



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

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THE UNIVERSITY OF NORTH CAROLINA

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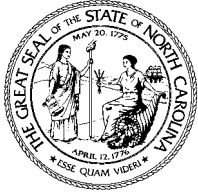
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Ralph Campbell, Jr.
State Auditor

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.ncauditor.net>

AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of Fayetteville 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 Fayetteville 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 Fayetteville 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 Fayetteville 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 - The following significant deficiencies in internal control over financial reporting and instances of noncompliance were noted as a result of our audit:

Finding

1. Internal Control Weaknesses over the Cash Disbursement Process
2. Internal Control Weaknesses over Machinery and Equipment

These matters are described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting and the Audit Findings and Recommendations section of this report.

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.ncauditor.net>

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the accompanying basic financial statements of Fayetteville 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 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 Fayetteville 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 April 14, 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, 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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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 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.

A handwritten signature in black ink that reads "Ralph Campbell, Jr." in a cursive script.

Ralph Campbell, Jr.
State Auditor

April 14, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Fayetteville State University (the "University") annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2003. This discussion has been prepared by University management along with the financial statements and related notes and should be read in conjunction with and is qualified in its entirety by the financial statements and notes. The financial statements, notes and this discussion are the responsibility of the University management.

Using the Annual Report

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (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*. These GASB financial statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis for the University as a whole, with resources classified for accounting and reporting purposes into four net asset categories. Previous financial reporting requirements focused on the accountability of individual funds groups rather than on the University as a whole. One of the most important questions asked is whether the University as a whole is better or worse off as a result of the year's activities. The key to understanding this question is the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. These statements present financial information in a form similar to that used by corporations. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

Summary of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The Statement of Net Assets is a point of time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of Fayetteville State University. The Statement of Net Assets presents end-of-year data concerning assets (property that we own and what we are owed by others), liabilities (what we owe to others and have collected from others before we have provided the service), and net assets (assets minus liabilities). It is prepared under the accrual basis of accounting, where revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service to us, regardless of when cash is exchanged.

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the Institution. They are also able to determine

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

how much the Institution owes vendors, investors, and lending institutions. Finally, the Statement of Net Assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the Institution.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the Institution's equity in property, plant, and equipment owned by the Institution. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. Restricted nonexpendable net assets consist primarily of the University's permanent endowment funds and are only available for investment purposes. Expendable restricted net assets are available for expenditures by the Institution but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the Institution for any lawful purpose of the Institution. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the University's unrestricted net assets have been designated for various academic and research programs and initiatives.

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used by private-sector companies. The University's supporting organization, the Fayetteville State University Foundation, Inc. (the "Foundation") is an independent nonprofit corporation formed for the exclusive benefit of the University. The Foundation is not a component unit of the University. Therefore, the results of its operations are not incorporated within these financial statements, or this Management's Discussion and Analysis.

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2003. Its combined net assets increased \$3.0 million from the previous year, which is an increase of approximately 6.9 percent.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Summary of Net Assets (in thousands)

	<u>2003</u>	<u>2002</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
ASSETS				
Current Assets	\$ 10,255	\$ 12,271	\$ (2,016)	-16.43%
Noncurrent Assets:				
Capital	34,490	32,286	2,204	6.83%
Other	17,471	11,371	6,100	53.65%
Total Assets	<u>62,216</u>	<u>55,928</u>	<u>6,288</u>	11.24%
LIABILITIES				
Current Liabilities	3,258	3,089	169	5.47%
Noncurrent Liabilities	11,795	8,725	3,070	35.19%
Total Liabilities	<u>15,053</u>	<u>11,814</u>	<u>3,239</u>	27.42%
NET ASSETS				
Invested in Capital Assets, Net of Related Debt	29,708	27,250	2,458	9.02%
Restricted:				
Nonexpendable	2,937	2,287	650	28.42%
Expendable	11,173	6,887	4,286	62.23%
Unrestricted	3,345	7,690	(4,345)	-56.50%
Total Net Assets	<u>\$ 47,163</u>	<u>\$ 44,114</u>	<u>\$ 3,049</u>	6.91%

Net Asset categories are defined in Note 1L to the financial statements.

As of June 30, 2003, total University assets were \$62.2 million. The University's largest asset is its net investment in its physical plant of \$34.5 million at June 30, 2003. Total assets of the University increased by \$6.3 million. Current assets decreased by \$2.0 million primarily due to a decrease in cash and cash equivalents of \$4.4 million.

The increase in restricted cash and cash equivalents, primarily attributable to the \$2.651 million November 2002 bond sale, was a major component of the \$6.1 million increase in other noncurrent assets. Also contributing was a \$1.8 million increase in the amount due from primary government resulting from increased construction activity related to the voter approved higher education bonds.

