



# STATE OF NORTH CAROLINA

**FINANCIAL STATEMENT AUDIT REPORT OF**  
**THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL**  
**CHAPEL HILL, NORTH CAROLINA**  
**FOR THE YEAR ENDED JUNE 30, 2001**

**OFFICE OF THE STATE AUDITOR**

**RALPH CAMPBELL, JR.**

**STATE AUDITOR**

**FINANCIAL STATEMENT AUDIT REPORT OF**  
**THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL**  
**CHAPEL HILL, NORTH CAROLINA**  
**FOR THE YEAR ENDED JUNE 30, 2001**

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Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

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## AUDITOR'S TRANSMITTAL

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The Honorable Michael F. Easley, Governor  
The General Assembly of North Carolina  
Board of Trustees, The University of North Carolina at Chapel Hill

This report presents the results of our financial statement audit of The University of North Carolina at Chapel Hill, a component unit of the State of North Carolina, for the year ended June 30, 2001. Our audit was made by authority of Article 5A of G.S. §147.

The accounts and operations of the University are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report* (CAFR) and the State's *Single Audit Report*. In those reports, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the audit results on the State's internal controls and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs.

As part of the audit work necessary for the CAFR and the *Single Audit Report*, the accounts and operations of the University were subject to audit procedures as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements and supplementary information that relate solely to The University of North Carolina at Chapel Hill. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is to present the results of our audit on the accompanying financial statements and supplementary information that relate solely to The University of North Carolina at Chapel Hill. A summary of our reporting objectives and audit results are:

- 1. Objective** - Express an opinion on the accompanying financial statements and supplementary information that relate solely to The University of North Carolina at Chapel Hill.

**Results** - The accompanying financial statements present fairly, in all material respects, the amounts and disclosures made in accordance with accounting principles generally accepted in the United States of America. The accompanying supplementary information

## AUDITOR'S TRANSMITTAL (CONCLUDED)

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presents information that is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

- 2. Objective** - Present instances of noncompliance, if any, with laws, regulations, contracts, or grants.

**Results** - Our tests disclosed no instances of noncompliance which require disclosure herein under *Government Auditing Standards*.

- 3. Objective** - Present significant deficiencies, if any, in internal control over financial reporting which could adversely affect the University's ability to record, process, summarize, and report financial data in the financial statements.

**Results** - Our tests disclosed no material weaknesses in internal control over financial reporting which require disclosure herein under *Government Auditing Standards*.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report



Ralph Campbell, Jr.  
State Auditor

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Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

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**INDEPENDENT AUDITOR'S REPORT**

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Board of Trustees  
The University of North Carolina at Chapel Hill  
Chapel Hill, North Carolina

We have audited the accompanying Balance Sheet of The University of North Carolina at Chapel Hill, a component unit of the State of North Carolina, as of June 30, 2001, and the related Statement of Changes in Fund Equity and Statement of Current Funds Revenues, Expenditures, and Other Changes for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The University of North Carolina at Chapel Hill as of June 30, 2001, and the changes in fund equity and the current funds revenues, expenditures, and other changes for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 16A to the financial statements, the University changed its method of accounting for securities lending transactions allocated from the State Treasurer's Cash and Investment Pool during the year ended June 30, 2001. As discussed in Note 16B to the financial statements, the University implemented Governmental Accounting Standards Board Statement #33, *Accounting and Financial Reporting for Nonexchange Transactions*, during the year ended June 30, 2001.

## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2001 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with the independent auditor's report in considering the results of our audit.

Schedules 1, 2 and 3 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ralph Campbell, Jr.  
State Auditor

October 31, 2001

**The University of North Carolina at Chapel Hill**  
**Balance Sheet**  
**June 30, 2001**  
**(dollars expressed in thousands)**

**Exhibit A**

	Current Funds			Fiduciary Funds			Plant Funds		
	Unrestricted		Restricted	Loan	Endowment	Agency	Unexpended	Debt Service	Investment in Plant
	General	Proprietary							
<b>ASSETS</b>									
Cash and Cash Equivalents	\$ 78,195	\$ 68,020	\$ 115,679	\$ 10,032	\$ 3,931	\$ 106	\$ 139,678	\$ 4,446	\$ 0
Investments	19,795	114,210	34,234	2,043	768,816	300,644	209	21,157	
Receivables:									
Accounts Receivable (Net)	5,639	29,527	54,150		22,162	5,966	3,266		
Intergovernmental Receivables	85		29,796						
Interest Receivable	2,529	664	324	31	53		424	5	
Due from Other Funds	54,051		33,525					23,246	
Due from Other Universities in UNC System		2,934	257						
Due from Primary Government	1,777	274	5,405				24,508		
Notes Receivable (Net)				30,119					
Inventories	1,661	14,304	121						
Prepaid Items	25	74	6					1,706	
Fixed Assets (Note 4)									1,630,896
<b>Total Assets</b>	<b>\$ 163,757</b>	<b>\$ 230,007</b>	<b>\$ 273,497</b>	<b>\$ 42,225</b>	<b>\$ 794,962</b>	<b>\$ 306,716</b>	<b>\$ 168,085</b>	<b>\$ 50,560</b>	<b>\$ 1,630,896</b>



**The University of North Carolina at Chapel Hill**  
**Balance Sheet**  
**June 30, 2001**  
**(dollars expressed in thousands)**

**Exhibit A**  
**Page 2**

	Current Funds			Fiduciary Funds			Plant Funds		
	Unrestricted		Restricted	Loan	Endowment	Agency	Unexpended	Debt Service	Investment in Plant
	General	Proprietary							
<b>LIABILITIES AND FUND EQUITY</b>									
<b>Liabilities:</b>									
Accounts Payable and Accrued Liabilities:									
Accounts Payable	\$ 3,539	\$ 10,711	\$ 8,439	\$ 0	\$ 16,061	\$ 0	\$ 15,830	\$ 0	\$ 0
Accrued Payroll	10,392	5,516	4,939						
Due to Other Funds		23,832	39,525	71	38,704		8,690		
Due to Other Universities in UNC System		374	763						
Due to Primary Government	6	98	2						
Capital Leases Payable									335
Bonds Payable (Note 5B)							80,406	22,342	294,330
Interest Payable								3,457	
Deposits Payable	7,483	1,154							
Accrued Vacation Leave	21,840	12,436	12,774						
Deferred Revenue	5,234	5,218	15						
Obligations Under Reverse Repurchase Agreements					9,027	3,193			
Funds Held in Trust for Pool Participants						303,417			
Funds Held for Others						106			
<b>Total Liabilities</b>	<b>48,494</b>	<b>59,339</b>	<b>66,457</b>	<b>71</b>	<b>63,792</b>	<b>306,716</b>	<b>104,926</b>	<b>25,799</b>	<b>294,665</b>
<b>Fund Equity:</b>									
Net Investment in Plant									1,336,231
Fund Balances:									
Restricted:									
U. S. Government Grants Refundable				29,008					
Endowment					225,475				
Quasi-Endowment					382,444				
Annuity and Life Income Funds					16,569				
Restricted for Debt Retirement								12,301	
Restricted for Repair and Replacement								5,219	
Other Restricted Funds			207,040	12,678			61,726	1,349	
Unrestricted:									
Quasi-Endowment					106,682				
Other Unrestricted Funds	115,263	170,668		468			1,433	5,892	
<b>Total Fund Equity</b>	<b>115,263</b>	<b>170,668</b>	<b>207,040</b>	<b>42,154</b>	<b>731,170</b>		<b>63,159</b>	<b>24,761</b>	<b>1,336,231</b>
<b>Total Liabilities and Fund Equity</b>	<b>\$ 163,757</b>	<b>\$ 230,007</b>	<b>\$ 273,497</b>	<b>\$ 42,225</b>	<b>\$ 794,962</b>	<b>\$ 306,716</b>	<b>\$ 168,085</b>	<b>\$ 50,560</b>	<b>\$ 1,630,896</b>

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

**The University of North Carolina at Chapel Hill**  
**Statement of Changes in Fund Equity**  
**Year Ended June 30, 2001**  
**(dollars expressed in thousands)**

**Exhibit B**

	Current Funds			Fiduciary Funds		Plant Funds		
	Unrestricted		Restricted	Loan	Endowment	Unexpended	Debt Service	Investment in Plant
	General	Proprietary						
<b>Revenues and Other Additions:</b>								
Tuition and Fees	\$ 139,319	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
State Appropriations	402,205					14,759		
Federal Contracts and Grants	67,608		311,822					
State Contracts and Grants	3,807		51,354			24,989		
Nongovernmental Contracts and Grants	4,890		70,342					
Gifts	3,578	2,560	73,869	3	17,478	10,198		8,739
Investment Income (Loss)	11,400	11,471	5,808	985	(41,718)	4,185	1,761	
Endowment Income	6,685		2,042	63	821	17		
Sales and Services	6,257	327,005						
Expended for Plant Facilities								103,959
Retirement of Indebtedness								13,129
Proceeds of Refunding Debt							13,453	
Other Revenues and Additions	9,868	12,700	7,222	484	3,112	112		
<b>Total Revenues and Other Additions</b>	<b>655,617</b>	<b>353,736</b>	<b>522,459</b>	<b>1,535</b>	<b>(20,307)</b>	<b>54,260</b>	<b>15,214</b>	<b>125,827</b>
<b>Expenditures and Other Deductions:</b>								
Educational and General	638,537		425,848					
Auxiliary Enterprises		127,425						
Internal Service Funds		8,281						
Professional Clinical Services		167,703						
Indirect Costs Recovered			75,140					
Refunded to Grantors			1,750					
Expended for Plant Facilities						52,924		
Retirement of Indebtedness							13,069	
Payment to Escrow Agent							13,453	
Interest on Indebtedness							18,206	
Disposal of Plant Facilities								16,190
Other Expenditures and Deductions				1,229	11,162	58		1,350
<b>Total Expenditures and Other Deductions</b>	<b>638,537</b>	<b>303,409</b>	<b>502,738</b>	<b>1,229</b>	<b>11,162</b>	<b>52,982</b>	<b>44,728</b>	<b>17,540</b>
<b>Transfers:</b>								
Mandatory Transfers In (Out)	(1,270)	(26,135)	(76)			125	27,356	
Non-Mandatory Transfers In (Out)	13,392	(15,717)	29,102	186	(31,571)	6,175	(1,566)	
<b>Net Transfers In (Out)</b>	<b>12,122</b>	<b>(41,852)</b>	<b>29,026</b>	<b>186</b>	<b>(31,571)</b>	<b>6,300</b>	<b>25,790</b>	
<b>Net Increase (Decrease) for the Year</b>	<b>29,202</b>	<b>8,475</b>	<b>48,747</b>	<b>492</b>	<b>(63,040)</b>	<b>7,578</b>	<b>(3,724)</b>	<b>108,287</b>
<b>Fund Equity July 1, 2000</b>	<b>86,061</b>	<b>162,193</b>	<b>147,942</b>	<b>41,662</b>	<b>727,798</b>	<b>55,581</b>	<b>28,485</b>	<b>1,227,944</b>
<b>Prior Period Adjustment (Note 17)</b>			<b>10,351</b>		<b>66,412</b>			
<b>Fund Equity June 30, 2001</b>	<b>\$ 115,263</b>	<b>\$ 170,668</b>	<b>\$ 207,040</b>	<b>\$ 42,154</b>	<b>\$ 731,170</b>	<b>\$ 63,159</b>	<b>\$ 24,761</b>	<b>\$ 1,336,231</b>

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

**The University of North Carolina at Chapel Hill**  
**Statement of Current Funds Revenues, Expenditures, and Other Changes**  
**Year Ended June 30, 2001, with comparative totals for 2000**  
**(dollars expressed in thousands)**

