

STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

ELIZABETH CITY STATE UNIVERSITY

ELIZABETH CITY, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

ELIZABETH CITY STATE UNIVERSITY

ELIZABETH CITY, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

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Ralph Campbell, Jr.
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, Elizabeth City State University

This report presents the results of our financial statement audit of Elizabeth City State University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, for the year ended June 30, 2003. Our audit was made by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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 subjected 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 that relate solely to Elizabeth City State University. 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 that relate solely to Elizabeth City State University. A summary of our reporting objectives and audit results is:

- 1. Objective** – To express an opinion on the accompanying financial statements that relate solely to Elizabeth City State University.

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. These matters are more fully described in the Independent Auditor's Report on the Financial Statements.

AUDITOR'S TRANSMITTAL (CONCLUDED)

2. **Objective** – To 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 and present instances of noncompliance, if any, with laws, regulations, contracts, or grants.

Results - Our tests disclosed no material weaknesses in internal control over financial reporting and no instances of noncompliance which require disclosure herein under *Government Auditing Standards*. These matters are more fully described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting.

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

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR’S REPORT	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
BASIC FINANCIAL STATEMENTS	
Exhibits	
A Statement of Net Assets	10
B Statement of Revenues, Expenses, and Changes in Net Assets	12
C Statement of Cash Flows	13
Notes to the Financial Statement	15
SUPPLEMENTARY INFORMATION	
Schedule	
1 Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures	36
INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING</i> <i>STANDARDS</i>	37
DISTRIBUTION OF AUDIT REPORT	39



Ralph Campbell, Jr.
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Elizabeth City State University
Elizabeth City, North Carolina

We have audited the accompanying basic financial statements of Elizabeth City State University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2003, as listed in the table of contents. 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 did not audit the financial statements of Elizabeth City State University Foundation, Inc., which represent 3.5 percent, 4.2 percent, and 1.8 percent, respectively, of the assets, net assets and revenues of the University. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Elizabeth City State University Foundation, Inc., is based on the report of the other auditors.

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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Elizabeth City State University as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 30, 2004 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,

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis (MD&A), as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion, based on our audit is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ralph Campbell, Jr.
State Auditor

January 30, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

New Accounting Standards

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement Number 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments." This, in conjunction with Statement Number 35, "Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities" established a new reporting format for public colleges and universities. The State of North Carolina adopted these standards in fiscal year 2002 and, as a component unit of the State government, Elizabeth City State University has adopted the standards as well.

The new standards require three basic financial statements: the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows.

The Statement of Net Assets includes all assets and liabilities. The University's net assets (the difference between assets and liabilities) are one indicator of the University's financial health. Over time, increases or decreases in net assets is one indicator of the improvement or erosion of the University's financial health when considered with nonfinancial facts such as enrollment levels and the condition of the facilities.

The Statement of Net Assets provides information about assets and liabilities in a format that distinguishes between current and noncurrent. Individual assets and liabilities are classified as current or noncurrent based on whether they are expected to generate or use cash within the next 12 months of the end of the fiscal period.

Net assets, or the difference between total assets and total liabilities, is divided into three major components. The first component, invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages or notes that are attributable to the acquisition, construction, or improvement of those assets. The next component, restricted net assets, is divided into two categories: expendable and nonexpendable. Net assets are restricted when constraints are placed on them by either external parties (creditors, grantors, donors, etc.) or by enabling legislation or constitutional provisions. Nonexpendable net assets are those that are required to be retained in perpetuity. The final component is unrestricted net assets. These are net assets that are available to the University for any lawful purpose of the University.

The Statement of Revenues, Expenses, and Changes in Net Assets represents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. All things being equal, a public university's dependency on State appropriations and gifts will result in operating deficits because GASB 35 classifies State appropriations and gifts as nonoperating revenues. In the past, these two revenue classifications were included within the scope of normal revenues and contributed to revenues over expenditures, typically a positive number.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The Statement of Revenues, Expenses, and Changes in Net Assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses generally result from providing goods and services and the cost of providing those goods and services. Nonoperating revenues are revenues received for which goods and services are not provided. This includes State appropriations for operating and capital purposes.

Another important factor to consider when evaluating financial viability is the University's ability to meet financial obligations as they occur. The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital financing, capital and related financing, and investing activities.