University liabilities totaled \$15.1 million at June 30, 2003. Long-term liabilities of \$8.7 million, consisting of \$6.9 million bonds payable and \$1.8 million compensated absences, are the largest liabilities. Noncurrent liabilities increased by \$3.1 million primarily due to a net increase of \$2.1 million in notes and bonds payable. Stadium upgrade bonds, which were issued in November 2002, of \$2.6 million outstanding at June 30, 2003, were the primary reason for the increase.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University's current assets of \$10.3 million covered the current liabilities of \$3.3 million, as the current ratio was \$3.12 in current assets to every \$1 in current liabilities.

At June 30, 2003, the University had outstanding bonds of \$7.4 million. Bonds payable is the University's largest liability at June 30, 2003, representing 49.2% of total University liabilities. On November 14, 2002, the University issued \$3.980 million in the University of North Carolina System Pool Revenue Bonds, Series 2002 B to advance refund \$1.245 million of outstanding United States Department of Education notes payable and to provide funding for stadium renovations of \$2.735 million.

Although all categories of net assets increased during the year, the \$3.0 million overall increase was largely attributable to the increase in capital assets, net of related debt of \$2.4 million, and the increase in capital projects of \$3.5 million.

Summary of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. A public University's dependency on State aid and gifts will result in operating deficits. The GASB requires that State appropriations and gifts to be classified as nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

Changes in total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the Statement is to present the revenues received by the Institution, both operating and nonoperating, the expenses paid by the Institution, operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by the Institution.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the Institution. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the Institution. Nonoperating revenues are revenues received for which goods and services are not provided. Capital grants and gifts are considered neither operating nor nonoperating revenues and are reported after "Income before other revenues, expenses, gains or losses".

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Summary of Revenues, Expenses, and Changes in Net Assets (in thousands)

	2003	2002	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees	\$ 9,099	\$ 7,231	\$ 1,868	25.83%
Grants and Contracts	9,048	6,982	2,066	29.59%
Auxiliary Activities	4,069	4,126	(57)	-1.38%
Other Educational Activities	259	1,336	(1,077)	-80.61%
Total Operating Revenues	22,475	19,675	2,800	14.23%
Operating Expenses:				
Salaries and Benefits	36,303	34,334	1,969	5.73%
Supplies and Services	18,884	14,140	4,744	33.55%
Student Financial Support	4,845	3,790	1,055	27.84%
Utilities	1,785	1,769	16	0.90%
Depreciation	1,790	1,705	85	4.99%
Total Operating Expenses	63,607	55,738	7,869	14.12%
Operating Loss	(41,132)	(36,063)	(5,069)	-14.06%
Nonoperating Revenues:				
State Appropriations, Operating	31,797	28,140	3,657	13.00%
Noncapital Grants	8,438	7,514	924	12.30%
Noncapital Gifts	443	690	(247)	-35.80%
Investment Income	701	30	671	2,236.66%
Interest and Fees on Capital Asset- Related Debt	(443)	(414)	(29)	7.00%
Net Operating Revenues	40,936	35,960	4,976	13.84%
Income Before Other Revenues, Expenses, Gains, or Losses	(196)	(103)	(93)	90.29%
Capital Grants	4,785		4,785	
Permanent Endowment Additions		198	(198)	-100.00%
Net Increase in Net Assets	4,589	95	4,494	4,730.53%
Net Assets:				
Beginning of Year (as Restated)	42,574	44,019	(1,445)	-3.28%
End of Year	\$ 47,163	\$ 44,114	\$ 3,049	6.91%

The Condensed Summary of Revenues, Expenses, and Changes in Net Assets reflects a positive year with an increase in net assets of \$4.6 million at the end of the year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total operating loss for fiscal 2003 was \$41.1 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB 35, the University will show a significant operating loss.

The sources of operating revenue for the University are tuition and fees, grants and contracts, auxiliary services, and other educational activities.

The University strives to provide students with the opportunity to obtain a quality education. Future University enrollments may be affected by a number of factors, including any material increase in tuition and other mandatory charges, stemming from any material decrease in appropriation funding from the State of North Carolina.

Operating expenditures, including depreciation of \$1.8 million, totaled \$63.6 million. Of this total, \$30.0 million or 47.2 percent was used for instruction and student support, and \$0.6 million or 1.0 percent for research.

The University's largest source of nonoperating revenue is the State of North Carolina appropriation. This is received in monthly payments, beginning in July of each year, since the State's fiscal year begins on July 1st. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year beginning July 1, 2002 and ending June 30, 2003, the appropriations from the State for the University were \$31.8 million for operations. This appropriation was fully recorded by the University during the University's fiscal year ending June 30, 2003.