**Exhibit C**

	Unrestricted			Restricted	Totals Year Ended June 30,	
	General	Proprietary	Total		2001	2000
<b>Revenues:</b>						
Tuition and Fees	\$ 139,319	\$ 0	\$ 139,319	\$ 0	\$ 139,319	\$ 121,507
State Appropriations	402,205		402,205		402,205	383,189
Federal Contracts and Grants	67,608		67,608	244,213	311,821	276,548
State Contracts and Grants	3,807		3,807	48,712	52,519	44,782
Nongovernmental Contracts and Grants	4,890		4,890	65,453	70,343	56,764
Gifts	3,578	2,560	6,138	73,869	80,007	53,484
Investment Income	11,400	11,471	22,871	5,808	28,679	18,619
Endowment Income	6,685		6,685	2,042	8,727	15,160
Sales and Services	6,257	327,005	333,262		333,262	307,929
Other Sources	9,868	12,700	22,568	7,222	29,790	15,506
<b>Total Revenues</b>	<b>655,617</b>	<b>353,736</b>	<b>1,009,353</b>	<b>447,319</b>	<b>1,456,672</b>	<b>1,293,488</b>
<b>Expenditures:</b>						
Educational and General:						
Instruction	323,689		323,689	166,758	490,447	435,839
Organized Research	31,291		31,291	182,542	213,833	186,550
Public Service	51,454		51,454	38,209	89,663	89,906
Academic Support	66,172		66,172	9,054	75,226	63,528
Student Services	15,948		15,948	731	16,679	14,735
Institutional Support	49,256		49,256	1,866	51,122	48,165
Plant Maintenance and Operations	71,910		71,910	835	72,745	69,525
Student Financial Aid	28,817		28,817	25,853	54,670	49,844
Auxiliary Enterprises		127,425	127,425		127,425	121,969
Internal Service Funds		8,281	8,281		8,281	5,474
Professional Clinical Services		167,703	167,703		167,703	156,522
<b>Total Expenditures</b>	<b>638,537</b>	<b>303,409</b>	<b>941,946</b>	<b>425,848</b>	<b>1,367,794</b>	<b>1,242,057</b>
<b>Transfers and Additions/(Deductions):</b>						
Refunded to Grantors				(1,750)	(1,750)	(668)
Mandatory Transfers Out	(1,270)	(26,135)	(27,405)	(76)	(27,481)	(27,620)
Non-Mandatory Transfers In (Out)	13,392	(15,717)	(2,325)	29,102	26,777	9,698
<b>Net Increase in Fund Equity</b>	<b>\$ 29,202</b>	<b>\$ 8,475</b>	<b>\$ 37,677</b>	<b>\$ 48,747</b>	<b>\$ 86,424</b>	<b>\$ 32,841</b>

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

**THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2001**

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Chapel Hill is a constituent institution of the sixteen campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have both delegated and statutory responsibilities for financial accountability of the University's funds. Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-CH Foundation), The Kenan-Flager Business School Foundation (Business School Foundation), The School of Social Work Foundation Inc. (Social Work Foundation), and UNC Law Foundation Inc. (Law Foundation), are reported as if they were part of the University.

The Investment Fund is governed by a board consisting of nine ex officio directors and one or two elected directors. Ex officio directors include all of the members of the Board of Trustees of the Endowment Fund of The University of North Carolina at Chapel Hill, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement. The UNC-CH Foundation Board may, in its discretion, elect one or two of its at-large members to the Investment Fund Board. The Investment Fund's purpose is to support the University by operating an investment fund for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Because the members of the Board of Directors of the Investment Fund are officials or appointed by officials of the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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University and the Investment Fund's primary purpose is to benefit The University of North Carolina at Chapel Hill and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The UNC-CH Foundation is governed by a 17-member board consisting of nine ex officio directors and eight elected directors. Ex officio directors include the Chairman of the Board of Trustees of The University of North Carolina at Chapel Hill, the Chancellor, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement (nonvoting). In addition, two ex officio directors are elected by the Board of Trustees from the membership of that board and three ex officio directors are elected by the Board of Trustees from the membership of the Board of Trustees of the Endowment Fund of The University of North Carolina at Chapel Hill who have not otherwise been selected. The eight remaining directors are elected to membership on the UNC-CH Foundation Board of Directors by action of the ex officio directors. The UNC-CH Foundation's purpose is to aid, support, and promote teaching, research and service in the various educational, scientific, scholarly, professional, artistic and creative endeavors of the University. Because the members of the Board of Directors of the UNC-CH Foundation are officials or appointed by officials of the University and the UNC-CH Foundation's sole purpose is to benefit The University of North Carolina at Chapel Hill, its financial statements have been blended with those of the University.

The Business School Foundation is governed by a board consisting of four ex officio directors and eight elected directors. Ex officio directors include the Dean of the Kenan-Flager Business School (Business School), the Chief Financial Officer of the Business School, the Assistant Dean of Academic Affairs, and the Associate Dean for MBA Programs of the Business School. The seven directors are elected to membership on the Business School Foundation Board of Directors by action of the ex officio directors, while the Executive Director (non voting) is appointed by the Board of Directors. The Business School Foundation's purpose is to aid, promote and support the Business School at The University of North Carolina at Chapel Hill. Because the members of the Board of Directors of the Business School Foundation are officials or appointed by officials of the University, the financial statements of the Business School Foundation have been blended with those of the University.

The Social Work Foundation is governed by a board consisting of three ex officio directors and six elected directors. Ex officio directors include the Dean of the School of Social Work, the Chairman of the Board of Advisors to the School of Social Work, and the Vice Chancellor for

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Development of The University of North Carolina at Chapel Hill. The six directors are elected to membership on the Social Work Foundation by action of the ex officio directors. The Social Work Foundation's purpose is to foster and promote the growth, progress and general welfare of social work practice and research at the School of Social Work of The University of North Carolina at Chapel Hill. Because the members of the Board of Directors of the Social Work Foundation are officials or appointed by officials of the University, the financial statements of the Social Work Foundation have been blended with those of the University.

The Law Foundation is governed by a board consisting of one ex officio director, six appointed directors and six elected directors. The ex officio director is the Dean of the School of Law (the Dean) of The University of North Carolina at Chapel Hill. The Dean appoints six directors, while the Board of Directors of the Law Alumni Association of the University of North Carolina, Inc. elects the other six directors. The Law Foundation's purpose is to provide support, foster, and encourage the study and teaching of law at the Law School of The University of North Carolina at Chapel Hill. Because the members of the Board of Directors of the Law Foundation are officials or appointed by officials of the University, the financial statements of the Law Foundation have been blended with those of the University.

Separate financial statements for the Investment Fund and blended foundations may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling 919-962-1370. Other related foundations and similar non-profit corporations for which the University is not financially accountable are not part of the accompanying financial statements except for their participation in the Investment Fund.

The University's financial statements include the financial activities of the clinical patient care programs as part of the Proprietary Funds. These clinical patient care programs established or maintained by the School of Medicine of The University of North Carolina at Chapel Hill are a component unit of the University of North Carolina Health Care System, which is a component unit of the University of North Carolina System.

- B. Basis of Presentation** - The accompanying financial statements are presented in accordance with accounting principals generally accepted in the United States of America applicable to governmental colleges and universities as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement #15 *Governmental College and University Accounting and Financial Reporting Models*, the University has elected to follow the fund accounting and reporting

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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guidelines set forth by the American Institute of Certified Public Accountants in its Industry Audit Guide, *Audits of Colleges and Universities*.

- C. **Fund Structure** - The accompanying financial statements are structured into three categories of funds: Current, Fiduciary, and Plant Funds.

**Current Funds** are used to account for the revenues and expenditures resulting from operations, with the Unrestricted Funds and Restricted Fund shown separately. The Restricted Fund represents resources that are restricted to use by either an outside donor or grantor. Current funds that are internally designated for specific purposes by the governing board or management having delegated authority are reported as Unrestricted Funds. The Unrestricted Proprietary Fund reflecting the operations of the student supply store, dormitories, other auxiliary enterprises, internal service funds, student activity funds and intercollegiate athletics is shown separately from the Unrestricted General Fund.

**Fiduciary Funds** are used to account for additions and deductions from fund equity of the Student Loan Fund and Endowment Fund. The Annuity and Life Income Fund is reported as part of the Endowment Fund. In addition, the Fiduciary Funds are used to account for funds of students and organizations held by the University as custodian in the Agency Fund. The transactions of the Agency Fund increase and decrease assets and liabilities but do not effect fund equity. As a result, the Agency Fund is not reflected in the Statement of Changes in Fund Equity.

**Plant Funds** are used to account for additions to and deductions from fund equity of the Unexpended Plant Fund, Debt Service Fund, and the Investment in Plant Fund. The Debt Service Fund includes the Repair and Replacement reserves as well as the reserves for Retirement of Indebtedness.

- D. **Basis of Accounting** - The financial statements of the University have been prepared on the accrual basis except that, in accordance with accounting practices customarily followed by public educational institutions, no provision is made for depreciation of fixed assets, interest on loans to students is recorded when collected, and revenue from tuition and student fees for summer sessions is reported totally within the fiscal year in which the session is primarily conducted. Otherwise, revenues are recorded when earned and expenditures are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the University receives value without directly giving equal value in exchange, include grants, state

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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appropriations, and private donations. On an accrual basis, revenues from these transactions are recognized in the fiscal year in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection.

The Statement of Current Funds Revenues, Expenditures, and Other Changes is a statement of financial activities of current funds related to the current reporting period. It does not purport to present the results of operations or the net income or loss for the period as would a statement of income or a statement of revenues and expenses.

- E. Cash and Cash Equivalents** - In addition to cash on deposit with private bank accounts, petty cash, and undeposited receipts, this classification includes savings accounts, cash on deposit with fiscal agents, and short-term investments with the State Treasurer's Cash and Investment Pool (a governmental external investment pool). All other short-term investments are reported as investments.
- F. Investments** - This classification includes long-term fixed income investments, repurchase agreements, equity investments, mutual funds, money market funds, certificates of deposit, limited partnerships, real estate investment trusts, and other asset holdings by the University. Except for money market funds, certificates of deposit, real estate not held by a governmental external investment pool and other asset holdings, these investments are reported at fair value for year-end financial reporting purposes. Fair value is the amount at which an investment could be exchanged between two willing parties. Fair value for financial reporting purposes is based on quoted market prices. The net increase (decrease) in the fair value of investments is recognized as a part of investment income.

Money market funds, real estate not held by a governmental external investment pool and other asset holdings are reported at cost, if purchased, or at fair market value or appraised value at date of gift, if donated.

- G. Receivables and Allowance for Doubtful Accounts** - The receivables for the UNC Physicians & Associates, the Dental Faculty Practice (both included in the current proprietary fund group) and the Loan Funds are shown in the accompanying financial statements net of the allowance for doubtful accounts of \$56,760,000, \$385,000, and \$3,244,000, respectively. The accounts and notes receivable for other funds are shown at book value with no provision for doubtful accounts considered necessary.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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**H. Inventories** - Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost or market. The inventories for the Unrestricted General Fund consist of expendable supplies, postage and fuel oil held for consumption. Inventories for the Unrestricted Proprietary Fund consist of textbooks and other merchandise for resale.

**I. Fixed Assets and Depreciation** – Fixed Assets are stated at cost at date of acquisition or fair market value at date of donation in the case of gifts. The University capitalizes fixed assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of one or more years. Library books acquired prior to June 30, 1983 are valued on the basis of industry statistics and expert judgments. Depreciation is not recorded.

To the extent that current funds are used to finance plant assets, the amounts provided are accounted for as: (1) expenditures, in the case of normal replacement of furniture and movable equipment; (2) mandatory transfers, in the case of required provisions for debt retirement and renewal and replacement; and (3) transfers of a non-mandatory nature for all other cases.

Fixed assets financed with debt proceeds are reported in the Investment in Plant Fund subgroup when expenditures are incurred. Construction period interest cost in excess of earnings associated with the debt proceeds is capitalized as a component of the fixed asset.

Fixed assets, such as utilities distribution systems, power plant systems, fiber optic network, and resident hall video network are capitalized as infrastructure.

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

The University has the policy of recording the cost of sick leave when taken and paid rather than when the leave is earned. The policy provides for unlimited accumulation of sick leave, but the employee cannot be compensated for any unused sick leave upon termination of employment.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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- K. Revenue Recognition** – Current Funds revenues, as reflected on Exhibit C, include all exchange and non-exchange transactions earned and in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection.

Certain Unrestricted Proprietary Fund auxiliary operations provide goods and services to activities reported in the Unrestricted General Fund. These auxiliary operations include activities such as utilities, telecommunications, materials management, service and repairs, laboratory services, and other interdepartmental activities. For purposes of financial statement presentation, the University eliminates the associated Proprietary Fund revenue and expenditures for these activities.

Tuition remission and waivers are recorded as “Tuition and Fees” revenue and as “Student Financial Aid” expenditures on the accompanying financial statements.

