



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

NORTH CAROLINA STATE UNIVERSITY

RALEIGH, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

NORTH CAROLINA STATE UNIVERSITY

RALEIGH, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

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Leslie W. Merritt, Jr., CPA, CFP
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AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of North Carolina 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, 2004. 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 North Carolina 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 North Carolina 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 North Carolina 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 significant deficiencies 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 Internal Control over Financial Reporting and on Compliance and Other Matters.

3. **Objective** – To present significant deficiencies, if any, in internal control over compliance that could adversely affect the University's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants and present instances of noncompliance with federal laws, regulations, contracts, or grants, the effects of which have a material effect in relation to a type of compliance requirement or audit objective identified in *OMB Circular A-133 Compliance Supplement*.

Results - Our tests disclosed no significant deficiencies in internal control over compliance and no instances of noncompliance which require disclosure herein under *OMB Circular A-133*.

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.



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
North Carolina State University
Raleigh, North Carolina

We have audited the accompanying financial statements of North Carolina 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, and its discretely presented component units, as of and for the year ended June 30, 2004, which collectively comprise the North Carolina State University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the North Carolina State University Foundation, Inc. and the NCSU Student Aid Association, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports 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. The financial statements of the North Carolina State University Foundation, Inc. and the NCSU Student Aid Association, Inc. were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of North Carolina State University and its discretely presented component units, as of

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the North Carolina State University's basic financial statements. Schedule 1 is presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures 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.



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

November 15, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

This section of the financial report provides an overview of the accompanying basic financial statements including comparative financial analysis with discussion of significant changes from the prior year, as well as a discussion of currently known facts, decisions, or conditions affecting the financial affairs of the University.



Financial Highlights

NC State University's net assets increased 18.7% to \$905,167,795 as of June 30, 2004. A major part of this increase was the result of capital infrastructure and facilities improvements through State grants and private foundations gifts of \$137,225,496. Fiscal year 2004 also provided for significant improvement in the market condition of the University's endowment funds with an increase of \$12,769,181 in reported investment values, for a total of \$132,715,846 as of June 30, 2004.

NC State continued to meet the challenge of providing for increased demand of its instructional services and increased its overall State Appropriation by \$3,756,385, through enrollment growth funding, for a total State Appropriation of \$341,731,964. In addition, NC State continued to strengthen its operating revenues with an increase in student tuition and fees of \$6,132,780 due to the increased enrollment and approved increases in student tuition.



During fiscal year 2004, NC State continued to see increased demand for research services. Federal appropriations and federally supported contract and grant revenues increased by \$10,666,459. In addition, NC State's commitment to improving the quality of its programs and contributions to society continued to strengthen as a result of advancement activities provided through the efforts from its various foundations, its endowment funds, centennial campus partnerships, and its technology transfer program.

Using the Financial Statements

The financial statements of the University are used primarily to evaluate its financial position as of June 30th and the results of operations for the fiscal year then ended. The *Statement of Net Assets* provides information relative to the evaluation of financial position; and the *Statement of Revenues, Expenses, and Changes in Net Assets* provides information relative to the evaluation of the results of operations. These statements are articulated by agreeing the ending net asset balance reported on both statements.

The financial statements also include a *Statement of Cash Flows*. This statement is used to identify the sources and uses of cash. This statement articulates with the other statements by agreeing the ending cash reported to the *Statement of Net Assets* and the net operating loss reported to the *Statement of Revenues, Expenses, and Changes in Net Assets*.



In using the financial statements, the *Note Disclosures* accompanying the financial statements should be read in conjunction with the financial statements. The note disclosures provide information regarding the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on long-term liabilities, detailed information on accounts receivable, accounts payable, revenues and expenses, required information on pension plans and other post employment benefits, insurance against losses, commitments and contingencies, accounting changes, and if necessary a discussion of adjustments to prior periods and events subsequent to the University's financial statement period. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the Financial Statements.

Effective for this year, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This statement requires that certain organizations providing resources to the University through fund raising activities be considered component units of the University's reporting entity if the organization is significant to the University's financial statements. As a result of this requirement, the North Carolina State University Foundation, Inc. and the NCSU Student Aid Association, Inc. financial statements are now presented in the Financial Report following the University's financial statements. Note 1A to the financial statements provides discussion about this new reporting standard. While presentation of these financial statements are required by the Governmental Accounting Standards Board, the financial information presented for these organizations is based on the accounting and reporting requirements of the Financial Accounting Standards Board (FASB).

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Comparative Condensed Financial Statement Information

Statement of Net Assets

The assets and liabilities of NC State are classified as either current or noncurrent with the difference between assets and liabilities reported as net assets on the Statement of Net Assets.



Current assets are those that are available to pay for current liabilities or current year expenditures. Current liabilities are those that are due and payable in the next fiscal year. Net asset balances are classified as either invested in capital assets (net of related debt), restricted or unrestricted. Net assets classified as restricted are classified in more detail as either nonexpendable or expendable. The *Statement of Net Assets* provides information to evaluate the financial strength of the

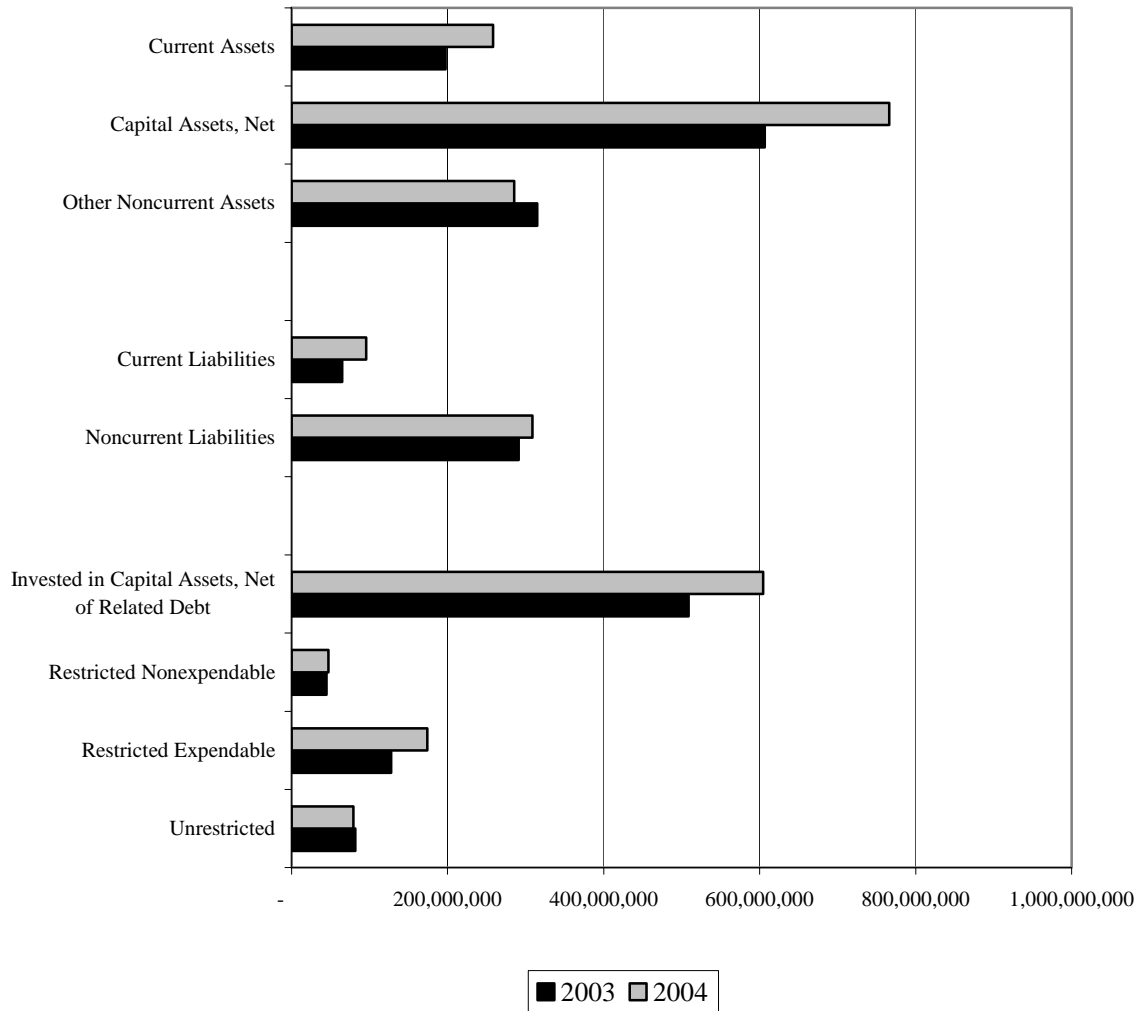
University and its ability to meet current and long-term obligations.