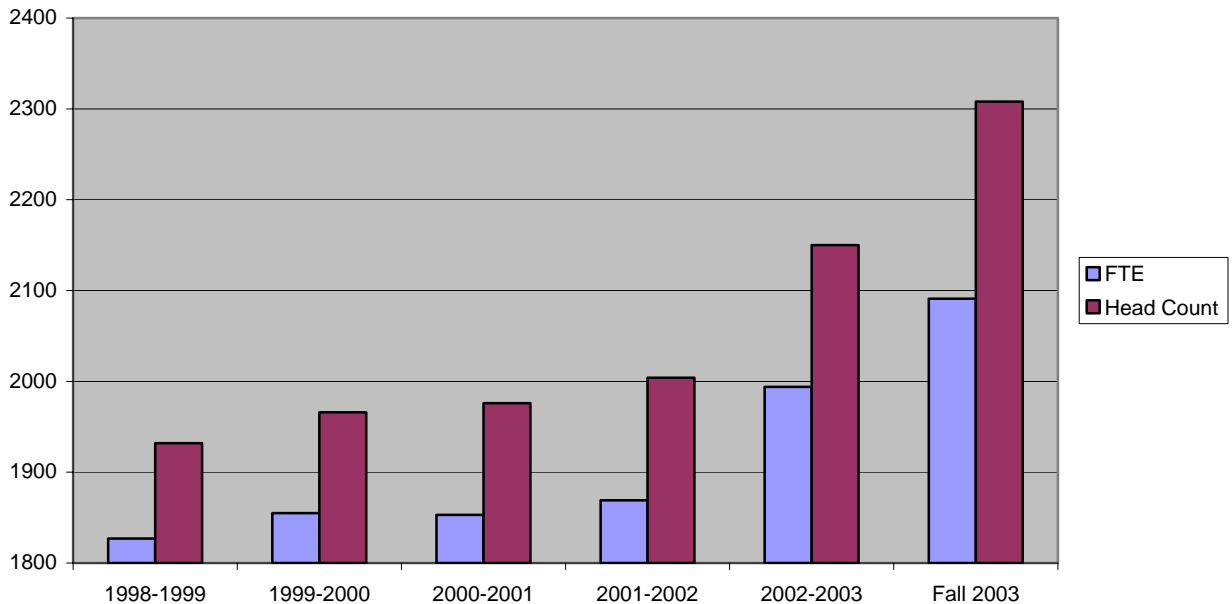
The following discussion and analysis provides an overview of the University's financial activities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Financial and Enrollment Highlights

- Enrollment increased by approximately seven percent for 2002/2003 based on headcount and FTE (full time equivalency). This increase continued in 2003/2004 with record enrollment of 2,308, which was another seven percent growth in headcount.
- Recurring North Carolina State appropriations were cut by \$1,519,648, or approximately six percent.
- A UNC Board of Governors tuition increase of five percent and student fee increases of three percent were implemented for Fall 2002.
- The UNC Higher Education Bond Referendum was initiated with \$7,073,289 expended of the University's total allotment of \$46.8 million.
- The University recorded a net income of \$9,514,452, which included investment income, including market appreciation of investments totaling \$369,839, net of related investment fees.

FTE and Head Count from 1999 to 2003



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Comparative, Condensed Statement of Net Assets

	<u>2003</u>	<u>2002</u>
Assets		
Current Assets	\$ 5,381,026	\$ 9,540,070
Capital Assets, Net	59,917,114	52,849,163
Other Assets	<u>19,483,083</u>	<u>8,331,609</u>
Total Assets	<u>84,781,223</u>	<u>70,720,842</u>
Liabilities		
Current Liabilities	3,760,401	2,811,608
Noncurrent Liabilities	<u>8,699,993</u>	<u>6,525,995</u>
Total Liabilities	<u>12,460,394</u>	<u>9,337,603</u>
Net Assets		
Invested in Capital Assets, Net of Related Debt	51,783,115	47,970,917
Restricted - Expendable	14,709,184	7,630,753
Restricted - Nonexpendable	1,911,830	1,790,131
Unrestricted	<u>3,916,700</u>	<u>3,991,438</u>
Total Net Assets	<u>\$ 72,320,829</u>	<u>\$ 61,383,239</u>

As of June 30, 2003, total University assets were \$84.8 million. Buildings less accumulated depreciation make up \$43.4 million of this total. The University's current Construction in Progress is \$9.5 million. This figure will increase significantly over the next several years due to the Higher Education Bond Projects.

The University's current assets of \$5.4 million fully covered the current liabilities of \$3.7 million, as the current ratio was \$1.43 in current assets to every \$1 in current liabilities.

University liabilities totaled \$12.5 million at June 30, 2003. Bonds payable totaling \$6.9 million is the largest liability. In November of 2002, the University participated in the UNC Bond Pool 2002B, which refinanced the Dormitory Revenue Bonds of 1992 C issue to take advantage of lower interest rates. The University also issued additional debt to renovate the Bedell Cafeteria and to purchase furniture for the dormitory system.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Comparative, Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	<u>2003</u>	<u>2002</u>
Operating Revenues:		
Student Tuition and Fees	\$ 4,166,659	\$ 2,511,894
Federal Contracts and Grants	4,767,501	4,024,571
Auxiliary Enterprises	3,492,388	3,690,817
Other Operating Revenues	299,255	623,541
	<hr/>	<hr/>
Total Operating Revenues	12,725,803	10,850,823
Operating Expenses	<hr/> 45,556,619	<hr/> 40,411,276
Operating Loss	(32,830,816)	(29,560,453)
Nonoperating Revenues and Expenses	<hr/> 29,374,420	<hr/> 26,802,540
Loss Before Other Nonoperating Gains or Losses	(3,456,396)	(2,757,913)
Capital Grants	12,892,774	2,581,639
Additions to Permanent Endowment	78,074	78,844
	<hr/>	<hr/>
Total Other Revenues	12,970,848	2,660,483
Increase (Decrease) in Net Assets	9,514,452	(97,430)
Net Assets at the Beginning of Year, Restated	<hr/> 62,806,377	<hr/> 61,480,669
Net Assets at the End of the Year	<hr/> <u>\$ 72,320,829</u>	<hr/> <u>\$ 61,383,239</u>