Student fees pledged under bond indentures are reported as unrestricted revenues when received unless such fees are not legally available for other purposes, in which case they are reported as an addition to Debt Service Fund equity.

- L. Endowment Investment Return** – Investments of the University’s endowment funds are pooled in the Investment Fund. Investment return of the University’s pooled endowment funds is predicated on the total return concept (yield plus appreciation). Annual distributions from the University’s pooled endowment funds have generally ranged between 4% and 7% of market value. To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not cover the distribution, the University uses available accumulated gains to make up the difference.

Endowments are classified as either “true” or “quasi.” True endowments are funds that the donor has specified, as a condition of the gift, that the principal be maintained indefinitely. Quasi-endowments are funds on which there is no such restriction placed by the donor. For classification purposes, the net change in fair value of investments is classified as quasi-endowment, unless the donor has stipulated otherwise.

- M. Funds Held in Trust by Others** – Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2001 is approximately \$30,040,000.

### NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** – The University is required by General Statute 147-77 to deposit its budget code cash and by the University of North Carolina Board of Governors pursuant to General Statute 116-36.1 to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, in the State Treasurer's Cash and Investment Pool. In addition, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer's Cash and Investment Pool. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

Deposits include cash and cash equivalents totaling \$419,929,000. At year-end, cash on hand was \$158,000. The University's portion of the State Treasurer's Cash and Investment Pool was \$419,900,000. It is the State Treasurer's policy and practice for the deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name. The carrying amount of the University's deposits not with the State Treasurer consists of cash and cash equivalents totaling \$187,000. The bank balance of these deposits was \$9,471,000 of which \$3,580,000 was covered by federal depository insurance or by collateral held by the University's agent in the University's name, and \$5,891,000 was uninsured and uncollateralized.

North Carolina General Statutes 147-69.1(c) and 147-69.2 authorize the State Treasurer to invest in the following: Obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; certificates of deposit of specified institutions; prime quality commercial paper; specified bills of exchange; asset-backed securities; corporate bonds and notes with specified ratings; general obligations of other states; general obligations of North Carolina local governments; certain venture capital limited partnerships; and the obligations or securities of the North Carolina Enterprise Corporation.

The financial statements and disclosures for the State Treasurer's Cash and Investment Pool are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.state.nc.us/OSC> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to General Statute 116-36.2 to invest its special funds and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as previously discussed.

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

General Statute 116-36(e) provides that the trustees of the Endowment Fund shall be responsible for the prudent investment of the Fund in the exercise of their sound discretion, without regard to any statute or rule of law relating to the investment of funds by fiduciaries but in compliance with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the University's component units, the UNC-CH Foundation, the Investment Fund, the Business School Foundation, the Social Work Foundation, and the Law Foundation are subject to and restricted by General Statute 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The University utilizes investment pools to manage investments and distribute investment income. The University utilizes the following investment pools:

**Temporary Investment Pool (Temporary Pool)** - This is a fixed income portfolio managed by the University's Investment Office and Wachovia Bank, N.A. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals and endowment revenue funds (internal portion), and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Participants in the University's Agency Funds. The Temporary Pool is not registered with the SEC and the University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Northern Trust Company is the custodian for the Temporary Pool and provides the University's Director of Accounting Services with monthly statements defining income and market value information. Through written request to Accounting Services, participants may purchase and sell shares in the Temporary Pool at a fixed value of \$1 per share. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, corporate bonds, mutual funds and money market funds. Generally, the purchase and sell of participation shares occur only at the beginning of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are sent to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund balance. The rates are set in coordination between the University Investment Office and the Vice Chancellor for Finance and Administration.

**UNC-CH Foundation Investment Fund Inc. (Investment Fund)** - This is a 501(c) 3 corporation established in January, 1997 by the University and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Funds from the University's Endowment, the UNC-CH Foundation, the Business School Foundation, the Social Work Foundation, and the Law Foundation are component units included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants in the University's Agency Funds.

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Board of Directors (See Note 1A). The Investment Board is responsible

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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for adopting investment objectives and policies, for hiring investment advisors, and for monitoring policy implementation and investment performance. The Board has generally chosen not to make individual security selection decisions. The Board's primary role is to oversee the allocation of the Investment Fund Portfolio among asset classes, investment vehicles, and investment managers. The Board will continually review, monitor, and adjust its allocation decisions based on a variety of factors.

The Northern Trust Company is the custodian for the Investment Fund and provides the University with monthly statements defining income and market value information which is then allocated among the fund's participants. The Investment Fund uses a unit basis to determine each participant's market value and to distribute the Fund's spending policy. There are no involuntary participants in the Investment Fund pool. The University has not provided or obtained any legally binding guarantees during the period to support the value for the pool's investments. The audited financial statements for the Investment Fund pool may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling 919-962-1370.

**Credit Risk Categories** - The University's investments (pooled and non-pooled) are categorized below to give an indication of the level of risk assumed by the entity at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment transaction fails. There are three categories of credit risk. Category 1 includes investments that are insured or registered or for which the securities are held by the University or its agent in the University's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the University's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by a counterparty's trust department or agent but not in the University's name.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

A summary of the University's investments at June 30, 2001 is presented below:

### *Temporary Pool Investments*

	Fair Value			<i>(in thousands)</i>
	Risk Category			
	1	2	3	
<b>Categorized Investments:</b>				
U. S. Government Securities	\$ 65,524	\$ 0	\$ 0	\$ 65,524
Collateralized Mortgage Obligations	43,724			43,724
State and Municipal Securities	4,562			4,562
Corporate Bonds	70,399			70,399
Corporate Stocks	30			30
<b>Total Categorized Investments</b>	<u>\$ 184,239</u>	<u>\$ 0</u>	<u>\$ 0</u>	\$ 184,239
<b>Investments Not Categorized:</b>				
Money Market Funds				7,969
Mutual Funds				14,982
Other Investments				3,428
<b>Total Investments Not Categorized</b>				<u>26,379</u>
<b>Total Temporary Pool Investments</b>				<u>\$ 210,618</u>

### *Investment Fund Pool Investments*

	Fair Value			<i>(in thousands)</i>
	Risk Category			
	1	2	3	
<b>Categorized Investments:</b>				
U. S. Government Securities	\$ 12,467	\$ 0	\$ 0	\$ 12,467
Collateralized Mortgage Obligations	10,829			10,829
State and Municipal Securities	524			524
Corporate Bonds	17,005			17,005
Corporate Stocks	134,051			134,051
<b>Total Categorized Investments</b>	<u>\$ 174,876</u>	<u>\$ 0</u>	<u>\$ 0</u>	\$ 174,876
<b>Investments Not Categorized:</b>				
Investments Held by Broker-Dealers				
Under Reverse Repurchase Agreements				
U. S. Government Securities				11,447
Money Market Funds				33,414
Mutual Funds				389,719
Limited Partnerships				294,058
Real Estate Investment Trusts				29,098
Other Investments				14,498
<b>Total Investments Not Categorized</b>				<u>772,234</u>
<b>Total Investment Fund Pool Investments</b>				<u>\$ 947,110</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### *Non-Pooled Investments*

	Fair Value			<i>(in thousands)</i>
	Risk Category			Total
	1	2	3	
<b>Categorized Investments:</b>				
U. S. Government Securities	\$ 6,036	\$ 981	\$ 0	\$ 7,017
State and Municipal Securities	796			796
Corporate Bonds	5,015			5,015
Corporate Stocks	23,343	1,381		24,724
<b>Total Categorized Investments</b>	<u>\$ 35,190</u>	<u>\$ 2,362</u>	<u>\$ 0</u>	\$ 37,552
<b>Investments Not Categorized:</b>				
Money Market Funds				34,569
Mutual Funds				18,540
Real Estate				9,026
Other Investments				<u>3,693</u>
<b>Total Investments Not Categorized</b>				<u>65,828</u>
<b>Total Non-Pooled Investments</b>				<u>\$ 103,380</u>

### *Total Investments*

	Fair Value			<i>(in thousands)</i>
	Risk Category			Total
	1	2	3	
<b>Total Categorized Investments</b>	<u>\$ 394,305</u>	<u>\$ 2,362</u>	<u>\$ 0</u>	\$ 396,667
<b>Total Investments Not Categorized</b>				<u>864,441</u>
<b>Total Investments</b>				<u>\$ 1,261,108</u>

Since a separate annual financial report of the Temporary Investment Pool, a governmental external investment pool, has not and is not planned to be issued, the following additional disclosures are being provided in the University's financial statements.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2001 are as follows:

<b>Temporary Pool</b>		<i>(in thousands)</i>
Statement of Net Assets		
June 30, 2001		
<b>Assets:</b>		
Accrued Investment Income	\$ 2,125	
Investments	210,618	
	<u>210,618</u>	
<b>Total Assets</b>	<b>\$ 212,743</b>	
<b>Liabilities:</b>		
Deferred Income	\$ 2,388	
	<u>2,388</u>	
<b>Net Assets:</b>		
Internal	133,050	
External	77,305	
	<u>77,305</u>	
<b>Total Net Assets Available to Participants</b>	<b>210,355</b>	
	<u>210,355</u>	
<b>Total Liabilities and Net Assets</b>	<b>\$ 212,743</b>	
	<u>212,743</u>	

<b>Temporary Pool</b>		<i>(in thousands)</i>
Statement of Operations and Changes in Net Assets		
For the Fiscal Year Ended June 30, 2001		
<b>Increase in Net Assets From Operations:</b>		
Revenues:		
Investment Income	\$ 14,699	
Expenditures:		
Investment Management	313	
	<u>313</u>	
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>14,386</b>	
	<u>14,386</u>	
<b>Distributions to Participants:</b>		
Distributions Paid and Payable	14,386	
	<u>14,386</u>	
<b>Share Transactions:</b>		
Net Share Purchases (Liquidations)	14,578	
	<u>14,578</u>	
<b>Total Increase in Net Assets</b>	<b>14,578</b>	
	<u>14,578</u>	
<b>Net Assets:</b>		
Beginning of Year	195,777	
	<u>195,777</u>	
End of Year	\$ 210,355	
	<u>210,355</u>	

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The major investment classifications of the Temporary Pool had the following attributes as of June 30, 2001:

*(in thousands)*

Investment Classification	Fair Value	Principal Amount	Range of Interest Rates	Range of Maturities
U.S. Government Securities	\$ 65,523	\$ 67,099	4.0%-11.5%	2002-2029
Collateralized Mortgage Obligations	43,724	44,650	4.1%-7.5%	2002-2028
State and Municipal Securities	4,562	4,397	5.4%	2009
Corporate Bonds	70,399	69,954	4.3%-7.0%	2001-2006
Money Market	7,969	7,969	4.0%	1 day
Mutual Funds	14,983	13,670	N/A	N/A
Corporate Stocks	30	30	N/A	N/A
Other Investments	3,428	3,428	N/A	N/A
<b>Total Temporary Pool Investments</b>	<b>\$ 210,618</b>	<b>\$ 211,197</b>		

**C. Non-Current Funds Gains and Losses on Investments** – The net change in fair value of investments is recorded as part of “Investment Income” on the accompanying financial statements. The additions and deductions to the non-current fund’s fund equity resulting from the net change in fair value of investments follow:

*(in thousands)*

	Net Unrealized Gains/Losses	Realized Gains	Realized Losses	Net Change in Fair Value
Loan Fund	\$ (221)	\$ 65	\$ 0	\$ (156)
Endowment Fund	(109,331)	67,716	(218)	(41,833)
Debt Service Fund	215	377		592

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**D. Endowment Fund Investments** - The Board of Trustees of the Endowment Fund of The University of North Carolina at Chapel Hill and the Board of Directors of the Foundation (included in the University's reporting entity) have established a policy that emphasizes growth orientation in the investment of endowment funds. The fair value of the Endowment Fund Investments pooled and non-pooled as of June 30, 2001 as compared to the prior year is as follows:

	<i>(in thousands)</i>	
	Balance June 30, 2001	Balance June 30, 2000
<b>Investments by Fund:</b>		
Endowment	\$ 226,232	\$ 262,396
Quasi-Endowment Unrestricted	110,088	137,070
Quasi-Endowment Restricted	400,486	390,365
Annuity and Life Income Funds	32,010	33,126
<b>Total</b>	<u>\$ 768,816</u>	<u>\$ 822,957</u>
<b>Investment by Type:</b>		
Debt Securities	\$ 28,727	\$ 33,909
Equity Securities	121,636	179,960
Collateralized Mortgage Obligations	7,999	11,000
Money Market Funds	27,669	16,294
Mutual Funds	307,219	328,593
Real Estate	9,021	9,056
Limited Partnerships	217,228	186,901
Real Estate Investment Trusts	21,495	24,282
Investments Held by Broker-Dealers Under Reverse Repurchase Agreements	8,456	18,508
Other Investments	19,366	14,454
<b>Total</b>	<u>\$ 768,816</u>	<u>\$ 822,957</u>

**E. Reverse Repurchase Agreements** - Under the University's authority to purchase and sell securities, it has entered into fixed coupon reverse repurchase (reverse repurchase) agreements, that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the University or provide securities or cash of equal value, the University would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. As of June 30, 2001 the University had no credit exposure.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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All sales of investments under reverse repurchase agreements are for fixed terms. In investing the proceeds of reverse repurchase agreements, the University's policy is for the term to maturity of the investment to be the same as the term of the reverse repurchase agreement. Such matching existed at year-end. The University's investments in the underlying securities and those purchased with proceeds from the reverse repurchase agreements are in accordance with the statutory requirements as noted. The interest earnings and interest cost arising from reverse repurchase agreement transactions are reported at gross amounts on the accompanying financial statements.