Following is a comparative analysis on the condensed balances reported in the *Statement of Net Assets* as of June 30, 2004, and 2003.

	2004	2003	Percent Change %
Assets			
Current Assets	\$ 258,249,931	\$ 197,370,856	30.8
Capital Assets, Net	766,108,970	606,397,706	26.3
Other Noncurrent Assets	285,072,065	314,667,430	(9.4)
Total Assets	<u>1,309,430,966</u>	<u>1,118,435,992</u>	17.1
Liabilities			
Current Liabilities	95,564,453	64,942,625	47.2
Noncurrent Liabilities	308,698,718	290,879,209	6.1
Total Liabilities	<u>404,263,171</u>	<u>355,821,834</u>	13.6
Net Assets			
Invested in Capital Assets, Net of Related Debt	604,572,196	508,624,461	18.9
Restricted			
Nonexpendable	52,821,358	49,905,153	5.8
Expendable	168,400,601	122,551,906	37.4
Unrestricted	79,373,640	81,532,638	(2.6)
Total Net Assets	<u>\$ 905,167,795</u>	<u>\$ 762,614,158</u>	18.7

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graphically illustrates the assets, liabilities and net assets of the University as of June 30, 2004, as compared to June 30, 2003.



Assets totaled \$1,309,430,966, an increase of \$190,994,974 over the prior year. The increase in assets is attributable to capital asset growth of \$159,711,264, an increase in current assets of \$60,879,075, and a decrease in other noncurrent assets of \$29,595,365.

The current asset increase is attributable to \$33,056,230 due from State of North Carolina component units, primarily the Golden Leaf Foundation, \$2,148,258 due from NC State's component units (the NCSU Student Aid Association, Inc. and the North Carolina State University Foundation, Inc.), an increase in unrestricted cash and cash equivalents of \$16,257,545, an increase in restricted cash of \$9,855,561 to cover current liabilities, as well as a net reduction of \$438,519 in other current asset line items.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The capital asset growth is attributable to \$130,813,373 in capital grants including the State's higher education bond program, \$5,634,123 in capital gifts, \$778,000 from capital appropriations, and \$22,485,768 from bond financing and available funds.

The net reduction in other noncurrent assets is attributable to an increase of \$20,078,665 in other long-term investments (mostly held for NC State's foundations), an increase of \$12,769,181 in endowment investments, a decrease of \$63,479,413 in restricted cash, as well as a net increase of \$1,036,202 in other noncurrent asset line items. The increase in investment balances is attributable to improved market valuations at June 30, 2004. The reduction in restricted cash is attributable to prior year unexpended debt proceeds being used for payment of construction obligations incurred during fiscal year 2004.



Liabilities totaled \$404,263,171, an increase of \$48,441,337 over the prior year. The increase in liabilities is attributable to increases in both current and noncurrent liability balances of \$30,621,828 and \$17,819,509 respectively.

The current liability increase is attributable to \$18,457,142 in accounts payable and accrued liabilities (mostly from construction contracts), \$15,000,000 in short term financing for construction projects, as well as a net reduction of \$2,835,314 in other current liability line items. The noncurrent liability increase is attributable to \$19,847,661 in funds held in trust for investment pool participants (various foundations) as well as a net reduction of \$2,028,152 in other noncurrent liability line items.

Net assets totaled \$905,167,795, an increase of \$142,553,637 over the prior year. The increase in net assets is attributable to \$95,947,735 in capital assets, net of related debt, \$48,764,900 in restricted balances, as well as a reduction of \$2,158,998 in unrestricted balances.

NC State's current assets are more than sufficient to cover current liabilities with a ratio of 2.7x as compared to 3.0x in the prior year. Total assets excluding capital assets, net of depreciation, are more than sufficient to cover total liabilities with a ratio of 1.3x as compared to 1.4x in the prior year. Total assets are significantly more than liabilities with a ratio of 3.2x as compared to 3.1x in the prior year. These financial ratios are indicators of NC State's financial strength and its ability to meet current and long-term obligations.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



Statement of Revenues, Expenses, and Changes in Net Assets

The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information regarding the University's activities for the year ending June 30, 2004. The activity balances are classified as operating, nonoperating, or other. Activities classified as operating include all revenues of the University except those considered nonoperating or those associated with funds received to enhance capital assets or permanent endowments, and all expenses except those related to interest expense on financing activities, loss on disposal of capital assets, and investment expenses (shown as net against investment income). Activities classified as nonoperating include State appropriations, noncapital gifts and grants revenue, investment income (net of investment expenses), and losses on disposal of capital assets. Activities classified as other include capital gifts or grants and additions to permanent endowments. Overall the *Statement of*

Revenues, Expenses, and Changes in Net Assets provides information to evaluate the University's management of operations and maintenance of financial strength.

Following is a comparative analysis on the condensed balances reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* for the fiscal years ended June 30, 2004, and 2003.

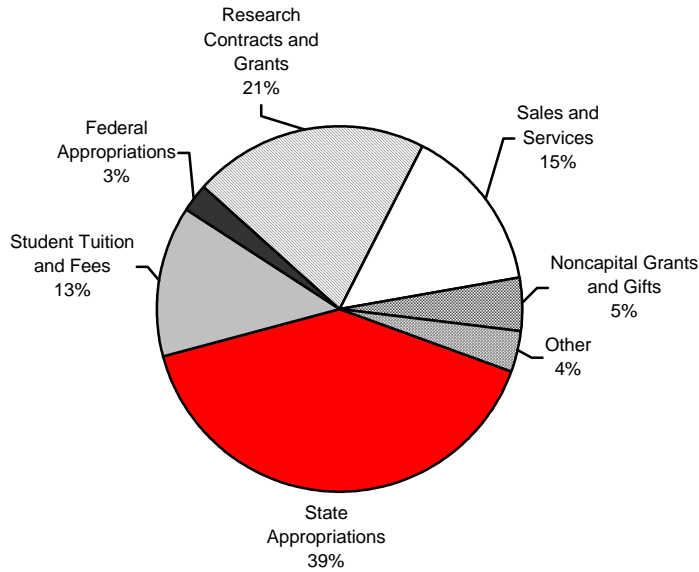
	2004	2003	Percent Change %
Operating Activities			
Operating Revenues	\$ 446,556,945	\$ 423,528,249	5.4
Operating Expenses	<u>839,378,166</u>	<u>805,078,744</u>	4.3
Net Operating Loss	<u>(392,821,221)</u>	<u>(381,550,495)</u>	3.0
Nonoperating Activities			
Nonoperating Revenues	402,061,246	375,665,396	7.0
Nonoperating Expenses	<u>6,377,699</u>	<u>6,737,943</u>	(5.3)
Net Nonoperating Revenues	<u>395,683,547</u>	<u>368,927,453</u>	7.3
Other Activities			
Capital Grants and Gifts	137,225,496	106,484,294	28.9
Additions to Permanent Endowments	<u>2,465,815</u>	<u>1,327,086</u>	85.8
Total Other Activity Increases	<u>139,691,311</u>	<u>107,811,380</u>	29.6
Increase in Net Assets	<u>\$ 142,553,637</u>	<u>\$ 95,188,338</u>	49.8

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

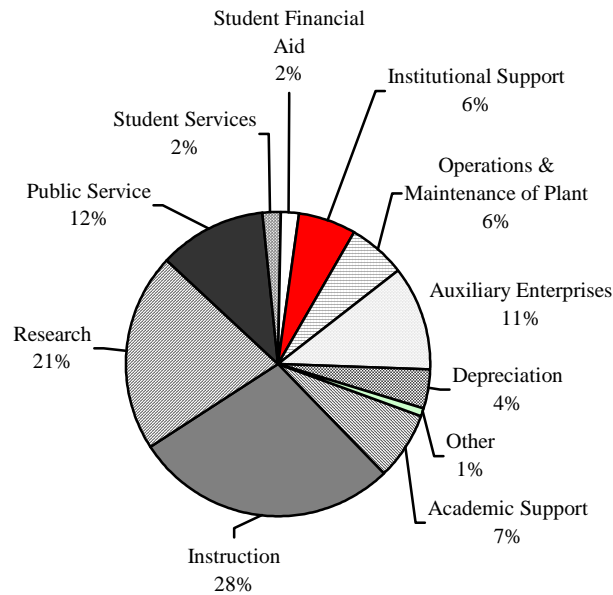
Operating and Nonoperating Activities

The following graphically illustrates the relationships of operating and nonoperating revenue sources and expense functions to total revenue/expenses for the fiscal year 2004.