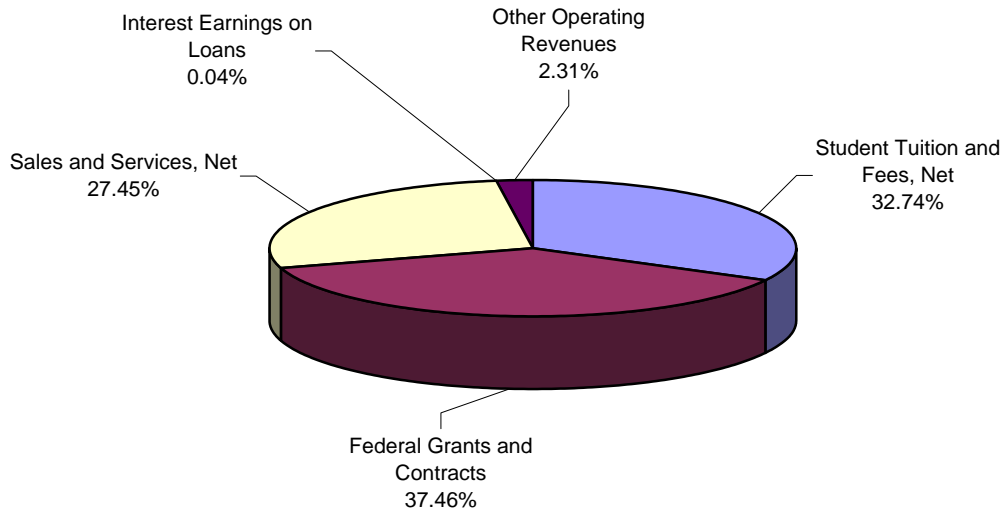
Total operating loss for fiscal year 2003 was \$32.8 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB 35, beginning last year and going forward the University will show an operating loss.

The sources of operating revenue for the University are student tuition and fees, certain grants and contracts, and auxiliary services.

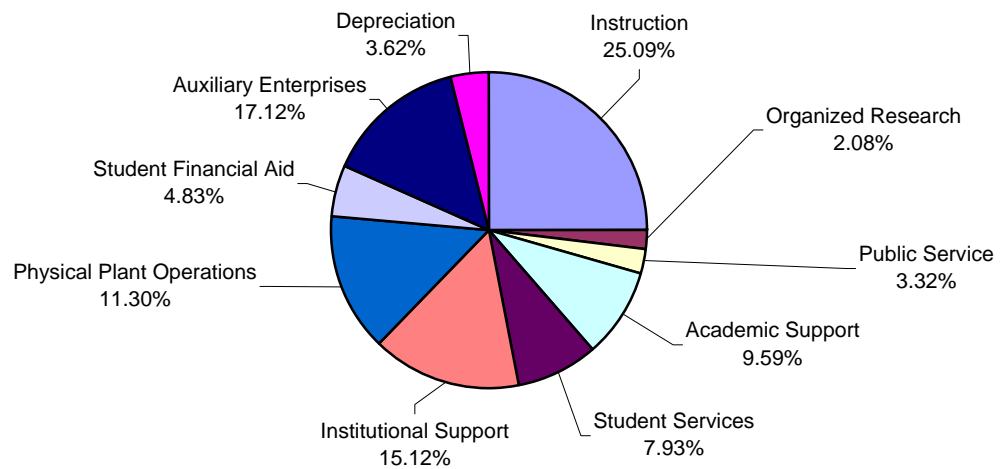
Enrollment increased by approximately seven percent for 2002/2003. Fall of 2003 saw another seven percent enrollment growth in headcount with 2,308 students.

Recurring North Carolina State appropriations, which are captured in nonoperating revenues and expenditures, were cut by approximately \$1.5 million, which relates to a six percent budget cut.

Operating Revenues by Source



Expenditures by Function



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Comparative, Condensed Statement of Cash Flows

	<u>2003</u>	<u>2002</u>
Net Cash Used by Operating Activities	\$ (30,433,875)	\$ (28,100,831)
Net Cash Provided by Noncapital Financing Activities	28,947,098	26,594,225
Net Cash Used by Capital Financing Activities	(269,050)	(1,834,553)
Net Cash Provided by Investing Activities	<u>666,389</u>	<u>758,657</u>
Net Decrease in Cash and Cash Equivalents	(1,089,438)	(2,582,502)
Cash and Cash Equivalents - Beginning of the Year	<u>10,909,523</u>	<u>13,492,025</u>
Cash and Cash Equivalents - End of Year	<u>\$ 9,820,084</u>	<u>\$ 10,909,523</u>

Major sources of funds included in operating activities include student tuition and fees (\$4,025,467), sales and services of auxiliary enterprises (\$3,265,850), and operating contracts and grants (\$4,730,437). Major uses of funds included in operating activities include payments to employees (\$25,561,020) and payments to vendors and suppliers (\$14,958,241).