- F. Derivative and Similar Transactions** - A derivative is a financial instrument created from, or whose value depends on (is derived from), the value of one or more underlying assets, reference rates, or indexes of asset values. These instruments may include forwards, futures, currency and interest rate swaps, options, floaters/inverse floaters and caps/floors/collars. Investment transactions similar to a derivative may include securitized assets, such as mortgage-backed securities and other asset backed securities. As required by generally accepted accounting principles, the nature of the derivative or similar transactions entered into by the University, and the reasons for entering into those transactions follow:

**Mortgage-Backed Securities** - The University invests in mortgage-backed securities issued by the Government National Mortgage Association (GNMA), an agency of the United States government, government sponsored enterprises including the Federal Home Loan Mortgage Corporation (FHLMC) or the Federal National Mortgage Association (FNMA), and private trusts or corporations. The University invests in these securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The values of mortgage backed securities are generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities may include mortgage pass-through securities and collateralized mortgage obligations (CMOs). Mortgage pass-through securities pay the holder of the security the principal and interest amounts received from the underlying pool of mortgages as these amounts are collected from the mortgage holders. In a CMO, cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple classes with different priority claims and payment streams (commonly referred to as tranches.) A holder of the CMO security thus chooses the class of security that best meets its risk and return objectives. Both pass-through

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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securities and CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets.

The mortgage pass-through securities issued by GNMA, FNMA, FHLMC are classified by the University as U.S. government securities. The mortgage pools underlying the GNMA pass-through securities are backed by the full faith and credit of the U.S. government by the Federal Housing Administration (FHA), Veterans Administration (VA), and the Farmers Home Administration (FHA). The FNMA and FHLMC securities are collateralized by underlying pools of mortgages primarily issued by GNMA, FNMA or FHLMC which guarantee full and timely payment of principal and interest.

The CMOs held by the University include mortgage-backed securities issued by FNMA, FHLMC, certain trusts and private corporations (including REMIC issuers). In addition, non-traditional mortgage pass-through securities, such as "interest-only strips" and "principal-only strips", if held by the University, are classified as CMOs. The University held non-traditional pass-through securities during the year.

As of June 30, 2001 the University was holding \$114,966,000 in mortgage-backed securities valued at fair (market) value representing approximately 9.1% of its total investments. Of this amount \$54,553,000 represent investments in CMOs.

**Other Asset-Backed Securities** - The University invests in various asset backed securities. As of June 30, 2001 these securities include mortgage servicing rights issued through the United States Small Business Administration (SBA). The University also invests in securities issued through the SBA which pay monthly interest at a rate equal to the prime rate minus 2% and the par value of the security at maturity.

The University invests in the various asset backed securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities. The SBA floating rate securities are used as a hedge against a rise in the level of interest rates.

The values of these other asset backed securities are generally based on the cash flows to be received from the underlying pools of assets. Accordingly, these securities are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets. For the SBA floating rate securities, the coupon income from holding these securities varies with the level of interest rates. As interest rates rise, these securities pay

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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higher levels of coupon income, and as rates fall, the interest income declines.

These security holdings are subject to credit related losses in the event of non-performance by the issuers or counterparties to these instruments. However, the University does not expect any issuers or counterparties to fail to meet their obligations given their high credit ratings. The credit risk is reduced by the assets that collateralize these securities which could be liquidated at market values at the time of non-performance. The SBA floating rate securities are backed by the full faith and credit of the U.S. government.

As of June 30, 2001 the University is holding \$16,960,000 in asset-backed securities valued at fair (market) value representing approximately 1.3% of its total investments.

**Futures** - The University purchases and sells equity index futures and futures on domestic and foreign securities and currencies. The University uses the futures market to securitize excess cash holdings, to gain exposure to non-U.S. markets, to exploit foreign interest rate yield opportunities, to diversify its overall investment portfolio, to lower its transaction costs and to improve its liquidity.

Futures contracts are traded on margin on various futures and options exchanges. Since there is no direct cost in establishing any given futures position, the book value of these securities is recorded at \$0. The margin amounts remitted by the University to the brokerage houses are reflected in the University's cash and cash equivalent or government securities holdings. Gains or losses from trading the futures are recognized in income when the futures positions are closed or liquidated. Unlike most securities investments, the losses on futures contracts can exceed their cost (of \$0).

The market value of a futures contract is dependent on the value of its underlying cash market security or securities. Accordingly, the futures contracts held by the University are sensitive to changes in their respective foreign currency rates or security values. They are also sensitive to changes in the level of interest rates. The University trades futures on organized exchanges which mitigates its credit risk of default by a counterparty.

As of June 30, 2001 the futures contracts held by the University had expiration dates not exceeding September 2001.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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**Options** - The University purchases and sells options on futures of U.S. and foreign securities. All options are traded through domestic and foreign exchanges.

The University uses the options to hedge certain of its futures positions, to gain exposure to non-U.S. markets, to exploit foreign interest rate yield opportunities, and to further diversify its overall investment portfolio.

The University records the book values of long and short call and put option contracts at the option premium paid (if the option is purchased) or collected (if the option is written.) The University records the book value of the options in an investment account at an amount equal to the quantity of contracts purchased (sold) at the respective option premium price paid (collected.) When the option contract expires, or is repurchased or is exercised, the University records any resulting gain or loss in related income accounts. Unlike purchased options and most securities investments, losses on written options can exceed their cost.

During the year ending June 30, 2001, the option contracts held by the University vary with changes in the market price of their underlying futures contracts and accordingly also fluctuate with changes in their respective foreign currency rates or security values. The University's option contracts are traded on organized exchanges which mitigates its credit risk of default by a counterparty.

As of June 30, 2001 the options contracts held by the University had expiration dates not exceeding August 2001.

**Indirect Derivative Holdings** - The University identifies various external investment funds (mutual funds, external investment pools, and limited partnerships) that meet asset allocation and investment management objectives. The University invests in these funds and partnerships to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. These investments generally include equity and bond funds. Certain investment funds and partnerships expose the University to significant amounts of market risk by trading or holding derivative securities and by leveraging the securities in the fund.

The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes. The investment funds which utilize derivative securities for the fiscal year ending June 30, 2001 are summarized in the chart below. The amounts shown in the chart represent the market value of the University's (including affiliated external foundations participating in the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investment Fund) investment in a fund, group of funds or limited partnership, and are not the market values of the derivatives each fund or partnership is holding. The chart also defines the market value and percent of holdings held in derivatives. The University's reporting entity comprises 73.87% of these totals.

### The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. Indirect Derivative Analysis For Fiscal Year Ending June 30, 2001

*(in thousands)*

<u>Investment Manager/Fund</u>	<u>Total Market Value</u>	<u>% Invested Derivatives</u>	<u>Amount</u>
<b>Domestic Equity</b>			
Feirstein Cap. Management Co. CI A	\$ 14,968		\$ 0
Raptor Global Fund	32,621	13.59%	4,433
Blue Ridge Capital	19,451	1.06%	206
Midtown Research Group (CI A, Ser. 4)	10,561	1.30%	137
Portable Alpha Program	497	100.00%	497
<b>International Equity</b>			
Nicholas-Applegate Capital Management	16,621		
Oechsle International Advisors	21,984		
Marathon Asset Management	42,391		
City of London Investment Management Co.	26,854		
SR Global Fund – Emerging Markets CI G	8,573		
Boyer Allan Pacific Fund Inc.	17,808	66.20%	11,789
<b>Opportunistic Equity</b>			
Maverick Fund	30,253		
SR Global Fund – International CI C	16,489		
Reservoir Capital Partners	8,277	0.50%	41
Cliffwood Equity Partners	10,166		
OCM Emerging Markets II	12,439	0.50%	62
Lansdowne European Equity Fund	10,188	22.73%	2,316
Bessent Capital Management	18,777	0.26%	49
<b>Absolute Return</b>			
Highfields Capital, Ltd.	19,737	12.60%	2,487
OZ Overseas Fund, Ltd.	14,409	9.33%	1,345
Satellite Asset Management CI A	11,686	3.15%	368
AQR Capital Management, LLC	9,740	90.34%	8,800
Citadel Investment Group, LLC	18,713	64.00%	11,976
Regiment Capital – Series I	11,153	1.42%	158
HBK Offshore	11,264		
Symphony Asset Management - Rhapsody LP	2,366	8.50%	201
Cerberus Asia Partners, L.P. Fund	5,617	8.50%	478
GS Oppert. (Asia) Offshore Fund, Ltd.	4,255	11.87%	505
Contrarian Capital Management	7,367		
OCM Opportunities Fund III, L.P	20,917	0.25%	52
UBS Global Equity Arbitrage	10,793	13.13%	1,417



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### Indirect Derivative Analysis (continued)

Investment Manager/Fund	Total Market Value	% Invested Derivatives	Amount
<b>Fixed Income</b>			
<hr/>			
Domestic Fixed Income			
Wachovia Asset Management	61,709	5.41%	3,339
Enhanced Fixed Income			
GMO - Global Fixed Income	17,749	39.63%	7,034
GMO- Emerging Country Debt	10,507	100.00%	10,507
OCM Expanded High Yield Fund, LP	9,713	4.60%	447
Venture Lending and Leasing III	2,000	0.21%	4
<hr/>			
<b>Energy and Natural Resources</b>			
Goldman Sachs Asset Management	9,809	100.00%	9,809
<hr/>			
Total	578,422		\$ 78,457
<hr/>			
<b>Total Market Value of Investment Fund</b>	<b>\$ 947,110</b>		
<hr/>			
<b>Total % of Market Value for Indirect Derivative Exposure</b>		8.28%	

The market values reported for each manager above do not include accrued income, reverse repurchase liabilities, or investments in the State Treasurer's Investment Fund.

The market risk associated with these indirect derivative holdings by fund type follows:

**Domestic Equity** - From time-to-time domestic equity managers will utilize equity index futures, options on equity index futures, and specific stock options. These are used mainly to hedge their portfolio or to take advantage of an options mispricing on a security they own.

**International Equity** - International equity managers will utilize foreign equity index futures and options to hedge their exposure to their respective markets.

**Opportunistic Equity** - Opportunistic equity managers will utilize a wide range of currency, equity, and fixed income futures and options. These are used to gain exposure to specific markets in the most cost-effective and liquid manner possible.

**Absolute Return** - Absolute Return managers utilize fixed income and equity futures both as a hedging tool and to gain exposure to specific markets.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**Fixed Income** - Fixed Income Funds utilize futures and options on global fixed income and currency markets. These vehicles are used purely to hedge exposure to a given market or to gain exposure to an illiquid market.

**Energy and Natural Resources** – Principally included as a hedge against unanticipated inflation. These strategies include direct energy investments, energy security investments, commodity-linked notes and direct investments in commodity indices or the future markets.