One of the University's greatest strengths is the diverse streams of revenues which supplement its student tuition and fees, including voluntary private support from individuals, foundations, and corporations, along with government and other sponsored programs, State appropriations and investment income. The University has in the past and will continue to seek funding aggressively from all possible sources consistent with its mission, to supplement student tuition, and manage prudently the financial resources realized from these efforts to fund its operating activities.

The Statement of Cash Flows

The Statement of Cash Flows presents detailed information about the cash activity of the Institution during the year. The Statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities of the Institution. The second section reflects cash flows from noncapital financing activities. This section reflects the cash received and spent for nonoperating, noninvesting, and noncapital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fourth section reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received from investing activities. The fifth section reconciles the net cash used to the operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Cash Flows (in thousands)

	<u>2003</u>	<u>2002</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Cash Provided by/(Used) in:				
Operating Activities	\$ (42,122)	\$ (37,990)	\$ (4,132)	10.88%
Noncapital Financing Activities	40,843	37,427	3,416	9.13%
Capital and Related Financing Activities	354	(1,683)	2,037	121.03%
Investing Activities	<u>245</u>	<u>575</u>	<u>(330)</u>	-57.39%
Net Decrease in Cash	<u>(680)</u>	<u>(1,671)</u>	<u>991</u>	59.31%
Cash - Beginning of the Year	<u>12,936</u>	<u>14,607</u>	<u>(1,671)</u>	-11.44%
Cash - End of Year	<u>\$ 12,256</u>	<u>\$ 12,936</u>	<u>\$ (680)</u>	-5.26%

Major sources of funds included in operating activities are received from customers (\$19.8 million). The largest payments in this group were compensation to employees (\$35.6 million) and to suppliers (\$21.2 million).

The largest inflow of cash in the noncapital financing activities is the State of North Carolina appropriation at \$31.8 million. Cash used in capital and related financing activities during fiscal year 2003 was primarily for the acquisition of capital assets and the repayment of debt.

Capital Assets

With the successful passage of the higher education bond referendum in November 2000, the University received a \$46.0 million allocation to enhance campus facilities. Major capital expenditures through the year ended June 30, 2003, include the Lyons Science Renovations (\$0.8 million), Seabrook Renovation (\$0.5 million) and Technology Infrastructure (\$0.5 million). The bond referendum is discussed in detail in Note 13B to the financial statements. Also, a Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures is presented in Schedule 1 of this report.

Factors Impacting Future Periods

Management believes that the University is well positioned to continue its strong financial condition and level of excellence in service to students, the community, and governmental agencies. This flexibility, along with the University's ongoing efforts toward revenue diversification and cost containment, will enable the University to provide the necessary resources to support this level of excellence.

A crucial element to the University's future will continue to be our relationship with the State of North Carolina, as we work to manage tuition to make it competitive while providing an

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

outstanding college education for our students. There is a direct relationship between the growth of State support and the University's ability to control tuition growth, as declines in State appropriations generally result in increased tuition levels.

The University continues to execute its long-range plan to modernize and expand its complement of facilities with a balance of new construction. This strategy addresses the University's growth and the continuing effects of technology on teaching methodologies.

Private gifts are an important supplement to the fundamental support from the State and student tuition, and a significant factor in the growth of academic units. Economic pressures affecting donors may also affect the future level of support the University receives from corporate and individual giving.

The University will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate the University's operations from temporary market volatility.

While it is not possible to predict the ultimate results, management believes that the University's financial condition is strong enough to weather any economic uncertainties.

Fayetteville State University
Statement of Net Assets
June 30, 2003

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 1,649,003.27
Restricted Cash and Cash Equivalents	1,034,699.75
Receivables, Net (Note 4)	6,530,155.18
Due from Primary Government	108,933.07
Inventories	320,357.94
Notes Receivable, Net (Note 4)	612,075.68
Total Current Assets	10,255,224.89

Noncurrent Assets:

Restricted Cash and Cash Equivalents	9,572,718.40
Restricted Due from Primary Government	1,782,835.83
Endowment Investments	3,802,488.55
Other Long-Term Investments	412,713.12
Notes Receivable, Net (Note 4)	1,900,185.27
Capital Assets - Nondepreciable (Note 5)	11,443,810.68
Capital Assets - Depreciable, Net (Note 5)	23,046,305.31
Total Noncurrent Assets	51,961,057.16

Total Assets	62,216,282.05
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	1,547,064.74
Due to Primary Government	33,753.52
Deferred Revenue	922,765.21
Interest Payable	58,989.35
Long-Term Liabilities - Current Portion (Note 7)	695,300.58
Total Current Liabilities	3,257,873.40

Noncurrent Liabilities:

Funds Held for Others	985,004.09
U. S. Government Grants Refundable	2,097,557.79
Long-Term Liabilities (Note 7)	8,712,818.93
Total Noncurrent Liabilities	11,795,380.81
Total Liabilities	15,053,254.21

Fayetteville State University
Statement of Net Assets
June 30, 2003

Exhibit A

Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	29,708,115.99
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	1,018,966.32
Endowed Professorships	1,303,000.00
Loans	614,699.39
Expendable:	
Scholarships and Fellowships	3,113,884.55
Endowed Professorships	205,316.76
Departmental Uses	1,825.94
Capital Projects	6,602,007.70
Debt Service	1,250,428.83
Unrestricted	3,344,782.36
Total Net Assets	\$ 47,163,027.84

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

Fayetteville 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 8)	\$	9,098,456.81
Federal Grants and Contracts		8,968,880.44
State and Local Grants and Contracts		79,445.03
Sales and Services, Net (Note 8)		4,069,203.33
Interest Earnings on Loans		9,108.56
Other Operating Revenues		249,413.68

Total Operating Revenues		22,474,507.85
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EXPENSES

Operating Expenses:

Salaries and Benefits		36,302,806.93
Supplies and Materials		8,531,181.21
Services		10,352,685.60
Scholarships and Fellowships		4,844,914.85
Utilities		1,785,332.32
Depreciation		1,789,678.33

Total Operating Expenses		63,606,599.24
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Operating Loss		(41,132,091.39)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations		31,797,116.00
Noncapital Grants		8,438,023.18
Noncapital Gifts, Net (Note 8)		442,996.27
Investment Income (Net of Investment Expense of \$11,646.14)		701,207.50
Interest and Fees on Capital Asset-Related Debt		(442,718.15)

Net Nonoperating Revenues		40,936,624.80
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Loss Before Other Revenues, Expenses, Gains, or Losses		(195,466.59)
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Capital Grants		4,784,478.00
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Increase in Net Assets		4,589,011.41
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NET ASSETS

Net Assets - July 1, 2002, as Restated (Note 15)		42,574,016.43
Net Assets - June 30, 2003	\$	47,163,027.84

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

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

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 19,810,048.47
Payments to Employees and Fringe Benefits	(35,601,257.08)
Payments to Vendors and Suppliers	(21,213,967.33)
Payments for Scholarships and Fellowships	(4,844,714.85)
Loans Issued	(762,663.83)
Collection of Loans	370,907.69
Interest Earned on Loans	4,380.61
US Government Grants Refundable Receipts (Net of Disbursements of \$3,403.97)	115,625.70
Net Cash Used by Operating Activities	(42,121,640.62)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	31,797,116.00
Grants for Other than Capital Purposes	8,438,023.18
Noncapital Gifts	407,675.61
Additions to Permanent and Term Endowments	35,320.66
William D. Ford Direct Lending Receipts	12,339,258.05
William D. Ford Direct Lending Disbursements	(12,339,258.05)
Related Activity Agency Receipts	164,746.54
Net Cash Provided by Noncapital Financing Activities	40,842,881.99

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	3,980,000.00
Capital Grants	3,020,301.30
Acquisition and Construction of Capital Assets	(4,640,647.17)
Principal Paid on Capital Debt and Leases	(1,593,535.52)
Interest and Fees Paid on Capital Debt and Leases	(412,586.63)
Net Cash Provided by Capital Financing and Related Financing Activities	353,531.98

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	858,470.69
Interest on Investments	715,304.09
Purchase of Investments and Related Fees	(1,328,347.38)
Net Cash Provided by Investing Activities	245,427.40

Net Decrease in Cash and Cash Equivalents	(679,799.25)
Cash and Cash Equivalents - July 1, 2002	12,936,220.67
Cash and Cash Equivalents - June 30, 2003	\$ 12,256,421.42

<i>Fayetteville State University</i>	
<i>Statement of Cash Flows</i>	<i>Exhibit C</i>
<i>For the Fiscal Year Ended June 30, 2003</i>	<i>Page 2</i>
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	
Operating Loss	\$ (41,132,091.39)
Adjustments to Reconcile Operating Loss to Net Cash Provided (Used) by Operating Activities:	
Depreciation Expense	1,789,678.33
Allowances, Write-Offs, and Amortizations	(347,705.24)
Changes in Assets and Liabilities:	
Receivables (Net)	(3,458,785.73)
Inventories	15,289.11
Accounts Payable and Accrued Liabilities	(295,989.70)
US Government Grants Refundable	115,625.70
Due to Primary Government	(11,570.35)
Deferred Revenue	862,265.21
Compensated Absences	733,399.58
Student Loans Issued	(762,663.83)
Student Loan Principal Repayments	370,907.69
Net Cash Used by Operating Activities	<u>\$ (42,121,640.62)</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS	
Current Assets:	
Cash and Cash Equivalents	\$ 1,649,003.27
Restricted Cash and Cash Equivalents	1,034,699.75
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>9,572,718.40</u>
Total Cash and Cash Equivalents - June 30, 2003	<u>\$ 12,256,421.42</u>
NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES	
Change in Fair Value of Investments	\$ 5,613.23
Reinvested Distributions	52,137.40
The accompanying notes to the financial statements are an integral part of this statement.	