The North Carolina State appropriation of \$22,294,551 is the largest inflow of cash in noncapital financing activities.

Elizabeth City State University
Statement of Net Assets
June 30, 2003

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents	\$	982,529.66
Restricted Cash and Cash Equivalents		655,233.43
Receivables, Net (Note 4)		2,875,604.76
Inventories		744,779.37
Notes Receivable, Net (Note 4)		122,878.43

Total Current Assets 5,381,025.65

Noncurrent Assets:

Restricted Cash and Cash Equivalents		8,182,321.31
Receivables, Net (Note 4)		9,297.05
Restricted Due from Primary Government		8,025,897.17
Endowment Investments		1,575,794.62
Other Long-Term Investments		1,225,236.95
Notes Receivable, Net (Note 4)		464,537.01
Capital Assets - Nondepreciable (Note 5)		11,119,608.84
Capital Assets - Depreciable, Net (Note 5)		48,797,504.54

Total Noncurrent Assets 79,400,197.49

Total Assets 84,781,223.14

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)		2,912,392.16
Due to Primary Government		15,643.43
Deferred Revenue		402,129.96
Interest Payable		42,827.03
Long-Term Liabilities - Current Portion (Note 7)		387,408.43

Total Current Liabilities 3,760,401.01

Noncurrent Liabilities:

Deposits Payable		58,441.32
Funds Held for Others		101,744.21
U. S. Government Grants Refundable		509,853.94
Long-Term Liabilities (Note 7)		8,029,953.53

Total Noncurrent Liabilities 8,699,993.00

Total Liabilities 12,460,394.01

Elizabeth City State University

Statement of Net Assets

June 30, 2003

Exhibit A

Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	51,783,115.01
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	878,062.07
Endowed Professorships	1,033,768.07
Expendable:	
Scholarships and Fellowships	1,976,857.60
Loans	381,289.82
Capital Projects	12,101,964.09
Debt Service	249,072.44
Unrestricted	3,916,700.03
Total Net Assets	\$ 72,320,829.13

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

Elizabeth City State University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2003

Exhibit B

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 4,166,659.39
Federal Grants and Contracts	4,767,500.61
Sales and Services, Net (Note 9)	3,492,387.53
Interest Earnings on Loans	5,042.07
Other Operating Revenues	294,213.26

Total Operating Revenues	12,725,802.86
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EXPENSES

Operating Expenses:

Salaries and Benefits	26,425,526.81
Supplies and Materials	5,638,942.84
Services	7,967,656.09
Scholarships and Fellowships	2,200,376.64
Utilities	1,673,193.38
Depreciation	1,650,923.31

Total Operating Expenses	45,556,619.07
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Operating Loss	(32,830,816.21)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	22,294,550.69
Noncapital Grants	6,404,508.98
Noncapital Gifts	678,131.43
Investment Income (Net of Investment Expense of \$17,328.20)	369,839.18
Interest and Fees on Capital Asset-Related Debt	(372,610.34)

Net Nonoperating Revenues	29,374,419.94
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Loss Before Other Revenues, Expenses, Gains, or Losses	(3,456,396.27)
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Capital Grants	12,892,773.73
Additions to Endowments	78,074.33

Increase in Net Assets	9,514,451.79
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NET ASSETS

Net Assets - July 1, 2002, as Restated (Note 15)	62,806,377.34
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Net Assets - June 30, 2003	\$ 72,320,829.13
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The accompanying notes to the financial statements are an integral part of this Statement.

Elizabeth City State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2003

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 12,021,754.36
Payments to Employees and Fringe Benefits	(25,561,021.18)
Payments to Vendors and Suppliers	(14,958,241.31)
Payments for Scholarships and Fellowships	(2,200,376.64)
Loans Issued	(63,277.00)
Collection of Loans	63,149.00
Other Receipts	264,137.92
Net Cash Used by Operating Activities	(30,433,874.85)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	22,294,550.69
Grants for Other than Capital Purposes	6,048,085.62
Noncapital Gifts	684,763.93
William D. Ford Direct Lending Receipts	4,853,153.00
William D. Ford Direct Lending Disbursements	(4,853,153.00)
Additions to Permanent and Term Endowments	78,074.33
Related Activity Agency Disbursements	(158,376.65)
Net Cash Provided by Noncapital Financing Activities	28,947,097.92

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	5,711,650.05
Capital Grants	5,212,725.56
Acquisition and Construction of Capital Assets	(7,155,648.67)
Principal Paid on Capital Debt and Leases	(3,643,701.00)
Interest and Fees Paid on Capital Debt and Leases	(394,076.06)
Net Cash Used by Capital and Related Financing Activities	(269,050.12)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	1,461,003.58
Interest on Investments	324,241.60
Purchase of Investments and Related Fees	(1,118,856.50)
Net Cash Provided by Investing Activities	666,388.68