The Fund's holdings in indirect derivatives (i.e., derivatives held by our external investment managers) are primarily used to decrease risk. This is because the indirect derivatives are used by the fund's hedge fund managers primarily to hedge underlying positions, or to gain exposure to specific markets in an efficient, inexpensive, liquid, and diversified manner. In the former case, risk is actually reduced by the use of derivatives because the derivative is directly offsetting market exposure. In the latter case, the derivatives are merely substituting for what would otherwise be a more traditional (individual security) array. Hence there would be no greater risk and often less risk than the traditional array that would exist in place of such derivatives. In limited cases, select managers are allowed to use derivatives to lever specific holdings or market positions. In aggregate, the Fund's 8.28% exposure to indirect derivative holdings reflects a smaller degree of risk than there would be without such derivatives in the portfolio. The University considers the risk associated with these holdings to be prudent and within acceptable bounds.

### NOTE 3 - INTER-FUND RECEIVABLES AND PAYABLES

Due From/To Other Funds as of June 30, 2001 are summarized below:

<b>Due From</b>	<b>Due To</b>			<b>Total Due From</b>
	Unrestricted General	Restricted Fund	Debt Fund	
Unrestricted Proprietary Fund	\$ 586	\$ 0	\$ 23,246	\$ 23,832
Restricted Fund	39,525			39,525
Loan Fund	71			71
Endowment and Similar Funds	5,179	33,525		38,704
Unexpended Plant Fund	8,690			8,690
<b>Total Due To</b>	<b>\$ 54,051</b>	<b>\$ 33,525</b>	<b>\$ 23,246</b>	<b>\$ 110,822</b>

*(in thousands)*

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The amount due to the Debt Service Fund from the Proprietary Fund represents current and non-current accrued bond interest payable of \$2,750,000 and \$20,496,000, respectively. The amount due to Unrestricted General and the Restricted Fund from Endowment and Similar Funds represents pending income distribution from the sale of certain holdings in the Investment Fund.

The amount of \$8,690,000 due to the Unrestricted General Fund from the Unexpended Plant Fund represents internal borrowings from the Temporary Investment Pool to fund capital projects. A variable interest rate, generally at 6.5% is charged on the borrowings. The period of borrowings does not exceed 5 years, and the latest due date is December 31, 2005.

### NOTE 4 - CHANGES IN FIXED ASSETS

A summary of changes in the fixed assets is presented as follows:

*(in thousands)*

	Balance June 30, 2000	Infrastructure Reclassification (Adjusted for Construction in Progress)	Additions	Deletions	Balance June 30, 2001
Land and Improvements	\$ 8,402	\$ 13,431	\$ 261	\$ 0	\$ 22,094
Furniture and Equipment	175,746		25,317	11,514	189,549
Buildings and Fixed Equipment	900,884	(179,882)	27,875	2,154	746,723
Infrastructure		194,727	20,221		214,948
Other Structures and Improvements	70,352	(28,276)	25,548		67,624
Artworks and Literature	228,024		12,852	2,557	238,319
Construction in Progress	113,778		86,762	48,901	151,639
<b>Total Fixed Assets</b>	<b>\$ 1,497,186</b>	<b>\$ 0</b>	<b>\$ 198,836</b>	<b>\$ 65,126</b>	<b>\$ 1,630,896</b>

### NOTE 5 - LONG-TERM OBLIGATIONS

**A. Changes in Long-Term Obligations** - A summary of changes in long-term obligations is presented as follows:

*(in thousands)*

	Balance July 1, 2000	Additions	Deletions	Balance June 30, 2001
<b>Bonds Payable</b>	<b>\$ 287,438</b>	<b>\$ 247,311</b>	<b>\$ 137,944</b>	<b>\$ 396,805</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**B. Long-Term Obligations** - The University was indebted for long-term bonds payable in the amount of \$396,805,000 at June 30, 2001 for the purposes shown in the following table:

*(in thousands)*

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 6/30/01	Accretion on Capital Appreciation Bonds	Principal Outstanding 6/30/01
<b>Dormitory System</b>							
	1991	5.400-5.900%	11/01/2002	\$ 3,200			
	1997A	4.500-5.100%	11/01/2017	9,170			
	1997B	4.000-5.000%	11/01/2011	7,210			
<b>Total Dormitory System</b>				<u>19,580</u>	<u>\$ 3,570</u>	<u>\$ 0</u>	<u>\$ 16,010</u>
<b>Utility System</b>							
Utility System	1997	5.250-5.500%	08/01/2021	30,379			
	1993	4.000-6.000%	08/01/2011	108,455			
	1992	3.000-6.000%	08/01/2007	3,490			
<b>Total Utility System</b>				<u>142,324</u>	<u>35,230</u>	<u>6,580</u>	<u>113,674</u>
<b>Parking System</b>							
	1997A	4.350-5.700%	05/15/2027	11,750			
	1997B	3.900-5.150%	05/15/2009	8,245			
<b>Total Parking System</b>				<u>19,995</u>	<u>2,630</u>		<u>17,365</u>
<b>General Revenue</b>							
	2001A	2.900-5.125%	12/01/2025	89,930			
	2001B	Variable	12/01/2025	54,970			
	2001C	Variable	12/01/2025	54,970			
<b>Total General Revenue</b>				<u>199,870</u>			<u>199,870</u>
Student Union	2000	4.550-5.659%	06/01/2022	12,465			12,465
Student Recreation Center	1997	3.900-5.000%	06/01/2011	3,545	215		3,330
U.S. EPA Project, Series 1991	1991	8.250-9.050%	02/15/2015	36,679	9,585	5,527	32,621
U.S. EPA Project, Series 1996	1996	6.720%	02/15/2006	2,400	930		1,470
<b>Total Bonds Payable</b>				<u>\$ 436,858</u>	<u>\$ 52,160</u>	<u>\$ 12,107</u>	<u>\$ 396,805</u>
Plus: Unamortized Premium							<u>273</u>
<b>Net Bonds Payable</b>							<u>\$ 397,078</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The schedule below shows the annual requirements to pay principal and interest on the long-term obligations at June 30, 2001:

<u>Fiscal Year</u>	<i>(in thousands)</i>
	Annual Requirements (Principal and Interest)
	<u>Revenue Bonds</u>
2002	\$ 31,065
2003	32,389
2004	32,407
2005	32,421
2006	32,472
2007-2011	158,567
2012-2016	140,474
2017-2021	113,133
2022-2026	68,446
2027-2031	840
<b>Total Requirements</b>	<b>\$ 642,214</b>

- C. **Demand Bonds** - Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a “put” feature that allows bondholders to demand payment before the maturity of the debt upon proper notice of the University’s remarketing or paying agents. With regards to the following demand bonds, the University has not entered into take out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

**General Revenue, Series 2001B and 2001C** - On February 7, 2001 the University issued two series of variable rate demand bonds in the amount of \$54,970,000 (2001B) and \$54,970,000 (2001C) that each have a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding December 1, 2001. The proceeds of these issuances were used to call the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Housing System, Series 2000; Kenan Stadium, Series 1996; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University’s remarketing agents, Lehman Brothers, Inc (2001B) and Paine Webber Incorporated (2001C).

Under an irrevocable letter of credit issued by Toronto-Dominion Bank and Chase Manhattan Bank, the trustee is entitled to draw amounts

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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sufficient to pay the principal, and, while the bonds are bearing interest at the daily or weekly rate, accrued interest on bonds delivered for purchase. The University is required to pay a quarterly commitment fee for the letters of credit of .08% per annum of the amount of bonds then currently outstanding.

Under the letter of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the letter of credit. Interest at the rate of prime plus 1.0% (prime plus 2.0% after 60 days) is payable quarterly and upon draw repayment. At June 30, 2001, no purchase drawings had been made under the letter of credit.

The letter of credit terminates on February 6, 2002, subject to extension by the agreement of both parties.

Effective October 3, 2000 the University entered into an interest rate swap contractual agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) on \$22,000,000 of University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Bonds, Series 2001B and 2001C, and the interest swap agreement was amended to reflect the refunding. Under this amended agreement, Lehman Brothers pays the University interest on the notational amount based on the Bond Market Association (BMA) Municipal Bond Index on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. For the fiscal year ended June 30, 2001, the University paid Lehman Brothers \$188,000 under this agreement.

- D. Capital Appreciation Bonds** - The Series 1997 Utility System and the Series 1991 U. S. Environmental Protection Agency Project bond issues include capital appreciation bonds ("zero coupon") with an ultimate maturity value of \$84,135,000 and \$25,275,000 respectively. These bonds are recorded in the amounts of \$36,959,000 and \$9,355,000, respectively, which is the accreted value at June 30, 2001. These bonds mature in the years from 2010 to 2021.
- E. Current Refundings - Ambulatory Care Clinic, Athletic Facilities, Carolina Inn, School of Dentistry, Housing System, Kenan Stadium, and Parking System** - On February 7, 2001, the University issued \$89,930,000 University of North Carolina at Chapel Hill General Revenue Bonds, Series 2001A, and two series of University of North Carolina at Chapel Hill Variable Rate General Revenue Bonds in the amounts of \$54,970,000 (2001B) and \$54,970,000 (2001C). The

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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refunding component of these bond issues was used for current refundings of the following University of North Carolina at Chapel Hill revenue bond issues; Ambulatory Care Clinic, Series 1990 (\$14,700,000), Athletic Facilities, Series 1998 (\$14,430,000), Carolina Inn, Series 1994 (\$12,400,000), School of Dentistry, Series 1995 (3,700,000), Housing System, Series 2000 (\$44,710,000), Kenan Stadium, Series 1996 (\$12,200,000), and Parking System, Series 1997C (\$10,565,000). The primary reason for the refunding was to restructure the source from which certain bond principal and interest payments will be paid, and to release certain funds held under bond sinking fund and maintenance reserve requirements. As the refunding was primarily variable rate for variable rate, no new interest rate fluctuation risk was acquired, and the effect on the University's debt service requirements is considered to be negligible.

- F. Bond Defeasance - Dining System** - On February 7, 2001, the University issued \$89,930,000 University of North Carolina at Chapel Hill General Revenue Bonds, Series 2001A, with an average interest rate of 4.6%. The refunding component of this bond issue was used to defease \$13,205,000 of outstanding Dining System Revenue Bonds, Series 1997 with a combined average interest rate of 5.28%. Of the net proceeds amount, \$13,453,000 combined with Bond Trustee funds of \$351,000 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University's debt service requirements to early redemption of the Dining System Revenue Bonds, Series 1997, were not affected by this advance refunding, and there was not economic gain on the transaction. At June 30, 2001, the outstanding balance was \$12,690,000 for the defeased outstanding Dining System Revenue Bonds, Series 1997.

**Dormitory System** - On December 1, 1999, the University defeased \$1,225,000 of outstanding Dormitory System Revenue Bonds, Series E, F & G (1963). Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. At June 30, 2001, the outstanding balance was \$899,000 for the defeased outstanding Dormitory System Revenue Bonds, Series E, F & G (1963).

**Student Apartment** - On December 1, 1999, the University defeased \$128,000 of outstanding Student Apartment Revenue Bonds, Series A (1961). Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. At June 30, 2001, the outstanding balance was \$85,000 for the defeased outstanding Student Apartment Revenue Bonds, Series A (1961).

**Student Union** - On December 1, 1999, the University defeased \$620,000 of outstanding Student Union Revenue Bonds, Series 1967. Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. At June 30, 2001, the outstanding balance was \$550,000 for the defeased outstanding Student Union Revenue Bonds, Series 1967.

**Housing System** - On October 30, 1997 the University defeased \$6,630,000 of outstanding Housing System Revenue Bonds, Series 1991. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's balance sheet. At June 30, 2001 the outstanding balance of the defeased Housing System bonds was \$6,630,000.

**Utility System** - On October 30, 1997 the University defeased \$19,337,000 of outstanding Utility System Revenue Bonds, Series 1992. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's balance sheet. At June 30, 2000 the outstanding balance of the defeased Utility System bonds was \$19,337,000.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### NOTE 6 - CAPITAL LEASES

Capital lease obligations relating to medical and research equipment are recorded at the present value of the minimum lease payments. The University had future minimum lease payments under capital lease obligations consisting of the following at June 30, 2001:

<u>Fiscal Year</u>	<i>(in thousands)</i>
	<u>Capital Leases</u>
2002	\$ 164
2003	124
2004	67
2005	49
2006	<u>10</u>
<b>Total Minimum Lease Payments</b>	<b>\$ 414</b>
Amount Representing Interest	<u>79</u>
<b>Present Value of Future Lease Payments</b>	<b><u>\$ 335</u></b>

Leased assets included in Plant Funds amounted to \$488,000 at June 30, 2001.