Operating and Nonoperating Revenues



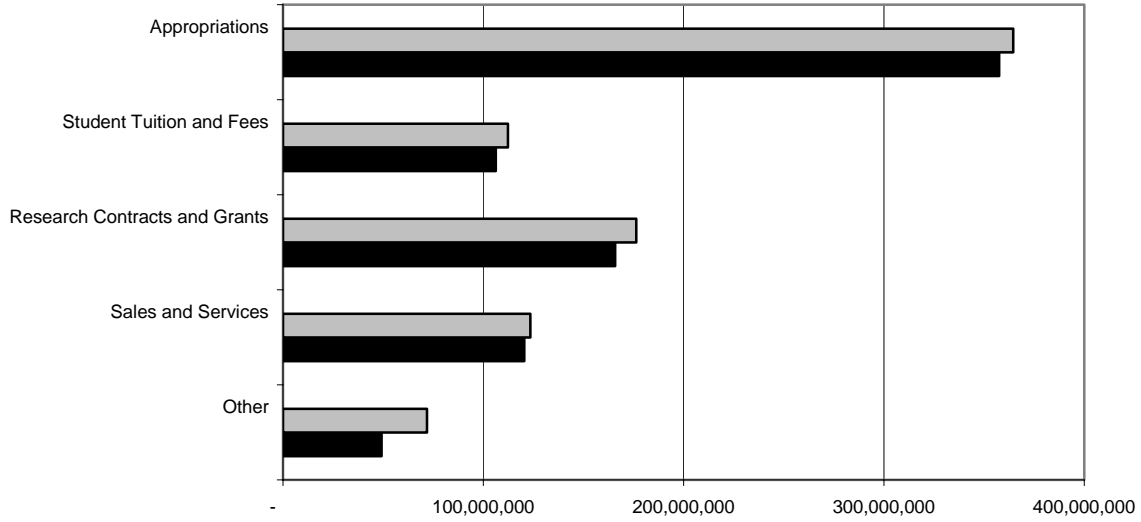
Operating and Nonoperating Expenses



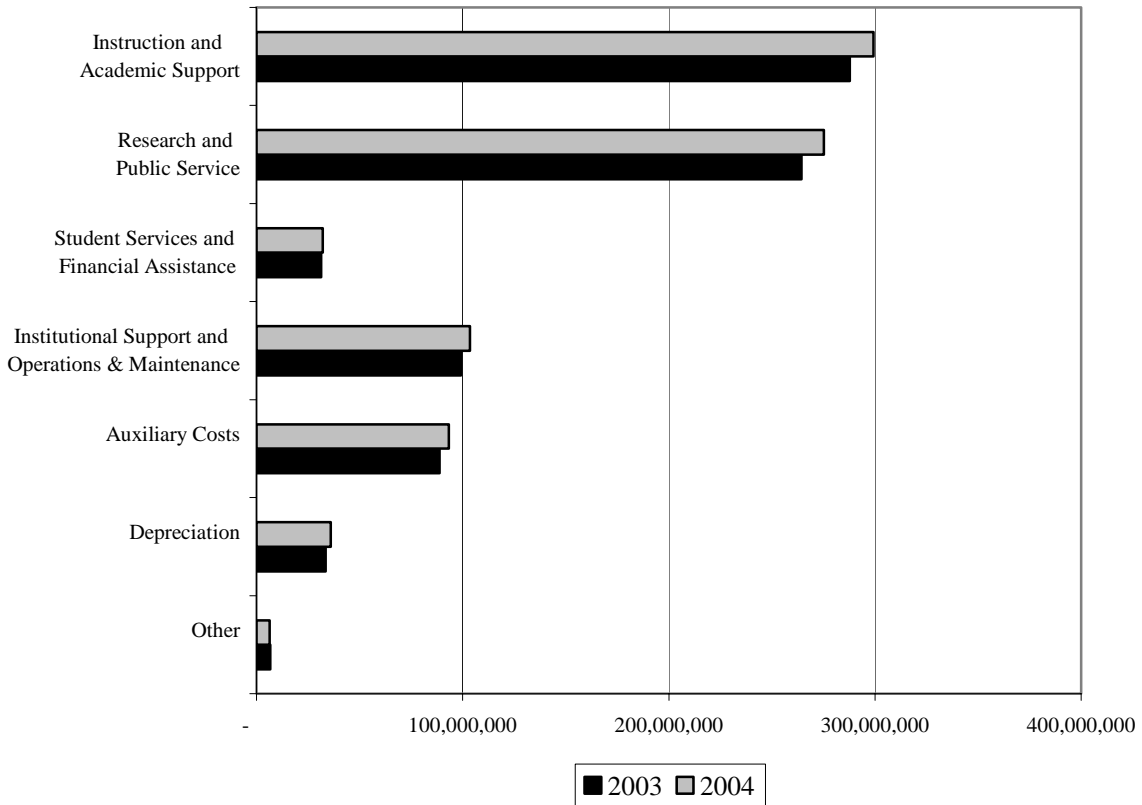
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graphically illustrates the University's operating and nonoperating revenues/expenses by source/function.

Operating and Nonoperating Revenues



Operating and Nonoperating Expenses



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total revenues (operating and nonoperating) increased \$49,424,546 or 6.2% over the prior year. Appropriations (State and Federal Land Grant Institution) increased by \$7,007,947 or 2.0% over the prior year as a result of increased enrollment and improved federal authorizations. Student tuition and fees increased by \$6,132,780 or 5.8% over the prior year as a result of enrollment growth and approved tuition rate increases. Research contracts and grants increased by \$10,558,601 or 6.4% over the prior year as a result of additional demand for services. Sales and services increased by \$3,042,365 or 2.5% over the prior year as a result of improvements in athletic programs and facilities and other auxiliary increases. Other revenues (including operating and nonoperating sources) had a net increase of \$22,682,853 or 46.1% over the prior year primarily as a result of improved market values of investments (investment income).

Total expenses (operating and nonoperating) increased \$33,939,178 or 4.2% over the prior year primarily as a result of increases in salaries and benefits of \$24,309,310, supplies and materials of \$7,780,646, utilities of \$3,420,251, depreciation of \$2,550,118, a decrease in services of \$4,557,687, and an increase in other expense line items of \$436,540. The salaries and benefits increase is the result of a \$550 one-time salary bonus and two weeks of bonus leave given to full time employees. The supplies and materials increase is the result of increased spending on technology, computers and other expendable equipment. Utility and depreciation increases are the result of an increase in number of buildings. The services decrease is attributable primarily to a reduction in sub contracting activities in the contract and grant area.

The functional presentation of operating expenses indicates a stable and conservative growth pattern. The reasons for the conservative increases are described in the previous paragraph.

Operating Expenses by Function

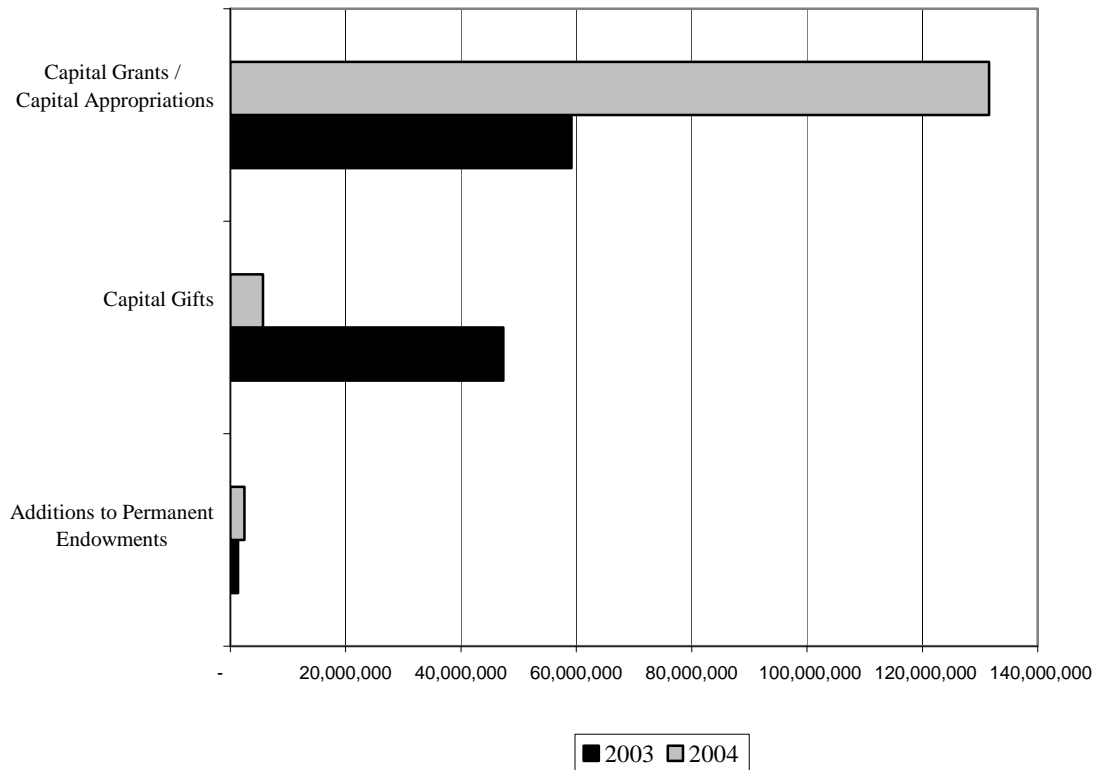
Function	FY04 cost	Amount of increase	% Change
Instruction	\$ 238,202,244	\$ 9,881,090	4.3%
Academic Support	61,076,478	1,545,983	2.6%
Research	176,846,274	7,731,096	4.6%
Public Service	98,281,459	3,044,460	3.2%
Student Services	14,223,021	280,714	2.0%
Student Financial Aid	17,887,136	507,962	2.9%
Institutional Support	50,967,119	595,644	1.2%
Operations and Maintenance	52,564,821	3,693,917	7.6%
Auxiliary Enterprises	93,267,215	4,468,438	5.0%
Depreciation	36,062,399	2,550,118	7.6%