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FAYETTEVILLE STATE UNIVERSITY
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. Fayetteville 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. 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. Related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements. These entities are not included because they are separately incorporated and there are neither common directors nor other evidence of common control.

- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 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 mutual funds and United States Government Securities held by the University. These investments are accounted for at fair value, as determined by quoted market prices. The net increase in the fair value of investments is recognized as a component of investment income.
- 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, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of expendable supplies, postage, fuel oil, and merchandise for resale, are valued at the lower of cost or market value using the first-in, first-out method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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, 30 years for buildings, and 3 to 11 years for equipment

The University does not capitalize its art collection. This collection adheres to the University's policy to maintain for public exhibition, education or research; protect, keep unencumbered, care for and preserve; and requires proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized.

- 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.
- 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.

The University's bond premiums/discounts are considered immaterial and 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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 and printing. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

Deposits include cash and cash equivalents totaling \$11,851,861.42. At year-end, cash on hand was \$404,560.00. The University's portion of the State Treasurer's Investment Pool was \$11,744,804.89. 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 \$107,056.53 and the bank balance was \$110,555.91. Of the bank balance, \$110,555.91 was covered by federal depository insurance.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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.

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, 2003 is presented below:

Non-Pooled Investments

	Fair Value			
	Risk Category			
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 412,713.12	\$ 0.00	\$ 0.00	\$ 412,713.12
Investments Not Categorized:				
Mutual Funds				3,802,488.55
Total Non-Pooled Investments				\$ 4,215,201.67

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 under classical trust doctrines. Unless the donor has stipulated otherwise, capital gains and losses are accounted for as part of the endowment principal and are not available for expenditure. The University's endowment spending policy governs the rate at which funds are released to the operating budget from the endowment. The University uses a disciplined spending rate with a long-term spending rule. The target rate for spending is set between 4% and 6% of the endowment's three-year average year-end market value. In order to preserve the purchasing power of the endowment, the portfolio is invested with the expectation of generating a long-term rate of return at least equal to the payout plus the rate of inflation. At June 30, 2003, there was no net appreciation available to be spent.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2003 were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 801,071.34	\$ 421,521.64	\$ 379,549.70
Accounts	194,647.96		194,647.96
Intergovernmental	5,849,924.68		5,849,924.68
Interest on Loans	75,536.33		75,536.33
Accrued Interest Receivable	30,496.51		30,496.51
Total Current Receivables	<u>\$ 6,951,676.82</u>	<u>\$ 421,521.64</u>	<u>\$ 6,530,155.18</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 611,700.68	\$ 0.00	\$ 611,700.68
Institutional Student Loan Programs	375.00		375.00
Total Notes Receivable - Current	<u>\$ 612,075.68</u>	<u>\$ 0.00</u>	<u>\$ 612,075.68</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 2,344,578.05</u>	<u>\$ 444,392.78</u>	<u>\$ 1,900,185.27</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	Increases	Decreases	Balance June 30, 2003
Capital Assets, Nondepreciable:				
Land	\$ 893,860.87	\$ 150,000.00	\$ 0.00	\$ 1,043,860.87
Construction in Progress	<u>8,241,358.29</u>	<u>2,158,591.52</u>		<u>10,399,949.81</u>
Total Capital Assets, Nondepreciable	<u>9,135,219.16</u>	<u>2,308,591.52</u>		<u>11,443,810.68</u>
Capital Assets, Depreciable:				
Buildings	56,938,169.27	256,878.68		57,195,047.95
Machinery and Equipment	4,691,450.95	1,428,409.57	5,897.90	6,113,962.62
General Infrastructure	<u>2,693,400.77</u>			<u>2,693,400.77</u>
Total Capital Assets, Depreciable	<u>64,323,020.99</u>	<u>1,685,288.25</u>	<u>5,897.90</u>	<u>66,002,411.34</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	36,359,213.07	1,277,641.23		37,636,854.30
Machinery and Equipment	3,537,840.87	429,568.78	5,897.90	3,961,511.75
General Infrastructure	<u>1,275,271.66</u>	<u>82,468.32</u>		<u>1,357,739.98</u>
Total Accumulated Depreciation	<u>41,172,325.60</u>	<u>1,789,678.33</u>	<u>5,897.90</u>	<u>42,956,106.03</u>
Total Capital Assets, Depreciable, Net	<u>23,150,695.39</u>	<u>(104,390.08)</u>		<u>23,046,305.31</u>
Capital Assets, Net	<u>\$ 32,285,914.55</u>	<u>\$ 2,204,201.44</u>	<u>\$ 0.00</u>	<u>\$ 34,490,115.99</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 777,977.48
Accrued Payroll	723,702.72
Contract Retainage	<u>45,384.54</u>
Total Accounts Payable and Accrued Liabilities	<u>\$ 1,547,064.74</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
Notes Payable	\$ 1,270,535.52	\$ 0.00	\$ 1,270,535.52	\$ 0.00	\$ 0.00
Bonds Payable	3,765,000.00	3,980,000.00	323,000.00	7,422,000.00	510,000.00
Compensated Absences	1,252,719.93	1,825,940.84	1,092,541.26	1,986,119.51	185,300.58
Total Long-Term Liabilities	\$ 6,288,255.45	\$ 5,805,940.84	\$ 2,686,076.78	\$ 9,408,119.51	\$ 695,300.58