### NOTE 7 - OPERATING AND OTHER LEASE AGREEMENTS

A. **Operating** - The University had future minimum lease payments under non-cancelable operating leases consisting of the following at June 30, 2001:

<u>Fiscal Year</u>	<i>(in thousands)</i>
	<u>Operating Leases</u>
2002	\$ 4,210
2003	1,969
2004	1,104
2005	976
2006	<u>256</u>
<b>Total Minimum Lease Payments</b>	<b><u>\$ 8,515</u></b>

Rental expense for all operating leases during the year was \$9,211,000.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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**B. Other Lease Agreements** - The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-CH Foundation) issued certificates of participation to provide for construction of Alumni Facilities. The University constructed the facilities as an agent for the UNC-CH Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-CH Foundation and simultaneously entered into a sublease agreement with the General Alumni Association, an affiliated organization, for the same time period for the use of the Alumni facilities.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the Alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2001, the aggregate principal amount of the certificates was \$9,950,000.

If the University complies with all of the terms of the lease agreement, title to the Alumni facilities will be conveyed to the University.

### NOTE 8 - COMMITMENTS AND CONTINGENCIES

**A. Commitments** - The University had outstanding commitments of \$121,704,000 at June 30, 2001 for various capital improvement projects that include construction and completion of new buildings, and renovations of existing buildings.

**B. Pending Litigation and Other Contingencies** - A claim related to the construction of the Alumni Center, which was completed in January 1993, had been submitted for extra costs allegedly associated with numerous changes throughout the life of the project. The initial judgement, awarded in May of 2000 and currently under appeal, is for \$1,400,000 plus yet to be determined costs and attorney fees.

The University is undertaking environmental remediation efforts at three sites on University property. These sites are the Airport Road Disposal Site, the Old Sanitary Landfill, and the Mason Farm Low Radioactive Waste Site. The amount of the liability associated with any of the three sites cannot reasonably be estimated at this time.

The University is a party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

- C. **University Improvement General Obligation Bonds** – The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of two billion five hundred million dollars of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA), establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization \$485,551,000 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

### NOTE 9 - BUDGETING AND BUDGETARY CONTROL

The State of North Carolina operates on a biennial budget cycle with separate annual departmental and institutional certified budgets adopted by the General Assembly.

Chapter 116, Article 1, Part 2A of the North Carolina General Statutes authorizes the universities within the sixteen campus University of North Carolina System to apply for special responsibility status, which sets the legal level of budgetary control at the institution's budget code level. A budget code is a convention used in the State's accounting system to distinguish the type of fund and the responsible department or institution. Budget codes are also used to segregate certain purposes within departments or institutions. Institutions with special responsibility status must still have certain budget revisions,

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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primarily those associated with unanticipated revenues, approved by the Office of State Budget and Management. Additionally, universities must maintain programs and services in accordance with the guidelines established by the Board of Governors of the consolidated University of North Carolina System. The University of North Carolina at Chapel Hill has applied for and received special responsibility status.

After the budget is approved by the General Assembly and adopted by the Board of Governors, the University follows an established system of budgetary controls. Periodic interim budget statements to department heads guide them in managing budget allocations. Monthly financial reports, which include budget and actual data, are provided for each fund to individual managers responsible for the fund. When actual conditions require changes to the budget, revisions are prepared and communicated to those affected. Changes to the budget are reviewed and approved at the University or State level as required. The University maintains an encumbrance accounting system as another method to ensure that imposed expenditure constraints are observed. The state budgetary control is maintained on a cash basis of accounting.

### NOTE 10 - RISK MANAGEMENT AND INSURANCE

The University is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in various state-administered risk pools, purchase of commercial insurance, and self retention of certain risks.

**Public Officers' and Employees' Liability Insurance** - Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides an additional \$11 million public officers' and employees' liability insurance via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the insurer.

**Fire and Other Property Loss** - The State Property Fire Insurance Fund (Fund), an internal service fund of the State, insures all State owned buildings and contents for fire and various other property losses up to \$2,500,000 per occurrence. The Fund purchases excess insurance from private insurers to cover losses over the amounts insured by the fund. Coverage for fire losses for all operations supported by the State's General Fund is provided at no cost to the University. Other operations not supported by the State's General Fund are charged for fire coverage. The University also purchased through the Fund extended coverage and other property coverage such as sprinkler leakage,

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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business interruption, vandalism, theft and “all risks” for buildings and contents. Wind coverage is provided by the Fund and its reinsurer. For losses involving a named storm, such as a hurricane, the University’s deductible is 1% of the total value of a building and contents replacement value for each building, including contents, with a minimum of \$100,000 per building and \$2,500,000 per occurrence.

**Automobile Liability Insurance** – All State-owned vehicles are covered by liability insurance handled by the State Department of Insurance. The State is self-insured for the first \$500,000 of any loss through a retrospective rated plan. Excess insurance coverage is purchased through a private insurer to cover losses greater than \$500,000. The liability limits for losses incurring in-state are \$500,000 per claimant and \$5,000,000 per occurrence. The University is charged premiums to cover the cost of excess insurance and to pay for those losses falling under the self-insured retention.

**Employee and Computer Fraud** - The University is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from State funds. The blanket honesty bond is with a private insurance company and is handled by the State Department of Insurance with coverage of \$5,000,000 per occurrence and a \$50,000 deductible.

Other coverage not handled by the State Department of Insurance is purchased through the State’s insurance agent of record.

**Comprehensive Major Medical Plan** – Employees and retirees are provided health coverage by the Comprehensive Major Medical Plan, a component unit of the State. The Plan is funded by employer and employee contributions and is administered by a third party contractor. Health care coverage is optionally available through contractual agreements with several HMO plans.

The North Carolina Workers’ Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the University’s primary responsibility is to arrange for and provide the necessary treatment for the work related injury. The University is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers’ Compensation Act. The University is self-insured for workers’ compensation.

**Liability Insurance Trust Fund** – The University participates in the Liability Insurance Trust Fund (the Fund), a claims-servicing public entity risk pool for professional liability protection. The Fund acts as a servicer of professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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participants and, accordingly, the insurance risks are not transferred to the Fund.

The Fund was created by Chapter 116, Article 26, of the General Statutes and The University of North Carolina Board of Governors Resolution of June 9, 1978 to provide professional liability protection for program participants and individual health care practitioners working as employees, agents, or officers of The University of North Carolina Hospitals at Chapel Hill (the Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (University Physicians and Associates). The Fund is exempt from federal and state income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

Participation in the Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the Hospitals, and any health care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the Hospitals. Only the University Physicians and Associates and the Hospitals have participated in the Fund to date. Participants provide management and administrative services to the Fund at no cost.

The Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of thirteen members as follows: one member each appointed by the State Attorney General, the State Auditor, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer), and eight members appointed to three year terms (with no limit on the number of terms) by the Board of Governors of the University of North Carolina.

The Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation and other factors. Participant assessments are determined at a level to fund claim liabilities, discounted for future investment earnings. Each participant is required by statute to maintain a fund balance of \$100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

The Fund provides occurrence coverage for participants as a corporate entity, as well as for the employees and professional staff of the participants. The Fund provides coverage of \$3,000,000 per occurrence and \$8,000,000 annual

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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aggregate for the negligence of individual employees of the participants within the course and scope of their employment. Commercial excess insurance of \$25,000,000 per occurrence and \$50,000,000 annual aggregate is provided above the self-insurance retention limits. The Fund provides coverage of \$500,000 per occurrence, in accordance with the limited waiver of sovereign immunity afforded by the State Tort Claims Act, for any recovery against the participants for the negligence of its employees. To assure that both existing and future claims will be paid, the Board of Governors of the University of North Carolina is authorized by law to borrow up to \$30 million to replenish the Trust Fund. No borrowings have been made under this line of credit to date. The Council believes adequate funds are on deposit in the Fund to meet estimated losses based upon the results of the independent actuary's report.

The Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs. The likelihood that the Fund will be required to make future payments on these claims is considered remote.

The Council may choose to terminate the Fund, or the respective participants may choose to terminate their participation. In the event of such termination by either the Council or a participant, an updated actuarial study will be performed to determine amounts due to or from the participants based on loss experience up to the date of termination.

At June 30, 2001, University assets in the Fund totaled \$20,136,000 while University liabilities totaled \$18,491,000, resulting in net assets of \$1,645,000.

Additional disclosures relative to the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund for the years ended June 30, 2001 and 2000. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 6001 East Wing, University of North Carolina Hospitals, 101 Manning Drive, Chapel Hill, North Carolina 27514, or by calling 919-966-3041.

**Term Life Insurance** - Term life insurance of \$25,000 to \$50,000 is provided to eligible workers. This self-insured death benefit is administered by the State Treasurer's Office and funded via employer contributions.

Additional details on State-administered risk management programs are disclosed in the State of North Carolina *Comprehensive Annual Financial Report*, issued by the Office of State Controller.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### NOTE 11 - PENSION PLANS

- A. **Retirement Plans** - Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. The Teachers' and State Employees' Retirement System (System) is a multiple-employer cost sharing defined benefit pension plan administered by the North Carolina State Treasurer.

After five years of creditable service, members of the Teachers' and State Employees' Retirement System qualify for a vested deferred benefit. Employees who retire on or after age 65 and complete 5 years of membership service (age 55 and 5 years of creditable service for law enforcement officers), reach age 60 with 25 years of membership service, or complete 30 years of creditable service receive a retirement allowance of 1.81% of an average final compensation (based on the 4 consecutive years that produce the highest average) multiplied by the number of years of creditable service. Employees may retire with reduced benefits if they reach age 50 with 20 years of creditable service or reach age 60 with 5 years of creditable service (age 50 with 15 years creditable service for law enforcement officers).

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by North Carolina General Statute 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2001, these rates were set at 5.33% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2001, the University had a total payroll of \$687,772,000 of which \$302,276,000 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for the year were \$18,137,000 and \$16,111,000, respectively. The University has no pension plan obligations beyond the required matching contributions already paid into the System. The University made one hundred percent of its required contributions for the years ended June 30, 2001, 2000, and 1999, which were \$16,111,000, \$24,505,000, and \$21,537,000, respectively.

In accordance with constitutional provisions requiring a balanced budget for the State of North Carolina, the Governor issued an executive order requiring the employers' share of retirement contributions for the months February 2001 through June 2001 to be transferred to a reserve account



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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rather than paid to the Teachers' and State Employees' Retirement System. A portion of those funds was ultimately used by the State of North Carolina for general fund purposes and not released to the retirement system. The total amount of employer contributions paid by the University has been recognized as pension costs in the financial statements. The contributions which were not released to the Teachers' and State Employees' Retirement System are considered immaterial to the University's financial statements taken as whole. The University has no liability for pension costs beyond the contributions already made.

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

The Optional Retirement Program (Program) is a defined contribution retirement plan, which provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Program offers plans administered by the Teachers' Insurance Annuity Association and College Retirement Equities Fund (TIAA-CREF), as well as Lincoln National Life Insurance Company, the Variable Annuity Life Insurance Company (VALIC) and Fidelity Investments. Participant eligibility and contributory requirements are established by General Statute 135-5.1. Participants contribute 6% of their salary and the University matches with a 6.84% contribution for pension benefits. The University assumes no liability other than its contribution.

Participants in the Program are vested after five years of service but plan administrators must return the value of the participant's and University's contribution to both the participant and the University if termination occurs prior to five years of service. Participants may direct their contributions to TIAA-CREF, Lincoln National, VALIC, Fidelity Investment or combinations of the aforementioned. Participants in all four plans may choose to invest among several alternatives, including fixed and variable accounts. Employees may elect to have their contributions deposited by one provider and the matching benefit deposited by another, or they may elect to have both deposited by the same provider.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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For the year ended June 30, 2001, the University had a total payroll of \$687,772,000 of which \$247,283,000 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$14,837,000 and \$16,914,000, respectively for the Program.

### **B. Deferred Compensation and Supplemental Retirement Income Plans**

**IRC Section 457 Plan** - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$207,000 for the year ended June 30, 2001.

**IRC Section 401(k) Plan** - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-163.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2001 were \$72,000. The voluntary contributions by employees amounted to \$1,917,000 for the year ended June 30, 2001.