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



Other Activity

The following graphically illustrates the University's other activities by source.



Other activity totaled \$139,691,311. This is attributable to new capital grants and appropriations of \$131,591,373 (primarily from the State of North Carolina and the Golden Leaf Foundation), new capital gifts of \$5,634,123 and new permanent endowments of \$2,465,815. Capital gifts declined as a result of major capital improvement gifts in the prior year from the NCSU Student Aid Association, Inc.

Overall, NC State increased its net assets by 18.7%. Net revenues (operating and nonoperating revenues less total expenses, excluding depreciation) were \$38,924,725 as compared to \$20,889,239 in the prior year, representing a growth in net revenues of \$18,035,486 or 86.3% over the prior year. Current assets as compared to operating expenses, excluding depreciation, were 32.1% as compared to 25.6% in the previous year. These performance measurements are indicators of NC State's management of operations and maintenance of financial strength.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Cash Flows



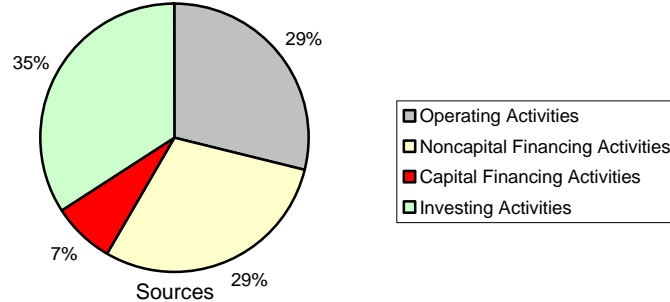
The *Statement of Cash Flows* provides information regarding the University's sources and uses of cash funds. The sources and uses of cash are classified as operating activities, noncapital financing activities, capital financing activities, and investing activities.

Following is a comparative analysis on the condensed balances reported in the *Statement of Cash Flows* for the fiscal years ended June 30, 2004, and 2003.

	2004	2003	Percent Change %
Operating Activities			
Sources	\$ 445,609,967	\$ 426,671,979	4.4
Uses	795,276,217	769,174,804	3.4
Cash Used by Operating Activities	<u>(349,666,250)</u>	<u>(342,502,825)</u>	2.1
Noncapital Financing Activities			
Sources	451,809,357	461,986,391	(2.2)
Uses	69,048,290	58,140,022	18.8
Cash Provided by Noncapital Financing Activities	<u>382,761,067</u>	<u>403,846,369</u>	(5.2)
Financing Activities			
Sources	113,270,602	143,790,767	(21.2)
Uses	189,517,384	126,048,102	50.4
Cash Provided (Used) by Financing Activities	<u>(76,246,782)</u>	<u>17,742,665</u>	(529.7)
Investing Activities			
Sources	526,468,584	570,638,405	(7.7)
Uses	520,682,926	583,116,886	(10.7)
Cash Provided (Used) by Investing Activities	<u>5,785,658</u>	<u>(12,478,481)</u>	146.4
Net Increase (Decrease) in Cash	<u>\$ (37,366,307)</u>	<u>\$ 66,607,728</u>	(156.1)

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following table illustrates the University's sources of cash:



Sources - Operating

Cash provided for Operating Activities totaled \$445,609,967. The primary source for this amount is "Received from Customers." Received from Customers totaled \$432,012,168, an increase of \$18,927,989 over the prior year. The increase is attributable to improved tuition rates and additional grants and contracts.

Sources – Noncapital Financing

Cash provided for Noncapital Financing Activities totaled \$451,809,357. The primary sources for this amount are "State Appropriations," "Federal Family Education Loan Receipts," and "Noncapital Gifts." State Appropriations totaled \$341,731,964, an increase of \$3,756,385 over the prior year and is attributable to enrollment growth. Federal Family Education Loan Receipts totaled \$67,024,559, an increase of \$8,750,960 over the prior year and is attributable to increased student borrowing for higher education. Noncapital Gifts totaled \$39,727,154, an increase of \$1,773,212 over the prior year and is attributable to increased foundation support.

Sources – Capital Financing

Cash provided for Capital Financing Activities totaled \$113,270,602. The primary sources for this amount are "Capital Grants" and "Proceeds from Capital Debt." Capital Grants totaled \$96,246,413, an increase of \$39,976,761 and is attributable to increased spending of the State Bond Fund Allotments. Proceeds from Capital Debt totaled \$15,000,000, a reduction of \$71,865,433 over the prior year.

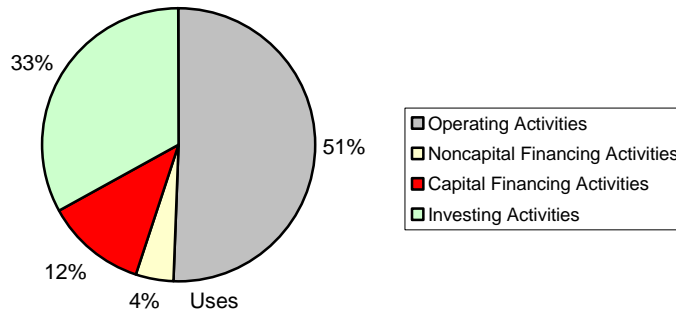
Sources - Investing

Cash provided for Investing Activities totaled \$526,468,584. The primary sources for this amount are "Proceeds from Sales and Maturities of Investments" and "Dividends and Interest on Investments." Proceeds from Sales and Maturities of Investments totaled \$517,300,351, a reduction of \$41,341,084 over the prior year. This is attributable to less trading as a result of a more stable market and improving market values. Dividends and Interest on Investments

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

totaled \$9,168,233, a reduction of \$2,828,737 over the prior year. This is attributable to declining interest rates.

The following table illustrates the University's uses of cash:



Uses - Operating

Cash used for operating activities totaled \$795,276,217. The primary reasons for the use of operating funds are "Payments to Employees and Fringe Benefits" and "Payments to Vendors and Suppliers." Payments to Employees and Fringe Benefits totaled \$518,881,603, an increase of \$21,910,838 over the prior year. This is attributable to increased salary and benefit amounts. Payments to Vendors and Suppliers totaled \$259,008,173, an increase of \$2,919,165 over the prior year. This is attributable to increased spending on technology, computers, and other expendable equipment.

Uses – Noncapital Financing

Cash used for noncapital financing activities totaled \$69,048,290. The primary reason for the use of noncapital financing funds is the "Federal Family Education Loan Disbursements." Federal Family Education Loan Payments totaled \$66,751,825, an increase of \$8,611,803 over the prior year. This is attributable to increased student borrowing for higher education.

Uses - Capital Financing

Cash used for Capital Financing Activities totaled \$189,517,384. The primary reason for the uses of capital financing funds are the "Purchase of Capital Assets," "Principal Paid on Capital Debt," and "Interest Paid on Capital Debt." Purchase of Capital Assets totaled \$175,921,868, an increase of \$75,057,514 over the prior year. This is attributable to the aggressive building program currently under way at NC State. Principal Paid on Capital Debt and Leases totaled \$7,569,580, a reduction of \$12,815,413 over the prior year. This is attributable to a prior year refunding of long-term debt. Interest Paid on Capital Debt and Leases totaled \$5,786,419, an increase of \$1,596,469 over the prior year. This is attributable to increases in capital debt in the prior year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Uses - Investing

Cash used for investing activities totaled \$520,682,926. The primary reason for the uses of investing activity funds is "Purchase of Investments." Purchase of Investments totaled \$520,682,926, a decrease of \$62,433,960 over the prior year. This is attributable to less trading as a result of a more stable market and improving market values.