Additional information regarding capital lease obligations is included in Note 9.

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
Dormitory System						
Dormitory System Revenue Bond	A	3.0%-3.625%	10/01/2005	\$ 920,000.00	\$ 808,000.00	\$ 112,000.00
Dormitory System Revenue Bond	B	8.0%-10.0%	10/01/2009	1,750,000.00	1,000,000.00	750,000.00
Total Dormitory System				2,670,000.00	1,808,000.00	862,000.00
Dining System						
Dining System Facility Fee Revenue Bond	1997	4.1%-5.7%	01/01/2023	3,040,000.00	345,000.00	2,695,000.00
The University of North Carolina System Pool Revenue Bonds						
Pooled General Revenue Bonds:	2002B	3.50%-5.375%	04/01/2012			
Refunding of U.S. Department of Education Notes Payable				1,245,000.00	20,000.00	1,225,000.00
Stadium Renovation				2,735,000.00	95,000.00	2,640,000.00
Total The University of North Carolina System Pool Revenue Bonds				3,980,000.00	115,000.00	3,865,000.00
Total Bonds Payable (principal only)				\$ 9,690,000.00	\$ 2,268,000.00	\$ 7,422,000.00

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>	<u>Annual Requirements</u>	
	<u>Bonds Payable</u>	
	<u>Principal</u>	<u>Interest</u>
2004	\$ 510,000.00	\$ 377,888.76
2005	535,000.00	353,335.01
2006	512,000.00	328,121.26
2007	525,000.00	304,141.26
2008	545,000.00	279,011.26
2009-2013	2,380,000.00	972,775.64
2014-2018	1,090,000.00	535,360.02
2019-2023	1,325,000.00	190,811.26
Total Requirements	<u>\$ 7,422,000.00</u>	<u>\$ 3,341,444.47</u>

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

On November 14, 2002 the University issued \$3,980,000 in the University of North Carolina System Pool Revenue Bonds, Series 2002B with an average interest rate of 4.46%. The refunding component of this bond issue was used to advance refund \$1,252,707.98 of outstanding United States Department of Education notes payable, with a combined average interest rate of 5.5%. Net proceeds of \$1,275,115.15 resulted from the bond sale. As a result, the University reduced its debt service requirements by \$81,486.14 over the next 20 years and obtained an economic gain of \$64,044.11. At June 30, 2003 there was no outstanding balance for the defeased United States Department of Education notes payable.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - 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	Less Allowance for Uncollectibles	Net Revenues	
Operating Revenues:						
Student Tuition and Fees	<u>\$ 14,543,966.55</u>	<u>\$ 0.00</u>	<u>\$ 5,023,988.10</u>	<u>\$ 421,521.64</u>	<u>\$ 9,098,456.81</u>	
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 2,533,812.93	\$ 0.00	\$ 882,592.50	\$ 0.00	\$ 1,651,220.43	(A)
Dining	1,902,569.70		678,917.32		1,223,652.38	(B)
Bookstore	280,510.13		135,783.46		144,726.67	
Other	1,398,576.41	744,338.53	67,891.73		586,346.15	
Sales and Services of Education and Related Activities	<u>463,257.70</u>				<u>463,257.70</u>	
Total Sales and Services	<u>\$ 6,578,726.87</u>	<u>\$ 744,338.53</u>	<u>\$ 1,765,185.01</u>	<u>\$ 0.00</u>	<u>\$ 4,069,203.33</u>	
Nonoperating - Noncapital Gifts	<u>\$ 442,996.27</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 442,996.27</u>	

Revenue Bonds Secured by Pledged Revenues:

(A) Dormitory System Revenue Bonds A and B

(B) Dining System Facility Fee Revenue Bond

NOTE 9 - 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	\$ 18,109,371.13	\$ 1,644,217.40	\$ 692,701.97	\$ 0.00	\$ 0.00	\$ 0.00	\$ 20,446,290.50
Research	233,461.13	179,996.99	161,728.06	3,988.25			579,174.43
Public Service	2,035,843.25	21,107.94	1,849,884.55	20,870.85	15.00		3,927,721.59
Academic Support	3,977,357.07	2,347,132.10	645,338.38	2,018.12			6,971,845.67
Student Services	2,051,548.67	216,223.13	359,215.67				2,626,987.47
Institutional Support	4,647,256.13	632,059.99	1,624,489.45	7,988.29			6,911,793.86
Operations and Maintenance of Plant	2,466,316.92	2,760,138.68	680,745.45		1,416,898.32		7,324,099.37
Student Financial Aid	304,873.81		18,851.50	4,471,018.34			4,794,743.65
Auxiliary Enterprises	2,476,778.82	730,304.98	4,319,730.57	339,031.00	368,419.00		8,234,264.37
Depreciation						<u>1,789,678.33</u>	<u>1,789,678.33</u>
Total Operating Expenses	<u>\$ 36,302,806.93</u>	<u>\$ 8,531,181.21</u>	<u>\$ 10,352,685.60</u>	<u>\$ 4,844,914.85</u>	<u>\$ 1,785,332.32</u>	<u>\$ 1,789,678.33</u>	<u>\$ 63,606,599.24</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - 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 \$30,109,092.81, of which \$22,065,236.87 was covered under the Teachers' and State Employees' Retirement System. Total employee contributions for pension benefits for the year were \$1,323,914.21. 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, \$431,900.98, and \$1,078,140.76, 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 \$30,109,092.81, of which \$5,308,724.87 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$318,523.49 and \$363,116.78, 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 \$107,383.36 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 \$24,367.74. The voluntary contributions by employees amounted to \$135,749.00 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 \$484,685.58 for the year ended June 30, 2003.

NOTE 11 - 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)

\$643,288.10. 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 \$142,344.60. 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 12 - 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 sprinkler leakage, business interruption, vandalism, theft, and “all risks” for all buildings and contents of the University. Losses are covered by the fund up to \$2,500,000 per occurrence and are subject to \$500 per occurrence deductible, except theft losses carry 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.

The University purchased Intercollegiate Sports Accident Insurance from a private insurance company through the North Carolina Department of Insurance. This policy covers medical expenses incurred for the treatment of injury to covered persons.

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 13 - COMMITMENTS AND CONTINGENCIES

- A. Commitments - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$2,762,839.46 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 \$40,636,922.00 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)

D. Chancellor's Academic Scholarship Program – The University has issued scholarship awards totaling approximately \$1,564,091.15. These awards will be paid to continuing students in future years contingent upon the students maintaining their academic eligibility. University management is of the opinion that the funding support for these awards will be derived from future years private donations and other University financial resources.

NOTE 14 - FAYETTEVILLE STATE UNIVERSITY FOUNDATION, INC.

There is one separately incorporated nonprofit foundation associated with the University, the Fayetteville State University Foundation, Inc. This organization serves as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundation, except for support from each organization to the University. This support approximated \$93,323.75 for the year ended June 30, 2003.

NOTE 15 - NET ASSET RESTATEMENTS

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

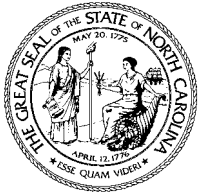
	<u>Amount</u>
July 1, 2002 Net Assets as Previously Reported	\$ 44,113,889.33
Restatements - Correction of Prior Period Errors	<u>(1,539,872.90)</u>
July 1, 2002 Net Assets as Restated	<u><u>\$ 42,574,016.43</u></u>