**IRC Section 403(b) Plans** - All University employees who work can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the accumulated balances are received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other non-profit institutions. All costs of administering and funding these plans are the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$17,031,000 for the year ended June 30, 2001.

### NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care** - The University participates in state administered programs which provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina, and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 1.28% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2001, the University's total contribution to the Plan was \$7,034,000. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Disability Income** - The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Plan. For the fiscal year ended June 30, 2001, the University's total contribution to the DIPNC was \$2,858,000. The University assumes no liability for long-term disability benefits under the plan other than its contribution. Additional detailed information about the Plan can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### NOTE 13 - CONSTRUCTION COSTS PAID FROM DEBT PROCEEDS

Construction costs paid from debt proceeds are not reflected as additions to fund equity in the Investment in Plant Fund but rather as an increase to Investment in Plant assets (such as Buildings and Fixed Equipment) and liabilities (Bonds Payable). During the year, \$35,732,000 was added to Investment in Plant assets and liabilities for assets purchased from debt proceeds.

### NOTE 14 - RELATED PARTIES

**Foundations** - There are 17 separately incorporated non-profit organizations associated with the University. These organizations are The Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The Golden Fleece Foundation, Inc., The Institute of Government Foundation, Inc., The Law Alumni Association of N.C., Inc., The Medical Foundation of North Carolina, Inc., The North Caroliniana Society, Inc., The Order of the Grail Valkyries, The Pharmacy Foundation of North Carolina, Inc., The School of Education Foundation, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., and The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc..

These organizations were established to assist and provide support to University programs by funding scholarships, fellowships, professorships, and other needs of specific schools as well as the University's overall academic endeavors. The University's financial statements do not include the assets, liabilities, net assets or operational transactions of these organizations, except for support from each organization to the University. This support approximated \$15,709,000 for the year ended June 30, 2001.

**Carolina Student Legal Services, Inc.** - Carolina Student Legal Services, Inc. is an incorporated entity created as a function of the Student Government at The University of North Carolina at Chapel Hill. Its purpose is to provide legal consultation and workshops for student groups and students enrolled at the University. Carolina Student Legal Services is funded from student fees from University of North Carolina Student Government that are a predetermined amount per student as established by a student referendum.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 15 - PLEDGES RECEIVABLE

The University, including the blended affiliated foundations, has pledges receivable in the amount of \$35,171,000. Pledges that are expected to be collectible and available for expenditure, that are both verifiable and measurable, are reported as part of receivables, and allowances are provided for the amounts estimated to be uncollectible. Pledges receivable for the University, UNC-CH Foundation, Business School Foundation and Law Foundation at June 30, 2001 are in the amounts of \$27,216,000, \$2,212,000, \$4,101,000 and \$1,642,000 respectively. Pledges are receivable over varying time periods ranging from one to ten years, and have been discounted based on a projected interest rate of 6% for the outstanding periods.

Scheduled receipts, the discounted amount under these pledge commitments, and allowances for uncollectible pledges are as follows:

<i>(in thousands)</i>	
<u>Fiscal Year</u>	<u>Amount</u>
2002	\$ 14,034
2003	8,198
2004	7,105
2005	6,288
2006	3,490
2007-2010	<u>729</u>
<b>Total Pledge Receipts Expected</b>	39,844
Discount Amount Representing Interest (6% Rate of Interest)	<u>4,235</u>
<b>Present Value of Pledge Receipts Expected</b>	35,609
Less Allowance for Uncollectible	<u>438</u>
<b>Pledges Receivable</b>	<u><u>\$ 35,171</u></u>

Pledges, not available for expenditure, such as additions to permanent endowments, are not recorded until received because the donor condition not to expend cannot start to be satisfied until received.

### NOTE 16 - ACCOUNTING CHANGES

**A. Securities Lending Transactions** - The University deposits certain funds with the State Treasurer's Cash and Investment Pool, which participates in securities lending activities. In prior years it was the State's policy to allocate the risk associated with these transactions to each component unit. For the year ending June 30, 2001, the State changed its policy, as a

result of discussion with the GASB technical staff, to report the associated risk as part of the State of North Carolina's fiduciary funds rather than to allocate the risk to component units. The effect of this change removes from the University issued financial statements the assets and liabilities associated with the State Treasurer's security lending program. This change does not affect the University's beginning fund equities.

- B. Governmental Accounting Standard Board, Statement #33 - Accounting and Financial Reporting for Nonexchange Transactions -** Effective July 1, 2000, the University implemented the new accounting and reporting standards required in GASB #33. This standard provides accounting rules over non-exchange transactions and changes the University's standards for the recognition of revenues and the reporting of funds received but not earned in the University's restricted fund. In prior years, the University reported funds received but not expended in its restricted fund as an addition to fund equity. Based on this new standard, revenues are recognized when earned and when the resource provider's conditions have been satisfied. Amounts received not meeting the recognition requirements are now reported as deferred revenue. In addition, the new standard requires promises to give (pledges) that are expected to be collected and available for expenditure, and that are verifiable and measurable, be recorded as a receivable and revenue, upon satisfying the resource provider's conditions. Prior to this year, pledges were not recorded as a receivable unless there was a legally enforceable right.

**NOTE 17 - PRIOR PERIOD ADJUSTMENTS**

As of July 1, 2000, the fund balances of the various funds as previously reported was restated as a result of corrections and the blending of three affiliated foundations financial statements with those of the University.

	<i>(in thousands)</i>	
	<u>Restricted</u>	<u>Endowment</u>
Fund Balance June 30, 2000		
As Previously Reported	\$ 147,942	\$ 727,798
Corrections		(7,466)
Restatement Due to Blending of Three Affiliated Foundations	<u>10,351</u>	<u>73,878</u>
Total Restatements	<u>10,351</u>	<u>66,412</u>
<b>Fund Balance July 1, 2000 as Restated</b>	<b><u><u>\$ 158,293</u></u></b>	<b><u><u>\$ 794,210</u></u></b>

**The University of North Carolina at Chapel Hill**

**Revenue Bond Funds**

**Balance Sheet**

**June 30, 2001**

**(dollars expressed in thousands)**

**Schedule 1**

	Dormitory System	Environmental Protection Agency Project	Housing Series 1997	Parking Systems	Student Recreation Center	Student Union	Utility System	Student Facility Fee*
<b>REVENUE FUND</b>								
<b>Assets:</b>								
Cash and Cash Equivalents	\$ 1,961	\$ 499	\$ 8,535	\$ 8,813	\$ 686	\$ (27)	\$ 3,324	\$ 829
Investments							15,718	
Receivables	278			10	(4)	60	1,410	9
Due From State Agencies				128				
Accrued Investment Income	17	2	36	37	1	1	5	4
Due From Other Funds							1,882	
Inventories	1						1,150	
<b>Total Assets</b>	<b>\$ 2,257</b>	<b>\$ 501</b>	<b>\$ 8,571</b>	<b>\$ 8,988</b>	<b>\$ 683</b>	<b>\$ 34</b>	<b>\$ 23,489</b>	<b>\$ 842</b>
<b>Liabilities and Fund Equity:</b>								
Liabilities:								
Accounts Payable	\$ 89	\$ 0	\$ 0	\$ 31	\$ 0	\$ 0	\$ 516	\$ 0
Accrued Salaries & Wages	285			119	7	38	192	
Accrual Leave Payable	366			219	5	64	283	
Deferred Revenue				527				
Due to Other Funds	132	6,352		117			17,809	
<b>Total Liabilities</b>	<b>872</b>	<b>6,352</b>		<b>1,013</b>	<b>12</b>	<b>102</b>	<b>18,800</b>	
Fund Equity (Deficit):								
Unrestricted	1,385	(5,851)	8,571	7,975	671	(68)	4,689	842
<b>Total Liabilities and Fund Equity</b>	<b>\$ 2,257</b>	<b>\$ 501</b>	<b>\$ 8,571</b>	<b>\$ 8,988</b>	<b>\$ 683</b>	<b>\$ 34</b>	<b>\$ 23,489</b>	<b>\$ 842</b>

**The University of North Carolina at Chapel Hill**  
**Revenue Bond Funds**  
**Balance Sheet**  
**June 30, 2001**  
**(dollars expressed in thousands)**

*Schedule 1*  
*Page 2*

	Dormitory System	Environmental Protection Agency Project	Housing Series 1997	Parking Systems	Student Recreation Center	Student Union	Utility System	Student Facility Fee*
<b>BOND AND INTEREST SINKING FUND</b>								
<b>Assets:</b>								
Cash and Cash Equivalents	\$ 842	\$ 0	\$ 0	\$ 1	\$ 0	\$ 0	\$ 0	\$ 0
Investments		1,717	429		1		12,155	
Due from Other Funds		6,352	132	118	13	54	16,576	
Prepaid Expense		42	69		20	146	223	
<b>Total Assets</b>	<b>\$ 842</b>	<b>\$ 8,111</b>	<b>\$ 630</b>	<b>\$ 119</b>	<b>\$ 34</b>	<b>\$ 200</b>	<b>\$ 28,954</b>	<b>\$ 0</b>
<b>Liabilities and Fund Equity:</b>								
<b>Liabilities:</b>								
Accrued Interest Payable	\$ 0	\$ 826	\$ 132	\$ 118	\$ 13	\$ 54	\$ 1,607	\$ 0
Bonds Payable		5,957	190		43	189	16,634	
Unamortized Bond Discount		(389)	(121)		(23)	(43)	(1,442)	
<b>Total Liabilities</b>		<b>6,394</b>	<b>201</b>	<b>118</b>	<b>33</b>	<b>200</b>	<b>16,799</b>	
<b>Fund Equity:</b>								
Restricted			403				11,636	
Unrestricted	842	1,717	26	1	1		519	
<b>Total Fund Equity</b>	<b>842</b>	<b>1,717</b>	<b>429</b>	<b>1</b>	<b>1</b>		<b>12,155</b>	
<b>Total Liabilities and Fund Equity</b>	<b>\$ 842</b>	<b>\$ 8,111</b>	<b>\$ 630</b>	<b>\$ 119</b>	<b>\$ 34</b>	<b>\$ 200</b>	<b>\$ 28,954</b>	<b>\$ 0</b>
<b>REPAIR AND REPLACEMENT RESERVE</b>								
<b>Assets:</b>								
Investments	\$ 0	\$ 0	\$ 526	\$ 264	\$ 412	\$ 0	\$ 5,276	\$ 0
<b>Liabilities and Fund Equity:</b>								
<b>Fund Equity:</b>								
Restricted			22	250	233		4,713	
Unrestricted			504	14	179		563	
<b>Total Fund Equity</b>			<b>526</b>	<b>264</b>	<b>412</b>		<b>5,276</b>	
<b>Total Liabilities and Fund Equity</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 526</b>	<b>\$ 264</b>	<b>\$ 412</b>	<b>\$ 0</b>	<b>\$ 5,276</b>	<b>\$ 0</b>

\*The Student Facility Fee secures the principal and interest payments for the Student Recreation Center bonds and the Student Union bonds.

As described in Note 5, the University issued general revenue bonds in February, 2001. These general revenue bonds are payable from available funds of the University, and they are not included in these bond schedules. The Debt Service Fund bonds payable include \$1,347,000 of general revenue bonds.