Capital Assets and Long-term Debt Activities

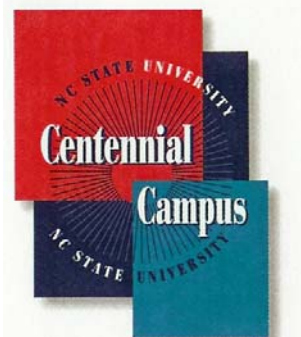
Capital Assets

Due to the passage of the Higher Education Improvement Bond Referendum by North Carolina voters on November 7, 2000, the University has undertaken a number of major construction projects to improve and modernize its facilities. The Referendum provided \$468,256,655 in State funds to the University beginning in fiscal year 2001. As of June 30, 2004, the University had received \$167,033,280 from the State and had \$301,223,375 outstanding pending future bond sales and allotment approvals.

During fiscal year 2004, the University recorded \$97,313,373 in funds from the referendum, \$33,500,000 from the Golden LEAF Foundation (a component unit of the State), \$15,000,000 from new debt financing and \$48,982,897 from prior year debt financing.

The University expended \$167,837,475 during the year for the construction of new buildings/infrastructure and for the renovation or repair of its facilities. Of this amount, \$43,614,280 was expended on improvements to Centennial Campus.

Centennial Campus



Centennial Campus is a research and advanced technology community where the University, industry, and government partners interact in multi-disciplinary programs directed toward the solution of contemporary problems. Since the Centennial Campus opened its first laboratory in 1989, its inventory of buildings has grown to 21 buildings, containing a total of approximately 1.6 million square feet of developed space. Of this space, approximately 47% is used by the University, 14% is for Governmental use, 32% is leased to private companies, and 7% is available for lease.

The College of Engineering neared completion of its Phase I Complex and began construction of its Phase II Complex at Centennial Campus. The Phase II complex will supply Computer Science and Electrical and Computer Engineering with laboratories, offices and classrooms.



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



Construction continues on the Partners III Research Building located at Centennial Campus. This 80,000 square foot facility will provide office and lab space for Physical and Mathematical Sciences and the College of Agricultural and Life Sciences.

You can find out more information about Centennial Campus by visiting <http://www.centennial.ncsu.edu/>.

Central Campus

Construction continues on the new Administrative Services III building, which will house various Finance and Business functions. The new 52,000 square foot building is part of the newly renamed George Worsley Administrative Services Complex. George Worsley retired on July 31st, after serving NCSU as the Vice Chancellor of Finance and Business for 28 years.



The Marye Anne Fox Science Teaching Lab was completed this year. Formerly known as the Undergraduate Science Teaching Lab, the new building was renamed in honor of Marye Anne Fox, who served as NCSU Chancellor for 6 years. The building provides instructional laboratories and classrooms for Chemistry, Physics and Horticultural sciences and provides 25,000 square feet of greenhouse space.

University Housing continues construction of the new Wolf Village Apartments. The eight building complex will house 1,200 students in fully furnished apartments. Each four-bedroom apartment will have two bathrooms, a living room, kitchen, and washer/dryer unit. The first building phase has been completed and students moved into the completed apartments in August 2004. For more information on the Wolf Village apartments, visit <http://www.ncsu.edu/housing/apartments/>.



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

College of Veterinary Medicine



The College of Veterinary Medicine continues construction of a new 103,000 square foot building. The new facility will house research laboratories, offices and conference rooms, and is scheduled for completion in the spring of 2005.

At June 30, 2004, outstanding commitments on construction contracts were \$124,573,119.

More information about the University's long-range capital plan is located at <http://www.ncsu.edu/facilities/univ-arch/masterplan.htm>.

Long-Term Debt Activities

As authorized by the General Assembly in fiscal year 2000, the University adopted a new financing methodology to allow it to pledge its available funds using general revenue bond acquisitions. Under this new financing methodology, the University entered into a joint Commercial Paper program with the University of North Carolina at Chapel Hill (UNC-CH) in March 2002. Proceeds of the program will be made available to UNC-CH (up to \$180,000,000) and to the University (up to \$60,000,000). During fiscal year 2004, the University issued \$15,000,000 in commercial paper to finance construction projects. While considered a short-term loan, the University intends to refinance the borrowings either through additional short-term loans, or by acquiring a long-term general revenue bond, depending on market interest rates.



On January 16, 2004, the University used available cash to defease \$935,000 of outstanding University of North Carolina System Pool Revenue Bonds, Series 1998B. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt payments on the defeased bonds. As a result, the University reduced its debt service requirement by \$1,014,362 over the next four years.

At June 30, 2004, the University had outstanding long-term bond indebtedness in the principal amount of \$145,637,000.

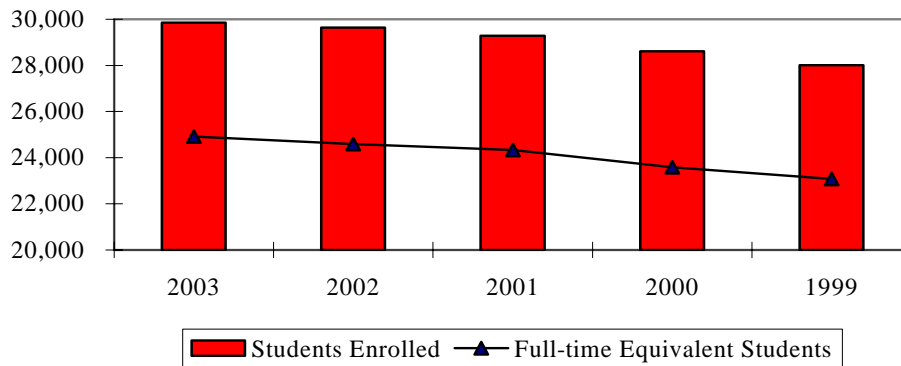
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Economic Factors That Will Affect the Future



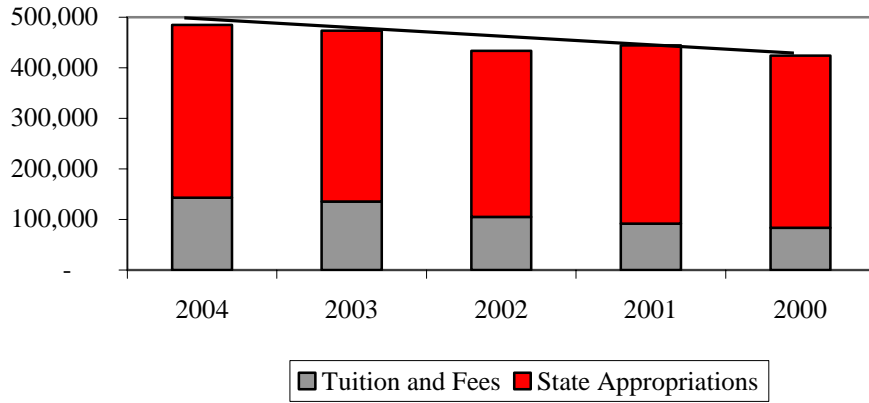
NC State's outlook for the future is good. The State of North Carolina's economy is starting to show signs of improvement. Unemployment rates are going down and contingency reserves are being rebuilt by the State. NC State's student enrollment is stable and growing, facilities continue to expand and improve, research contracts and grants continue to increase, revenues from the university football program continue to increase, and related foundations continue to provide excellent support. While tuition cost is increasing, the University still enjoys a low tuition rate in comparison to other similar Universities. Following are illustrations of these factors.