***Fayetteville 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
<i>Projects Started</i>							
Residence Hall	Feb 2001	\$ 6,528,685.00	\$ 0.00	\$ 6,528,685.00	\$ 396,381.30	6.07%	Mar 2005
Lyons Science Renovation	Feb 2001	14,389,555.00	1,350,000.00	15,739,555.00	829,729.60	5.27%	May 2006
Seabrook Renovation	Mar 2001	6,508,750.00		6,508,750.00	519,823.50	7.99%	Mar 2005
Campus Improvements	Apr 2001	1,363,250.00		1,363,250.00	289,348.59	21.22%	Aug 2004
Spaulding Conversion	Nov 2000	977,645.00	443,200.00	1,420,845.00	368,533.36	25.94%	May 2004
Technology Infrastructure	Mar 2001	1,080,720.00		1,080,720.00	530,153.53	49.06%	Oct 2004
Science Annex Renovation	Mar 2002	1,653,475.00		1,653,475.00	108,696.00	6.57%	Apr 2005
Chestnutt Library Renovation	Apr 2003	832,105.00		832,105.00	5,730.00	0.69%	Dec 2004
Taylor Gym Conversion	Mar 2002	3,192,000.00		3,192,000.00	179,356.00	5.62%	Jan 2006
Cook Dining Hall	Mar 2003	1,684,825.00		1,684,825.00	41,179.00	2.44%	Dec 2004
Continuing Education Renovation	Mar 2003	410,970.00		410,970.00			Oct 2004
Lilly Gym Renovation	Jun 2003	3,093,580.00		3,093,580.00			Dec 2005
Residence Hall Fire Department	Jul 2001	581,115.00		581,115.00	528,966.62	91.03%	Dec 2003
Reserve EFF Pro MGT		2,276,070.00		2,276,070.00	214,138.52	9.41%	
<i>Projects Not Started - To Be Funded in Future Years</i>							
Taylor Building Renovation	Nov 2003	840,085.00		840,085.00			
Collins Building Renovation	Feb 2004	608,570.00		608,570.00			
Total All Projects		\$ 46,021,400.00	\$ 1,793,200.00	\$ 47,814,600.00	\$ 4,012,036.02		
<p>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.</p>							

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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.ncauditor.net>

**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
Fayetteville State University
Fayetteville, North Carolina

We have audited the financial statements of Fayetteville 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 April 14, 2004. 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.

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*.

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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in

**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)**

our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions noted as a result of our audit are described in the Audit Findings and Recommendations section of this report.

Finding

1. Internal Control Weaknesses over the Cash Disbursement Process
2. Internal Control Weaknesses over Machinery and Equipment

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above are 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

April 14, 2004

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings and recommendations were identified during the current audit and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, or grants. Both findings were also reported in the prior year.

1. INTERNAL CONTROL WEAKNESSES OVER THE CASH DISBURSEMENT PROCESS

During our testing of cash disbursements we found the following:

- Payments to vendors were not made on a timely basis. Eighteen of our thirty-nine sample items were not paid in a timely manner.
- Payments were made without the proper approval. Four of our thirty-nine sample items tested did not have evidence of approval for payment.

A proper system of internal control ensures that the University develop procedures to include a proper review and approval process, and that payments are made in a timely manner. Cash disbursement transactions made without proper approval for payment lead to an increased risk of errors or irregularities. Payments that are not made in a timely manner could lead to the loss of cash discounts or noncompliance with cash management guidelines.

Recommendation: The University should improve internal control to ensure all cash disbursements are made timely and are properly approved for payment.

University's Response: The University concurs with the audit finding. Based on the Office of the State Controller's guidelines for internal control and cash management, the University developed policies and procedures for the cash disbursement process. These procedures require timely payment and proper approval with an authorized signature. Management oversight and internal verification will be increased to ensure timely payment, proper approval, and compliance with all cash disbursement policies and procedures.

2. INTERNAL CONTROL WEAKNESSES OVER MACHINERY AND EQUIPMENT

During our testing of machinery and equipment, including an inspection of assets, we found the following:

- The University was unable to locate some equipment items. Seven of thirty-nine equipment items selected for inspection could not be located.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

- Equipment was not at the location recorded on the capital asset system. Of the thirty-two items in our sample that were located, ten of these items were not at the location recorded on the capital asset system.
- Equipment was not properly tagged. Seven of the thirty-two items located were not properly tagged.
- Obsolete or surplus items were not removed from the capital asset system. Eight of the thirty-two items located were either no longer in use or had been surplus. These items had not been removed from the capital asset system.

A proper system of internal control provides for procedures to ensure that the University can accurately summarize and report financial data as well as provide for the safeguarding of assets. The failure to maintain adequate internal controls over machinery and equipment could lead to inadequate safeguarding of assets as well as misstatements on the financial statements.

Recommendation: The University should improve internal controls over machinery and equipment assets to ensure accurate financial reporting and the safeguarding of assets.

University's Response: The University concurs with the audit finding. Based on the Office of the State Controller's guidelines for internal control and accounting for capital assets, the University revised the policies and procedures for recording and safeguarding capital assets. The University is currently reviewing all assets in the capital asset system to ensure that all data is accurate. In addition, a complete physical inventory is being taken to ensure that all assets can be located, the location is recorded correctly, the asset is properly tagged, and obsolete or surplus items are removed from the capital asset system. The data review, physical inventory, and system entries will be completed prior to June 30, 2004. Management oversight and internal verification will be increased to ensure accurate financial reporting, safeguarding of assets, and compliance with all capital asset policies and procedures.

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 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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Director, Fiscal Research Division

June 28, 2004

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