Net Decrease in Cash and Cash Equivalents	(1,089,438.37)
Cash and Cash Equivalents - July 1, 2002	10,909,522.77
Cash and Cash Equivalents - June 30, 2003	\$ 9,820,084.40

Elizabeth City State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2003

Exhibit C

Page 2

**RECONCILIATION OF NET OPERATING REVENUES (EXPENSES)
TO NET CASH USED BY OPERATING ACTIVITIES**

Operating Loss	\$ (32,830,816.21)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	1,650,923.31
Changes in Assets and Liabilities:	
Receivables (Net)	(671,789.59)
Inventories	347,813.07
Accounts Payable and Accrued Liabilities	552,962.99
Due to Primary Government	(494.83)
Deferred Revenue	190,371.93
Compensated Absences	328,111.48
Note Principal Repayments	84,812.00
Notes Issued	(85,769.00)
Net Cash Used by Operating Activities	<u>\$ (30,433,874.85)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 982,529.66
Restricted Cash and Cash Equivalents	655,233.43
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	8,182,321.31
Total Cash and Cash Equivalents - June 30, 2003	<u>\$ 9,820,084.40</u>

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 18,764.00
Change in Fair Value of Investments	(39,900.63)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003

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. Elizabeth City State University 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 delegated responsibilities for financial accountability of the University's funds. Although legally separate, Elizabeth City State University Foundation, Inc. (Foundation), a component unit of the University, is reported as if it was part of the University.

The Foundation is governed by a 25-member board consisting of 13 ex officio directors and 11 elected directors. The 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 elected directors of the Foundation are appointed by the members of the Elizabeth City State University Board of Trustees and the Foundation's sole purpose is to benefit Elizabeth City State University, its financial statements have been blended with those of the University.

Separate financial statements for the Foundation may be obtained from the University Controller's Office, 1704 Weeksville Road, Elizabeth City, NC 27909, or by calling (252)-335-3224. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*, the full scope of the University’s activities is considered to be a single business-type activity (BTA) and accordingly, is reported within a single column in the basic financial statements.

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

- C. Basis of Accounting** - The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange includes State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, savings accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - This classification includes long-term fixed income investments, mutual funds, money market funds, and other asset holdings

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

by the University. Except for money market funds, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

- F. Receivables** – Receivables consist of tuition and fees charges to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of expendable supplies, are valued at cost using the first-in, first-out method. Merchandise for resale is valued using the retail inventory method.
- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 25 years for general infrastructure, 50 years for buildings, and 15 years for equipment.

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- J. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refundings. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refundings are amortized over the life of the new debt using the straight-line method. Issuance costs are expensed.

- K. Compensated Absences** - 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.

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

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

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

- L. Net Assets** – The University's net assets are classified as follows:

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

Restricted Net Assets – Nonexpendable – Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

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

Unrestricted Net Assets – Unrestricted net assets include resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

- M. Scholarship Discounts** – Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.
- N. Revenue and Expense Recognition** – The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

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

- O. Internal Sales Activities** – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as central stores, copy centers, motor pool, postal services, and telecommunications. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** – Unless specifically exempt, the University is required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to General Statute 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, 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. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Deposits include cash and cash equivalents and certificates of deposit totaling \$9,818,339.40. At year-end, cash on hand was \$1,745.00. The University's portion of the State Treasurer's Investment Pool was \$9,634,255.29. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for 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 was \$184,084.11 and the bank balance was \$470,530.12. Of the bank balance, \$272,243.13 was covered by federal depository insurance and \$198,286.99 was uninsured and uncollateralized.

North Carolina General Statutes 147-69.1(c), applicable to the State's General Fund, and 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper, and asset-backed securities with specified ratings. Also, General Statute 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. General Statute 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

The financial statements and disclosures for the State Treasurer's Investment Pool are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.state.nc.us/> 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 and Chapter VI of the Administrative Manual of the University of North Carolina, 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.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 unit, the Foundation, are subject to and restricted by General Statute 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on it 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 pool:

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unit value method. Under this method, each participating fund's investment balance is determined on a market value basis. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

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.

A summary of the University's investments at June 30, 2003 is presented below:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool

	Fair Value
	Total
Investments Not Categorized:	
Mutual Funds	\$ 2,593,183.28

Non-Pooled Investments

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U.S. Government Securities	\$ 0.00	\$ 207,848.29	\$ 0.00	\$ 207,848.29

Total Investments

	Fair Value			
	Risk Category			
	1	2	3	Total
Total Categorized Investments	\$ 0.00	\$ 207,848.29	\$ 0.00	\$ 207,848.29
Total Investments Not Categorized				2,593,183.28
Total Investments				\$ 2,801,031.57

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, State law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which limits spending between 0% and 5% of the endowment principal's market value. Under this policy, the prior year spending percentage is increased by