Student Enrollment
Fall Semester

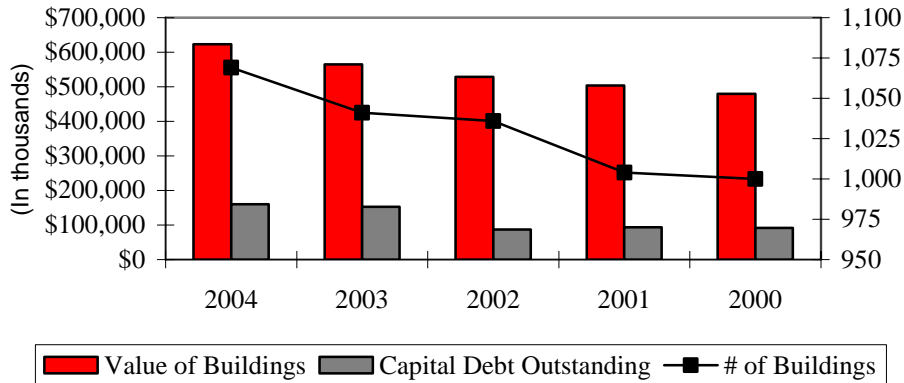


MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Tuition & Fees (gross)/State Appropriations
(in thousands)

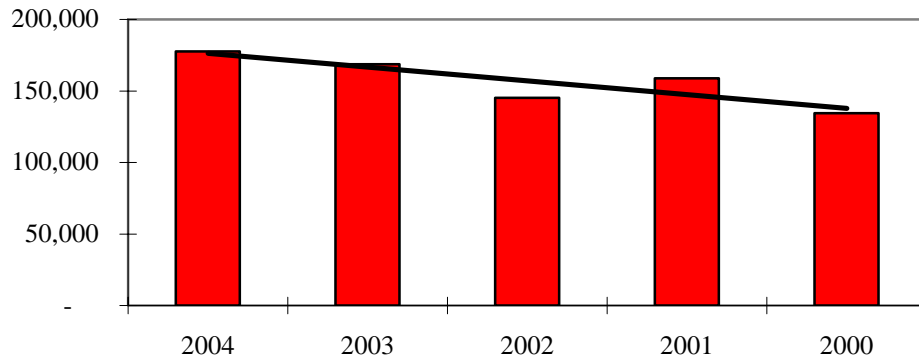


University Buildings (completed)
and Capital Debt

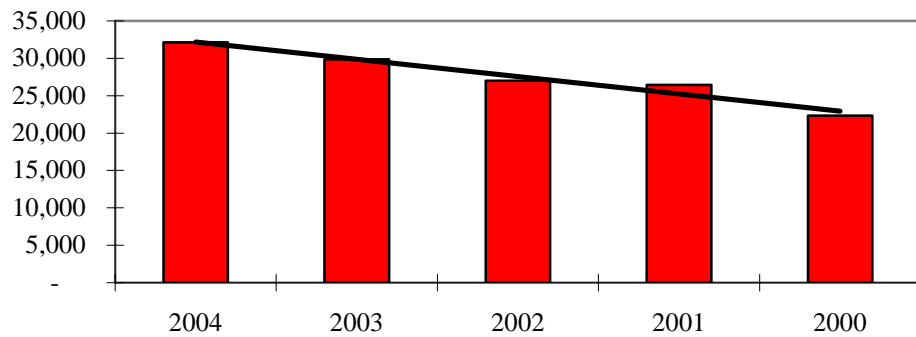


MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

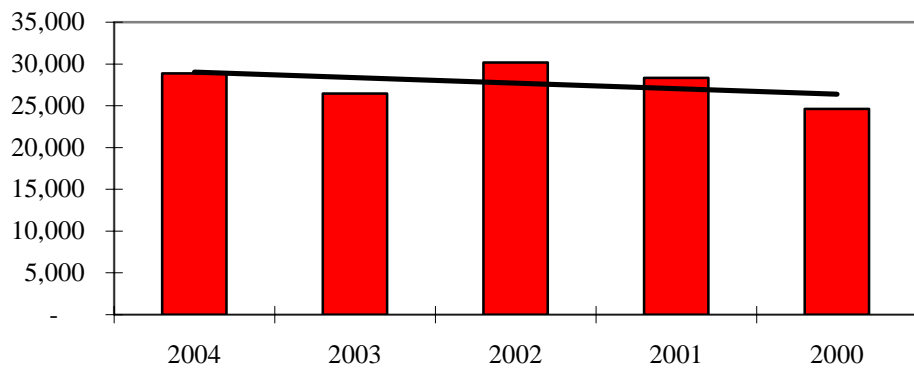
Research Contract and Grant Revenues
(in thousands)



Athletic Program Revenues
(in thousands)



University Foundation Support (noncapital)
(in thousands)



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Tuition and Fees				
Public Peer Institutions				
Full-Time Students - 2003-04				
	Undergraduate		Graduate	
	In-State	Out-of-State	In-State	Out-of-State
Pennsylvania State University	\$ 9,706	\$ 19,328	\$ 10,420	\$ 20,240
Rutgers University	7,927	14,441	10,030	14,202
University of Illinois - Urbana	7,010	18,046	7,756	18,866
Purdue University	5,860	17,278	5,860	17,278
University of California - Davis	5,853	20,063	7,063	19,553
University of California - San Diego	5,508	19,718	6,715	19,405
University of Wisconsin	5,139	19,139	7,593	22,863
Virginia Polytechnic & State University	5,095	15,029	6,944	10,663
Texas A&M University	5,051	12,131	5,281	10,945
Iowa State University	5,028	14,370	5,686	14,862
University of Georgia	4,078	14,854	4,720	17,420
Georgia Institute of Technology	4,076	16,002	4,718	16,268
NC State University	3,970	15,818	4,189	16,187

NC State has a strong history and reputation. The aggressive building program currently under way, the strength of our financial assets, the quality of our faculty and staff, the institutional commitment to serve our students, the State's rural community and society, the innovation and transfer of technology improvements, as well as the centennial campus mission of partnering with industry to improve goods and services, and the low cost of our services makes NC State an outstanding value for its customers and for the public service provided to the State and the Nation.



North Carolina State University
Statement of Net Assets
June 30, 2004

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 126,062,809
Restricted Cash and Cash Equivalents	48,252,944
Restricted Short-Term Investments	2,106,544
Receivables, Net (Note 4)	30,339,236
Due from Primary Government	9,468,400
Due from State of North Carolina Component Units	34,302,028
Due from University Component Units	2,148,258
Inventories	4,292,246
Notes Receivable, Net (Note 4)	1,277,466
	<hr/>
Total Current Assets	258,249,931

Noncurrent Assets:

Restricted Cash and Cash Equivalents	5,399,846
Restricted Due from Primary Government	16,927,899
Endowment Investments	132,715,846
Other Long-Term Investments	120,153,970
Notes Receivable, Net (Note 4)	9,874,504
Capital Assets - Nondepreciable (Note 5)	237,803,840
Capital Assets - Depreciable, Net (Note 5)	528,305,130
	<hr/>
Total Noncurrent Assets	1,051,181,035
	<hr/>
Total Assets	1,309,430,966

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	48,433,739
Due to Primary Government	391,596
Deferred Revenue	22,110,822
Interest Payable	1,035,148
Short-Term Debt (Note 7)	15,000,000
Long-Term Liabilities - Current Portion (Note 8)	8,593,148
	<hr/>
Total Current Liabilities	95,564,453

Noncurrent Liabilities:

Deposits Payable	23,895
Funds Held for Others	2,092,757
U. S. Government Grants Refundable	6,707,585
Funds Held in Trust for Pool Participants	118,200,781
Long-Term Liabilities (Note 8)	181,673,700
	<hr/>
Total Noncurrent Liabilities	308,698,718
	<hr/>
Total Liabilities	404,263,171

North Carolina State University
Statement of Net Assets
June 30, 2004

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	604,572,196
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	9,084,004
Endowed Professorships	24,145,041
Departmental Uses	13,056,696
Loans	5,451,439
Other	1,084,178
Expendable:	
Scholarships and Fellowships	18,727,625
Research	10,121,368
Endowed Professorships	49,160,879
Departmental Uses	26,053,473
Loans	1,397,394
Capital Projects	48,491,495
Debt Service	8,171,969
Other	6,276,398
Unrestricted	79,373,640
Total Net Assets	<u>\$ 905,167,795</u>

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

North Carolina State University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2004

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 10)	\$ 112,345,884
Federal Appropriations	22,825,433
Federal Grants and Contracts	100,392,949
State and Local Grants and Contracts	32,931,549
Nongovernmental Grants and Contracts	43,005,279
Sales and Services, Net (Note 10)	123,508,372
Interest Earnings on Loans	287,582
Other Operating Revenues (Note 10)	11,259,897

Total Operating Revenues	446,556,945
--------------------------	-------------

EXPENSES

Operating Expenses:

Salaries and Benefits	529,784,963
Supplies and Materials	99,757,561
Services	135,454,725
Scholarships and Fellowships	14,896,493
Utilities	23,422,025
Depreciation	36,062,399

Total Operating Expenses	839,378,166
--------------------------	-------------

Operating Loss	(392,821,221)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	341,731,964
Noncapital Grants	1,280,176
Noncapital Gifts	39,586,597
Investment Income (Net of Investment Expense of \$680,111)	19,462,509
Interest and Fees on Capital Asset-Related Debt	(4,058,746)
Other Nonoperating Expenses	(2,318,953)

Net Nonoperating Revenues	395,683,547
---------------------------	-------------

Income Before Other Revenues, Expenses, Gains, or Losses	2,862,326
----------------------------------------------------------	-----------

Capital Appropriations	778,000
Capital Grants	130,813,373
Capital Gifts	5,634,123
Additions to Endowments	2,465,815

Increase in Net Assets	142,553,637
------------------------	-------------

NET ASSETS

Net Assets - July 1, 2003	762,614,158
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Net Assets - June 30, 2004	\$ 905,167,795
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The accompanying notes to the financial statements are an integral part of this statement.