**The University of North Carolina at Chapel Hill**  
**Revenue Bond Funds**  
**Schedule of Changes in Fund Equity**  
**Year Ended June 30, 2001**  
**(dollars expressed in thousands)**

**Schedule 2**

	Dormitory System	Environmental Protection Agency Project	Housing Series 1997	Parking Systems	Student Recreation Center	Student Union	Utility System	Student Facility Fee*
<b>REVENUE FUND</b>								
<b>Additions:</b>								
Sales and Services	\$ 19,545	\$ 4,659	\$ 488	\$ 12,683	\$ 136	\$ 1,672	\$ 53,144	\$ 827
Investment Income	273	27	488	607	43	13	709	16
<b>Total Additions</b>	<b>19,818</b>	<b>4,686</b>	<b>488</b>	<b>13,290</b>	<b>179</b>	<b>1,685</b>	<b>53,853</b>	<b>843</b>
<b>Deductions:</b>								
Personnel Compensation	7,323			3,269	169	1,165	5,282	
Supplies and Materials	2,203			658	18	87	28,109	
Current Services	6,520			2,078	8	513	5,561	
Fixed Charges	169	23		98	5	14	264	
Capital Outlay	147			363			332	
Miscellaneous				2,409				
Mandatory Transfers In (Out)	2,979	4,939		2,619	(14)	(54)	9,583	1
Non-Mandatory Transfers In (Out)	(1,558)			2,474	(406)	1	9,108	
<b>Total Deductions</b>	<b>17,783</b>	<b>4,962</b>		<b>13,968</b>	<b>(220)</b>	<b>1,726</b>	<b>58,239</b>	<b>1</b>
<b>Net Increase (Decrease) in Fund Equity</b>	<b>2,035</b>	<b>(276)</b>	<b>488</b>	<b>(678)</b>	<b>399</b>	<b>(41)</b>	<b>(4,386)</b>	<b>842</b>
<b>Fund Equity (Deficit) July 1, 2000</b>	<b>(650)</b>	<b>(5,575)</b>	<b>8,083</b>	<b>8,653</b>	<b>272</b>	<b>(28)</b>	<b>9,075</b>	
<b>Fund Equity (Deficit) June 30, 2001</b>	<b>\$ 1,385</b>	<b>\$ (5,851)</b>	<b>\$ 8,571</b>	<b>\$ 7,975</b>	<b>\$ 671</b>	<b>\$ (69)</b>	<b>\$ 4,689</b>	<b>\$ 842</b>

**The University of North Carolina at Chapel Hill**  
**Revenue Bond Funds**  
**Schedule of Changes in Fund Equity**  
**Year Ended June 30, 2001**  
**(dollars expressed in thousands)**

	Dormitory System	Environmental Protection Agency Project	Housing Series 1997	Parking Systems	Student Recreation Center	Student Union	Utility System	Student Facility Fee*
<b>BOND AND INTEREST SINKING FUND</b>								
<b>Additions:</b>								
Investment Income	\$ 0	\$ 103	\$ 12	\$ 2	\$ 4	\$ 0	\$ 818	\$ 0
Mandatory Transfers	2	4,939	1,607	2,029	426	615	9,593	
<b>Total Additions</b>	<b>2</b>	<b>5,042</b>	<b>1,619</b>	<b>2,031</b>	<b>430</b>	<b>615</b>	<b>10,411</b>	
<b>Deductions:</b>								
Retirement of Indebtedness		2,159	787	778	250	(10)	5,011	
Interest on Indebtedness		3,159	801	1,228	176	624	5,960	
Debt Service Fees	2	11	7	27	4	1	33	
<b>Total Deductions</b>	<b>2</b>	<b>5,329</b>	<b>1,595</b>	<b>2,033</b>	<b>430</b>	<b>615</b>	<b>11,004</b>	
<b>Net Increase (Decrease) in Fund Equity</b>		<b>(287)</b>	<b>24</b>	<b>(2)</b>			<b>(593)</b>	
<b>Fund Equity July 1, 2000</b>	<b>842</b>	<b>2,004</b>	<b>405</b>	<b>3</b>	<b>1</b>		<b>12,748</b>	
<b>Fund Equity June 30, 2001</b>	<b>\$ 842</b>	<b>\$ 1,717</b>	<b>\$ 429</b>	<b>\$ 1</b>	<b>\$ 1</b>	<b>\$ 0</b>	<b>\$ 12,155</b>	<b>\$ 0</b>
<b>REPAIR AND REPLACEMENT RESERVE</b>								
<b>Additions:</b>								
Investment Income	\$ 0	\$ 0	\$ 27	\$ 10	\$ 45	\$ 0	\$ 268	\$ 0
Mandatory Transfers				125				
<b>Total Additions</b>			<b>27</b>	<b>135</b>	<b>45</b>		<b>268</b>	
<b>Net Increase in Fund Equity</b>			<b>27</b>	<b>135</b>	<b>45</b>		<b>268</b>	
<b>Fund Equity July 1, 2000</b>			<b>499</b>	<b>129</b>	<b>367</b>		<b>5,008</b>	
<b>Fund Equity June 30, 2001</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 526</b>	<b>\$ 264</b>	<b>\$ 412</b>	<b>\$ 0</b>	<b>\$ 5,276</b>	<b>\$ 0</b>

\*The Student Facility Fee secures the principal and interest payments for the Student Recreation Center bonds and the Student Union bonds.

**The University of North Carolina at Chapel Hill**  
**Schedule of General Obligation Bond Project Authorizations, Budgets and Expenditures**  
**For Project-to-Date as of June 30, 2001**  
**(dollars expressed in thousands)**

**Schedule 3**

<b>Capital Improvement Projects</b>	<b>Projected Start Date</b>	<b>General Obligation Bonds Authorized</b>	<b>Other Sources</b>	<b>Total Project Budget</b>	<b>Amount Expended</b>	<b>Percent Completed</b>	<b>Expected Completion Date</b>
<b>Projects Started</b>							
Medical Biomolecular Research Building	Dec 2000	\$ 26,718	\$ 38,613	\$ 65,331	\$ 16,257	24.88%	May 2003
RB House Library - Renovations	Apr 2001	9,899	9,933	19,832	10,252	51.69%	Aug 2002
Murphey Hall Classroom Building Complete Renovation	Jun 2001	6,724	300	7,024	354	5.04%	Nov 2002
Memorial Hall - Comp Renovation and Addition	Jun 2001	9,200	1,200	10,400	645	6.20%	Jul 2003
Renovate Health Sciences Library	Jun 2001	11,000	400	11,400	476	4.18%	Jan 2004
Teaching Research Building - School of Public Health Project Supplement	Jun 2001	13,383	25,598	38,981	1,509	3.87%	Dec 2004
School of Dentistry Building Renovation and Conversion from Operatory	Jun 2001	8,397		8,397	93	1.11%	Jul 2003
Carrington Hall - Addition for School of Nursing Project Supplement	Jun 2001	10,082	7,904	17,986	624	3.47%	Sep 2003
Peabody Hall - Classroom Building Complete Renovation	Jun 2001	8,510	371	8,881	369	4.15%	May 2004
Institute Marine Sciences - Morehead City Complete Renovation	Jun 2001	1,833		1,833	1	0.05%	Feb 2004
Science Complex Phase I	Jun 2001	55,013		55,013	129	0.23%	Nov 2005
Burnett Womack Building Research Lab Complete Renovation	Jun 2001	24,848		24,848	10	0.04%	Nov 2004
Medical Research Building - Complete Renovation of Classrooms	Jun 2001	12,895		12,895			Dec 2004
Carolina Living and Learning Center	Jun 2001	1,154		1,154			Sep 2002
School of Medicine - Bioinformatics Building-Supplement	Feb 2001	2,000		2,000			Dec 2002
<b>Projects Not Started - To Be Funded in Future Years</b>							
Land Acquisition	Sep 2001	8,000		8,000			Feb 2006
Campus Fiber Optics Network	Nov 2001	17,533		17,533			Feb 2006
Caldwell and Howell Hall Class and Lecture Halls Renovation	Jan 2002	1,732		1,732			Nov 2004
Steam Distribution System Replacement	Apr 2002	6,300		6,300			Oct 2003
Phillips Hall - Comp Classroom and Lecture Renovation	Jul 2002	1,450		1,450			Oct 2005
Gerard Hall Classroom Building Complete Renovation	Jul 2002	1,350		1,350			Nov 2003
Community Health Building Consolidation of Programs	Aug 2002	18,340		18,340			Dec 2004
Hill and Davie Halls - Classroom and Lecture Renovation	Aug 2002	1,949		1,949			Oct 2006
Electrical Systems Improvement	Sep 2002	8,400		8,400			Feb 2004
Infrastructure Improvements	Sep 2002	32,298		32,298			Feb 2006
Technology Infrastructure Expansion	Sep 2002	9,165		9,165			Feb 2006
Storm Drainage Improvements	Oct 2002	10,500		10,500			Jan 2007
Physical Plant Support Facilities	Oct 2002	7,875		7,875			Apr 2004
Upgrade Campus Energy Management and Control System	Oct 2002	3,683		3,683			Mar 2005
Beard Hall and Lab Building Complete Renovation	Nov 2002	3,500		3,500			Jun 2004
Saunders Hall Classroom Building - Complete Renovation	Nov 2002	4,194		4,194			Dec 2003
440 W Franklin Street Renovation and Conversion for Info Tech	May 2003	9,170		9,170			Mar 2005
Wollen and Fetzer Gyms Complete Renovation of Classrooms	Jul 2003	1,598		1,598			Oct 2007
Brauer Hall Complete Renovation of Dental Clinic	Dec 2003	13,415		13,415			Nov 2005
Coker and Mitchell Hall - Complete Renovation of Classrooms	Jan 2004	1,718		1,718			Nov 2009
Rosenau Hall Lab Building Comprehensive Renovation	Mar 2004	9,000		9,000			Oct 2005
Academic Facilities to Consolidate Int'l Education Programs	Mar 2004	20,000		20,000			Jul 2006
Berryhill Hall Lab Building Complete Renovation	Apr 2004	10,700		10,700			Jul 2005

**The University of North Carolina at Chapel Hill**

**Schedule of General Obligation Bond Project Authorizations, Budgets and Expenditures**

**For Project-to-Date as of June 30, 2001**

**(dollars expressed in thousands)**

**Schedule 3**

**Page 2**

<b>Capital Improvement Projects</b>	<b>Projected Start Date</b>	<b>General Obligation Bonds Authorized</b>	<b>Other Sources</b>	<b>Total Project Budget</b>	<b>Amount Expended</b>	<b>Percent Completed</b>	<b>Expected Completion Date</b>
<i>Projects Not Started - To Be Funded in Future Years (continued)</i>							
Hanes and Manning Halls and Alumni Building-Renovation of Classrooms	May 2004	2,233		2,233			Oct 2005
Student Services Building - Consolidation of Services	Jun 2004	27,000		27,000			Feb 2006
Cogeneration Facility - Back Pressure Turbine Generator	Jul 2004	2,625		2,625			Dec 2005
New West Classroom Building - Complete Renovation	Jul 2004	4,500		4,500			Nov 2005
Steele Building - Comp Renovation and Conversion of Admin Office	Jul 2004	3,429		3,429			Nov 2005
Arts & Sciences - Digital Multimedia Institute Center and Music Library	Mar 2005	20,150		20,150			Aug 2007
Greenlaw Hall - Complete Renovation of Classrooms	May 2005	1,825		1,825			Oct 2008
Wilson Hall Lab - Completion Renovation	May 2005	8,920		8,920			Dec 2006
Smith Hall - Complete Renovation	Aug 2005	1,355		1,355			Jan 2007
Science Complex Phase II	Oct 2005	33,437		33,437			Sep 2008
Hamilton Hall - Complete Renovation of Classrooms	Jul 2006	1,539		1,539			Nov 2007
<b>Total All Projects</b>		<b>\$ 510,539</b>	<b>\$ 84,319</b>	<b>\$ 594,858</b>	<b>\$ 30,719</b>		

Note: The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of two billion five hundred million dollars of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The projects listed on this schedule are those funded or to be funded by bond proceeds from the general obligation bonds authorized by Senate Bill 912.

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Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

**INDEPENDENT AUDITOR'S REPORT  
ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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Board of Trustees  
The University of North Carolina at Chapel Hill  
Chapel Hill, North Carolina

We have audited the financial statements of The University of North Carolina at Chapel Hill, a component unit of the State of North Carolina, as of and for the year ended June 30, 2001, and have issued our report thereon dated October 31, 2001.

As discussed in Note 16A to the financial statements, the University changed its method of accounting for securities lending transactions allocated from the State Treasurer's Cash and Investment Pool during the year ended June 30, 2001. As discussed in Note 16B to the financial statements, the University implemented Governmental Accounting Standards Board Statement #33, *Accounting and Financial Reporting for Nonexchange Transactions*, during the year ended June 30, 2001.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**INDEPENDENT AUDITOR'S REPORT  
ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Audit Committee, the Board of Trustees and Board of Governors, management and staff of the University, the Governor, the State Controller, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.



Ralph Campbell, Jr.  
State Auditor

October 31, 2001

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In accordance with G.S. § 147-64.5 and G.S. § 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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Minority Leader of the N.C. House of Representatives  
N. C. House Speaker Pro-Tem  
Director, Fiscal Research Division

April 30, 2002

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Office of the State Auditor  
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