimate there to be approximately 30 governments that hold these bonds.

There are two types of bonds issued by the Authority: taxable bonds and tax-exempt bonds. Approximately \$700 million of taxable bonds were called successfully in July such that many governments that held these securities were relieved of the liquidity problem shortly after fiscal year-end. There may be other taxable bonds yet to be called. Approximately \$1.3 billion of tax-exempt bonds with certain CUSIP numbers are expected to be called by September 30, 2008. We believe that fewer governments hold these tax-exempt securities. The type of disclosure that will appear in each unit's June 30, 2008 financial report will depend on the type of bonds held at June 30th, the materiality of those investments to the unit, and whether or not the bonds have been refinanced before the issuance of the financial statements.

- All material investments should be disclosed in the interest rate risk note since they were illiquid at June 30, 2008 regardless of type. (*An example follows.*)
- There must be a subsequent event note in the unit's financial statements that discusses the taxable bonds called and settled in July if the unit held such investments. If the unit's tax exempt bonds are called in the September 30th refinancing and the statements are issued after that date then these statements will have a subsequent event note as well. Please check the CUSIP numbers. (*An example follows.*)

- Material investments regardless of type that have not been called by the NCSEAA before the unit's financial statements are issued must also include comments in the MD&A since there are illiquid assets the status of which is not evident on the face of the financial statements.

Sample of GASB 40 disclosure:

The North Carolina State Education Assistance Authority (NCSEAA) instruments in the portfolio have final stated maturities ranging from 2015 to 2036. Historically they could be redeemed at par and the interest rate reset every 7,28 or 35 days making the effective maturity date the next reset date, until February 2008 when the auctions began failing. At that time the instruments became illiquid and there was no secondary market.

Can be included in Interest rate risk section or following chart of securities ...

Sample of Subsequent Event note:

The North Carolina State Education Assistance Agency instruments in the portfolio having final stated maturities ranging from 2015 to 2036; have been called effective July xx, 2008 resolving the matter of illiquid investments for the County/City.

Management Discussion & Analysis:

If material taxable or tax exempt notes are held at the time the statements are issued, additional disclosures must be included in the MD&A since there will be illiquid assets the status of which is not visible on the face of the financial statements.

- Clarify that there are restrictions on the use of assets (illiquid) not apparent in the statements
- Coming year/future section: Mention any information regarding refinancing or expected calls

This continues to be an evolving issue but since the July refinancing of the taxable bonds and the pending September 30th call for the tax-exempt bonds, it is becoming more settled. Any local government that held these securities at June 30, 2008 is expected to have the additional disclosures. Future refinancings can be found at the Authority's website at www.ncseaa.edu as they are scheduled. Select Investor Information on the left side of the screen to see the date for the next call and the CUSIPs to be included. If there are questions, or if we can be of further assistance please contact Sara Shippee at 919-807-2356 or sara.shippee@nctreasurer.com.