North Carolina State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2004

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 432,012,168
Payments to Employees and Fringe Benefits	(518,881,603)
Payments to Vendors and Suppliers	(259,008,173)
Payments for Scholarships and Fellowships	(14,896,493)
Loans Issued	(2,489,948)
Collection of Loans	2,069,319
Interest Earned on Loans	268,583
Other Receipts	11,259,897
	<hr/>
Net Cash Used by Operating Activities	(349,666,250)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	341,731,964
Noncapital Grants	1,194,380
Noncapital Gifts	39,727,154
Federal Family Education Loan Receipts	67,024,559
Federal Family Education Loan Disbursements	(66,751,825)
External participation in Investment Fund	2,131,300
Other Payments	(2,296,465)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	382,761,067

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	15,000,000
State Capital Appropriations	778,000
Capital Grants	96,246,413
Capital Gifts	1,073,662
Proceeds from Sale of Capital Assets	172,527
Acquisition and Construction of Capital Assets	(175,921,868)
Principal Paid on Capital Debt and Leases	(7,569,580)
Interest and Fees Paid on Capital Debt and Leases	(5,786,419)
Other Payments	(239,517)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(76,246,782)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	517,300,351
Investment Income	9,168,233
Purchase of Investments and Related Fees	(520,682,926)
	<hr/>
Net Cash Provided by Investing Activities	5,785,658

Net Decrease in Cash and Cash Equivalents	(37,366,307)
Cash and Cash Equivalents - July 1, 2003	217,081,906
	<hr/>
Cash and Cash Equivalents - June 30, 2004	\$ 179,715,599

North Carolina State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2004

Exhibit A-3

Page 2

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

Operating Loss	\$	(392,821,221)
Adjustments to Reconcile Operating (Loss) to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense		36,062,399
Allowances, Write-Offs, and Amortizations		(338,260)
Changes in Assets and Liabilities:		
Receivables (Net)		329,605
Inventories		12,637
Accounts Payable and Accrued Liabilities		1,976,824
Deferred Revenue		(2,637,184)
Compensated Absences		7,920,865
Deposits Payable		(171,915)
		<hr/>
Net Cash Provided (Used) by Operating Activities	\$	<u>(349,666,250)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	\$	126,062,809
Restricted Cash and Cash Equivalents		48,252,944
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		5,399,846
		<hr/>
Total Cash and Cash Equivalents - June 30, 2004	\$	<u>179,715,599</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$	4,566,964
Change in Fair Value of Investments		15,874,177

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

North Carolina State University Foundations
Statements of Financial Position
June 30, 2004

Exhibit B-1

	North Carolina State University Foundation, Inc.	NCSU Student Aid Association, Inc.
ASSETS		
Cash and Cash Equivalents	\$ 1,702,100	\$ 24,443,574
Investments	61,874,405	16,413,035
Cash Surrender Value of Life Insurance	35,137	69,427
Real Estate Held for Resale	2,022,222	7,529,229
Receivables, Net		147,978
Pledges Receivable/Promises	8,082,781	39,791,111
Prepaid Expenses		8,394
Notes/Loans Receivable, Net		106,350
Interest Rate Swap Fair Value		935,585
Property and Equipment, Net	216,908	29,455,200
	<hr/>	<hr/>
Total Assets	73,933,553	118,899,883
LIABILITIES		
Accounts Payable and Accrued Expenses	358,472	5,440,518
Due to University and Other Foundations	65,801	2,082,457
Deferred Revenue		323,738
Interest Payable		114,758
Deposits Payable		77,600
Funds Held for Others	222,092	
Interest Rate Swap Fair Value Liability		906,423
Life Income Funds Payable	4,420,170	
Notes Payable		7,791,513
Bonds Payable		60,345,000
	<hr/>	<hr/>
Total Liabilities	5,066,535	77,082,007
NET ASSETS		
Unrestricted	9,156,067	10,902,100
Temporarily Restricted	29,699,983	14,883,997
Permanently Restricted	30,010,968	16,031,779
	<hr/>	<hr/>
Total Net Assets	\$ 68,867,018	\$ 41,817,876

See Note 1 in the Notes to the Financial Statements

North Carolina State University Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2004

Exhibit B-2

	North Carolina State University Foundation, Inc.	NCSU Student Aid Association, Inc.
CHANGES IN UNRESTRICTED NET ASSETS		
Revenues and Gains:		
Contributions	\$ 385,441	\$ 7,910,583
Donated services and noncash contributions	167,900	2,056,497
Alumni membership and sales	724,748	491,584
Income on Long-Term Investments	663,836	
Other Investment Income		899,505
Net Unrealized and Realized Gains on Long-Term Investments	557,793	
Unrealized Gain on Swap Contracts		1,397,293
Other	703,119	1,179,238
Total Unrestricted Revenues and Gains	<u>3,202,837</u>	<u>13,934,700</u>
Net Assets Released from Restrictions		
Satisfaction of Program Restrictions	3,887,316	
Satisfaction of Equipment Acquisition Restrictions		6,675,883
Total Net Assets Released from Restrictions	<u>3,887,316</u>	<u>6,675,883</u>
Total Unrestricted Revenues, Gains, and Other Support	<u>7,090,153</u>	<u>20,610,583</u>
Expenses and Losses:		
University Support	5,149,939	6,930,011
University Facilities Support		6,740,634
Alumni activities	584,058	
Management and General	268,740	426,012
Fund Raising	315,657	2,404,360
Total Expenses	<u>6,318,394</u>	<u>16,501,017</u>
Increase in Unrestricted Net Assets	<u>771,759</u>	<u>4,109,566</u>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
Contributions	4,089,526	13,404,171
Alumni membership and sales	50,342	
Donated services and noncash contributions		63,293
Other	101,544	21,331
Income on Long-Term Investments	391,428	73,343
Net Unrealized and Realized Gains on Long-Term Investments	4,256,581	
Unrealized Gain on Swap Contracts		1,131,313
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	(3,887,316)	
Satisfaction of Equipment Acquisition Restrictions		(6,675,883)
Increase in Temporarily Restricted Net Assets	<u>5,002,105</u>	<u>8,017,568</u>
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Contributions	1,657,306	2,308,314
Income on Long-Term Investments	(135,703)	484,418
Change in value of split interest agreements	(421,081)	
Other		(7,498)
Net Unrealized and Realized Gains on Long-Term Investments	3,275	
Increase in Permanently Restricted Net Assets	<u>1,103,797</u>	<u>2,785,234</u>
Increase in Net Assets	6,877,661	14,912,368
Net Assets at Beginning of Year	61,989,357	26,905,508
Net Assets at End of Year	<u>\$ 68,867,018</u>	<u>\$ 41,817,876</u>

See Note 1 in the Notes to the Financial Statements

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NORTH CAROLINA STATE UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

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. North Carolina 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. The University's component units are either blended or discretely presented in the University's financial statements. The blended component units, although legally separate, are, in substance, part of the University's operations and therefore, are reported as if they were part of the University. Discretely presented component units' financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness

Blended Component Units - Although legally separate, the NC State Investment Fund, Inc. (Investment Fund), and the NC State University Partnership Corporation (Corporation), component units of the University, are reported as if they were part of the University.

The Investment Fund is governed by a Members Board consisting of six ex officio directors and five elected representatives from the participating entities. The Investment Fund's purpose is to support the University by operating an investment fund for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The Investment Fund is a governmental external investment pool. Because the majority of the Members Board of the Investment Fund consist of University

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Administrators and Board Members and the Investment Fund's primary purpose is to benefit North Carolina State University, its financial statements have been blended with those of the University.

The Corporation is governed by a Board of Directors appointed by the Chancellor of the University. The Corporation's purpose is to support and benefit the University with the aims of creating new knowledge and improving the lives of the people of North Carolina. In addition, the Corporation formed NC State University Conference Center, LLC (LLC) on January 25, 2002, to develop, own, and operate a hotel, conference center, and public golf course on the Centennial Campus as outlined in the Campus Master Plan. Because the Corporation's Board is appointed by the Chancellor and its sole purpose is to support and benefit the University, both the Corporation and the LLC are considered part of the University for financial reporting purposes.