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the inflation rate to determine the current year spending percentage. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2003 were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 1,233,347.00	\$ 125,662.77	\$ 1,107,684.23
Accounts	352,745.00		352,745.00
Intergovernmental	1,005,851.00		1,005,851.00
Pledges	107,830.00		107,830.00
Investment Earnings	20,428.10		20,428.10
Interest on Loans	281,066.43		281,066.43
Total Current Receivables	<u>\$ 3,001,267.53</u>	<u>\$ 125,662.77</u>	<u>\$ 2,875,604.76</u>
Noncurrent Receivables:			
Pledges	<u>\$ 9,297.05</u>	<u>\$ 0.00</u>	<u>\$ 9,297.05</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	<u>\$ 137,704.43</u>	<u>\$ 14,826.00</u>	<u>\$ 122,878.43</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 881,949.83</u>	<u>\$ 417,412.82</u>	<u>\$ 464,537.01</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2002	Adjustments	Increases	Decreases	Balance June 30, 2003
Capital Assets, Nondepreciable:					
Land	\$ 1,654,818.66	\$ 0.00	\$ 0.00	\$ 0.00	\$ 1,654,818.66
Construction in Progress	2,768,050.21		6,696,739.97		9,464,790.18
Total Capital Assets, Nondepreciable	<u>4,422,868.87</u>		<u>6,696,739.97</u>		<u>11,119,608.84</u>
Capital Assets, Depreciable:					
Buildings	60,558,482.56				60,558,482.56
Machinery and Equipment	6,563,272.20		602,117.05	53,759.73	7,111,629.52
General Infrastructure	3,274,772.50				3,274,772.50
Total Capital Assets, Depreciable	<u>70,396,527.26</u>		<u>602,117.05</u>	<u>53,759.73</u>	<u>70,944,884.54</u>
Less Accumulated Depreciation/Amortization for:					
Buildings	17,124,850.33	(1,177,309.65)	1,177,309.65		17,124,850.33
Machinery and Equipment	4,477,321.82	(191,099.84)	418,884.89	50,638.23	4,654,468.64
General Infrastructure	368,061.07	(54,728.77)	54,728.77		368,061.07
Total Accumulated Depreciation	<u>21,970,233.22</u>	<u>(1,423,138.26)</u>	<u>1,650,923.31</u>	<u>50,638.23</u>	<u>22,147,380.04</u>
Total Capital Assets, Depreciable, Net	<u>48,426,294.04</u>	<u>1,423,138.26</u>	<u>(1,048,806.26)</u>	<u>3,121.50</u>	<u>48,797,504.54</u>
Capital Assets, Net	<u>\$ 52,849,162.91</u>	<u>\$ 1,423,138.26</u>	<u>\$ 5,647,933.71</u>	<u>\$ 3,121.50</u>	<u>\$ 59,917,113.38</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 1,023,127.66
Accrued Payroll	1,746,056.15
Contract Retainage	<u>143,208.35</u>
Total Accounts Payable and Accrued Liabilities	<u>\$ 2,912,392.16</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2003 is presented as follows:

	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Current Portion
Bonds Payable	\$ 4,905,000.00	\$ 5,520,000.00	\$ 3,610,000.00	\$ 6,815,000.00	\$ 285,000.00
Deduct Discount	(26,035.08)	210,019.13		183,984.05	
Deduct Deferred Charge on Refunding		(89,985.68)		(89,985.68)	
Total Bonds Payable	<u>4,878,964.92</u>	<u>5,640,033.45</u>	<u>3,610,000.00</u>	<u>6,908,998.37</u>	<u>285,000.00</u>
Compensated Absences	<u>1,180,252.52</u>	<u>1,376,160.11</u>	<u>1,048,049.04</u>	<u>1,508,363.59</u>	<u>102,408.43</u>
Total Long-Term Liabilities	<u><u>\$ 6,059,217.44</u></u>	<u><u>\$ 7,016,193.56</u></u>	<u><u>\$ 4,658,049.04</u></u>	<u><u>\$ 8,417,361.96</u></u>	<u><u>\$ 387,408.43</u></u>

B. Bonds Payable - The University was indebted for bonds payable for the purposes shown in the following table:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2003	Principal Outstanding 06/30/2003
<u>Dormitory System Revenue Bonds of 1981</u>						
Wamack Hall and Mitchell-Lewis Hall	A	3.00%	10/01/2017	\$ 675,000.00	\$ 285,000.00	\$ 390,000.00
Wamack Hall and Mitchell-Lewis Hall	B	3.00%	10/01/2020	<u>1,680,000.00</u>	<u>725,000.00</u>	<u>955,000.00</u>
Total Dormitory System Revenue Bonds of 1981				<u>2,355,000.00</u>	<u>1,010,000.00</u>	<u>1,345,000.00</u>
<u>The University of North Carolina System Pool Revenue Bonds</u>						
Refinance of Dormitory-200 Bed (1992 - Series C Bonds)	B	3.5%-5.375%	04/01/2027	3,410,000.00	30,888.00	3,379,112.00
Bedell Cafeteria Renovation	B	3.5%-5.375%	04/01/2027	1,225,000.00	11,096.00	1,213,904.00
Dormitory Furniture	B	3.5%-5.375%	04/01/2027	<u>885,000.00</u>	<u>8,016.00</u>	<u>876,984.00</u>
Total The University of North Carolina System Pool Revenue Bonds				<u>5,520,000.00</u>	<u>50,000.00</u>	<u>5,470,000.00</u>
Total Bonds Payable (principal only)				<u><u>\$ 7,875,000.00</u></u>	<u><u>\$ 1,060,000.00</u></u>	6,815,000.00
Less: Unamortized Loss on Refunding						(89,985.68)
Plus: Unamortized Premium						<u>183,984.05</u>
Total Bonds Payable						<u><u>\$ 6,908,998.37</u></u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2003 are as follows:

<u>Fiscal Year</u>	Annual Requirements	
	Bonds Payable	
	Principal	Interest
2004	\$ 285,000.00	\$ 170,333.13
2005	295,000.00	163,983.13
2006	300,000.00	157,433.13
2007	310,000.00	151,295.63
2008	325,000.00	144,995.63
2009-2013	1,865,000.00	603,346.90
2014-2018	2,290,000.00	336,259.39
2019-2023	835,000.00	81,418.75
2024	310,000.00	20,000.00
Total Requirements	\$ 6,815,000.00	\$ 1,829,065.69

D. Bond Defeasance - The University has extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

(Dormitory System Revenue Bonds of 1992): On November 14, 2002 the University defeased \$3,495,000.00 of outstanding (200 Bed Dormitory) Revenue Bonds, Series C (original issue amount \$4,145,000.00). As a result, the University reduced its debt service requirements by \$531,169.51 over the next 16 years and obtained an economic gain of \$437,301.07.

NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for equipment and chemicals for science departments. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2003:

<u>Fiscal Year</u>	<u>Amount</u>
2004	\$ 97,132.79
2005	18,000.95
2006	3,556.79
2007	469.07
2008	469.07
Total Minimum Lease Payments	\$ 119,628.67

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Rental expense for all operating leases during the year was \$138,854.39.

NOTE 9 - REVENUES

A summary of eliminations and allowances by revenue classification and revenues pledged as security for revenue bonds is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Net Revenues
Operating Revenues:				
Student Tuition and Fees	\$ 7,058,154	\$ 0	\$ 2,891,495	\$ 4,166,659
Sales and Services:				
Sales and Services of Auxiliary Enterprises:				
Residential Life	\$ 2,979,464	\$ 0	\$ 1,266,075	\$ 1,713,389 (A)
Dining	1,701,186		709,806	991,380
Bookstore	601,573		251,945	349,628
Other	579,518	141,527		437,991
Total Sales and Services	<u>\$ 5,861,741</u>	<u>\$ 141,527</u>	<u>\$ 2,227,826</u>	<u>\$ 3,492,388</u>

Revenue Bonds Secured by Pledged Revenues:
(A) Housing and Student Center System

NOTE 10 - OPERATING EXPENSES BY FUNCTION

The University's operating expenses by functional classification are presented as follows:

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 10,573,798	\$ 526,619	\$ 330,573	\$ 0	\$ 0	\$ 0	\$ 11,430,990
Research	422,311	183,445	340,230				945,986
Public Service	1,012,248	41,277	457,471				1,510,996
Academic Support	2,605,368	1,308,869	453,781				4,368,018
Student Services	2,256,235	543,010	812,592				3,611,837
Institutional Support	4,875,573	521,925	1,491,773				6,889,271
Operations and Maintenance of Plant	2,658,592	358,756	931,820		1,200,372		5,149,540
Student Financial Aid				2,200,377			2,200,377
Auxiliary Enterprises	2,021,402	2,155,042	3,149,416		472,821		7,798,681
Depreciation						1,650,923	1,650,923
Total Operating Expenses	<u>\$ 26,425,527</u>	<u>\$ 5,638,943</u>	<u>\$ 7,967,656</u>	<u>\$ 2,200,377</u>	<u>\$ 1,673,193</u>	<u>\$ 1,650,923</u>	<u>\$ 45,556,619</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

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

For the year ended June 30, 2003, the University had a total payroll of \$21,038,347.53, of which \$15,389,473.84 was covered under the Teachers' and State Employees' Retirement System. Total employee contributions for pension benefits for the year were \$923,368.43. No employer contributions were required. The University made one hundred percent of its annual required contributions for the years ended June 30, 2003, 2002, and 2001, which were \$0.00, \$230,372.19, and \$640,121.21, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.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 that 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

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

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

For the year ended June 30, 2003, the University had a total payroll of \$21,038,347.53, of which \$3,295,882.24 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$197,752.93 and \$225,438.35, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$26,808.55 for the year ended June 30, 2003.

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 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2003 were \$19,538.95. The voluntary contributions by employees amounted to \$157,390.00 for the year ended June 30, 2003.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$205,516.97 for the year ended June 30, 2003.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** 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 2.35% 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, 2003, the University's total contribution to the Plan was

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$99,152.39. 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. Long-Term Disability** - 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 and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the fiscal year ended June 30, 2003, the University's total contribution to the DIPNC was \$97,163.85. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and 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 State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

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

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible. The

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University also purchased through the Fund extended coverage for buildings and contents to cover windstorm, explosions or damage caused by vehicle or aircraft impacts. The extended coverage applies to all campus buildings and contents with coverage amounts varying based on the value of each building and its contents. Losses for buildings and contents are subject to a \$500 per occurrence deductible, and losses for theft are subject to a \$1,000 per occurrence deductible.

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses occurring in-State are \$500,000 per claim and \$5,000,000 per occurrence and out-of-State are \$1,000,000 per claim and \$5,000,000 per occurrence. The University pays premiums to the Department of Insurance for the coverage.

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence with a \$50,000 deductible and a 10% participation in each loss above the deductible.

University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

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 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.

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects. Outstanding commitments on construction contracts were \$18,877,943.42 at June 30, 2003.
- B. Pending Litigation and Claims** – The University is a party to 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 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 \$39,546,138.17 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.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 15 - NET ASSET RESTATEMENT

As of July 1, 2002, net assets as previously reported was restated as follows:

	<u>Amount</u>
July 1, 2002 Net Assets as Previously Reported	\$ 61,383,239.08
Overstatement of Accumulated Depreciation	<u>1,423,138.26</u>
July 1, 2002 Net Assets as Restated	<u><u>\$ 62,806,377.34</u></u>

NOTE 16 - SUBSEQUENT EVENTS

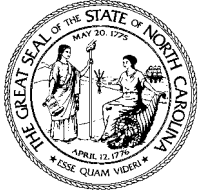
On August 21, 2003, a blended foundation issued \$14,155,000 in tax-exempt bonds to finance a privatized housing complex to serve the students of the University.

**Elizabeth City State University
 Schedule of General Obligation Bond Project Authorizations,
 Budgets, and Expenditures
 For Project-to-Date as of June 30, 2003**

Schedule 1

Capital Improvement Projects	Projected Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Expected Completion Date
Projects Started							
Student Center	2001	\$ 8,268,300.00	\$ 0.00	\$ 8,268,300.00	\$ 1,512,124.77	18.29%	Aug 2004
Williams Hall Renovation	2001	2,502,700.00	447,675.00	2,950,375.00	1,334,015.29	45.22%	Dec 2003
Physical Education Facility	2001	1,447,500.00		1,447,500.00	1,443,949.77	99.75%	May 2003
Trigg Hall Renovation	2002	2,019,000.00	12,337.50	2,031,337.50	27,569.00	1.36%	Jul 2006
Lane Hall Renovation	2002	2,275,600.00	56,086.00	2,331,686.00	3,874.00	0.17%	Aug 2005
Johnson Hall Renovation	2002	2,876,300.00	20,000.00	2,896,300.00	178,467.51	6.16%	Aug 2004
K.E.White Graduate Renovation	2002	1,514,000.00	152,051.00	1,666,051.00	405,236.00	24.32%	Sep 2004
200 Bed Dormitory	2002	5,247,500.00		5,247,500.00	111,471.00	2.12%	Aug 2004
Technology Infrastructure	2002	3,149,400.00	7,402.92	3,156,802.92	1,180,271.76	37.39%	Jun 2005
Chiller Plant	2002	5,401,500.00		5,401,500.00	316,978.00	5.87%	Aug 2004
Campus Infrastructure	2002	1,939,300.00	489,986.30	2,429,286.30	408,693.37	16.82%	Jun 2006
Lester Hall Renovation	2003	165,000.00	54,758.03	219,758.03	70,758.00	32.20%	Dec 2004
Electrical Distribution Upgrade	2003	825,000.00		825,000.00	560.50	0.07%	Mar 2005
Land Acquisition	2003	650,000.00		650,000.00	79,321.00	12.20%	May 2005
Projects Not Started - To Be Funded in Future Years							
Wilkins Lab Renovation		413,800.00		413,800.00			
Energy Management System		886,400.00	66,493.00	952,893.00			
Mitchell Lab Renovation		1,958,700.00		1,958,700.00			
Womack Renovation		3,114,300.00		3,114,300.00			
Doles Hall Renovation		1,642,500.00		1,642,500.00			
Total All Projects		\$ 46,296,800.00	\$ 1,306,789.75	\$ 47,603,589.75	\$ 7,073,289.97		

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 System. 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.



Ralph Campbell, Jr.
State Auditor

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**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**

Board of Trustees
Elizabeth City State University
Elizabeth City, North Carolina

We have audited the financial statements of Elizabeth City State University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2003, and have issued our report thereon dated January 30, 2004. We did not audit the financial statements of Elizabeth City State University Foundation, Inc., which represent 3.5 percent, 4.2 percent, and 1.8 percent, respectively, of the assets, net assets and revenues of the University. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Elizabeth City State University Foundation, Inc., is based on the report of the other auditors.

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. The financial statements of Elizabeth City State University Foundation, Inc. were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to that Foundation.

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)**

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 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



January 30, 2004

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Director, Fiscal Research Division

March 5, 2004

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