Separate financial statements for the Investment Fund may be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 515-2110. Financial information relative to the Corporation and the LLC may be obtained from the Corporation's Executive Director, Campus Box 7012, Raleigh, NC 27695, or by calling (919) 515-0388. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

Discretely Presented Component Units – The North Carolina State University Foundation, Inc. (Foundation) and NCSU Student Aid Association, Inc. (Athletic Club) are legally separate not-for-profit corporations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Foundation and Athletic Club are legally separate, tax-exempt component units of the University. These entities act primarily as a fundraising organization to supplement the resources that are available to the University in support of its programs. Separate Boards of Directors govern these entities independent of the University's Board of Trustees. Although the University does not control the timing or amount of receipts from these entities, the majority of resources, or income thereon, that these entities hold and invest are restricted to the activities of the University by the donors. Because these restricted resources held by these entities can only be used by, or for the benefit of the University, these entities are considered component units of the University and are reported in separate financial statements because of the difference in their reporting model, as described below.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Foundation and Athletic Club are private not-for-profit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to their financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2004, the Foundation distributed \$5,085,785 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 515-2110.

During the year ended June 30, 2004, the Athletic Club distributed \$7,744,276 to the University for both restricted and unrestricted purposes. Complete financial statements for the Athletic Club can be obtained from NCSU Student Aid Association, PO Box 37100, Raleigh, NC 27627, or by calling (919) 865-1500.

- 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, for proprietary activities, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, cash on deposit with fiscal agents, and short-term investments with the State Treasurer’s Cash and Investment Pool (a governmental external investment pool). 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, equity investments, mutual funds, money market funds, real estate investment trusts, real estate, and other asset holdings by the University. Except for money market funds, real estate not held by a governmental external investment pool and other asset holdings, 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, real estate not held by a governmental external investment pool and other asset holdings 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 fee 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 and merchandise for resale, are valued at the lower of cost or market value using the first-in, first-out method except for the bookstore that uses the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

retail method and physical plant that uses the moving weighted average 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 University capitalizes assets that have a value or cost equal to or greater than \$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 15 to 75 years for infrastructure, 10 to 50 years for buildings, and 3 to 15 years for equipment. The University does not capitalize its collections. Collections not capitalized adhere 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. Funds Held in Trust for Pool Participants** – Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.
- K. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable, capital lease obligations and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premium or discount. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. Losses on refundings and issuance costs on bonds payable are not material to the accompanying financial statements and are expensed in the year incurred.

- L. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002, and as of July 1, 2003. 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.

M. 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

- N. 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 operating 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.
- O. 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 activities 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

P. 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, University Graphics, the Copy Center, the Creamery, Telecommunications, Physical Plant, and Motor Pool. 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.

Deposits include cash and cash equivalents totaling \$179,695,573. At year-end, cash on hand was \$20,026. The University's portion of the State Treasurer's Investment Pool was \$179,337,154. 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 \$358,419 and the bank balance was \$837,325. Of the bank balance, \$355,940 was covered by federal depository insurance and \$481,385 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 Section 600.2.4 of the Policy 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 that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

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

Investments of the Investment Fund, a component unit of the University, are subject to and restricted by General Statute 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Pool 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. This pool also participates in the Investment Fund.

The Investment Fund – This is a governmental external investment pool sponsored by the University. The Investment Fund was established in April 1999. The Investment Fund is utilized as one of the investment managers for the Long Term Investment Pool (the Investment Fund's internal participant) and to manage the investments for other affiliated organizations that are organized and operated primarily to support the University (the Investment Fund's external participants). Fund ownership of the pool is measured using the dollar-day method, which assigns a weighted value for the time the funds are on deposit. The external portion of the pool is presented in the accompanying financial statements as "Funds Held in Trust for Pool Participants."

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Members Board or its Board of Directors. The Members Board is responsible for adopting investment objectives and policies and for monitoring policy implementation and investment performance. The Members Board has chosen not to make individual security selection decisions. The Board of Directors have responsibility to oversee the allocation of the Fund's portfolio among the asset classes, investment vehicles, and investment managers.

State Street Bank & Trust Company is the custodian for the fund and provides the University with quarterly statements defining income and fair value information, which is then allocated among the fund's participants. There are no involuntary participants in the fund. The University has not provided or obtained any legally binding guarantees during the period to support the value of the Fund's investments. Separate financial statements for the Investment Fund may be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 515-2110.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2004, is presented below:

*Long-Term Investment Pool**

	Fair Value			Total
	Risk Category			
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 4,782,683	\$ 0	\$ 0	\$ 4,782,683
Collateralized Mortgage Obligations	189,590			189,590
Corporate Bonds	2,762,702			2,762,702
Corporate Stocks	119			119
International Bonds	239,597			239,597
Total Categorized Investments	\$ 7,974,691	\$ 0	\$ 0	7,974,691
Investments Not Categorized:				
Money Market Funds				1,745,169
Mutual Funds				5,244,745
Pooled Investments (Life Income Pools)				293,132
Other Investments				6,536,565
Total Investments Not Categorized				13,819,611
Total Long-Term Investments				\$ 21,794,302

* Excludes amounts reported in the Investment Fund

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investment Fund (External Investment Pool)

	Fair Value			
	Risk Category			Total
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 2,184,146	\$ 0	\$ 0	\$ 2,184,146
Corporate Stocks	98,406,686			98,406,686
International Stocks	7,521,919			7,521,919
Total Categorized Investments	\$ 108,112,751	\$ 0	\$ 0	108,112,751
Investments Not Categorized:				
Money Market Funds				3,013,131
Mutual Funds				84,422,873
Real Estate Investment Trusts				10,685,946
Total Investments Not Categorized				98,121,950
Total External Investment Pool				\$ 206,234,701

Non-Pooled Investments

	Fair Value			
	Risk Category			Total
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 131	\$ 0	\$ 0	\$ 131
Corporate Stocks	1,900,027			1,900,027
Total Categorized Investments	\$ 1,900,158	\$ 0	\$ 0	1,900,158
Investments Not Categorized:				
Money Market Funds				3,831,053
Real Estate				20,626,517
Other Investments				589,629
Total Investments Not Categorized				25,047,199
Total Non-Pooled Investments				\$ 26,947,357

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments

	Fair Value			Total
	Risk Category			
	1	2	3	
Total Categorized Investments	\$ 117,987,600	\$ 0	\$ 0	\$ 117,987,600
Total Investments Not Categorized				136,988,760
Total Investments				\$ 254,976,360

C. Derivative and Similar Transactions - A derivative is a financial instrument created from, or whose value depends on (is derived from), the value of one or more underlying assets, reference rates, or indexes of asset values. These instruments may include forwards, futures, currency and interest rate swaps, options, floaters/inverse floaters and caps/floors/collars. During the year the University did not invest in derivative investments but did invest in transactions similar to a derivative instrument. Investment transactions similar to a derivative may include securitized assets, such as mortgage-backed securities and other asset-backed securities. As required by accounting principles generally accepted in the United States of America, the nature of derivative or similar transactions entered into by the University, and the reasons for entering into those transactions follow:

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

The values of mortgage-backed securities are generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities may include mortgage pass-through securities and collateralized mortgage obligations (CMOs). Mortgage pass-through securities pay the holder of the security the principal and interest amounts received from the underlying pool of mortgages as these amounts are collected from the mortgage holders. In a CMO, the cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple security

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

classes with different priority claims and payment streams (commonly referred to as tranches). A holder of the CMO security thus chooses the class of security that best meet its risk and return objectives. Both pass-through securities and CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets.

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

The CMOs held by the University include mortgage-backed securities issued by FNMA, FHLMC, and certain trusts and private corporations (including REMIC issuers). In addition, nontraditional mortgage pass-through securities, such as “interest-only strips” and “principal-only strips”, if held by the University, are classified as CMOs. The University did not hold any nontraditional pass-through securities during the year.

As of June 30, 2004, the University was holding \$4,683,679 in mortgage-backed securities valued at fair value representing approximately 1.84% of its total investments. Of this amount, \$189,590 represents investments in CMOs and \$2,184,146 represents investment with the Investment Fund.

Other Asset-Backed Securities - The University invests in various asset-backed securities such as automobile loan securitizations, credit card securitizations, and home equity loans. The University invests in the various asset-backed securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The values of these other asset-backed securities are generally based on the cash flows to be received from the underlying pools of assets. Accordingly, these securities are subject to market risk due to fluctuations in interest rates, prepayment rates, and various liquidity factors related to their specific markets. The market risk is reduced by the University’s preference to invest in the shorter average life securities.

These security holdings are subject to credit-related losses in the event of non-performance by the issuers or counterparties to these instruments.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

However, the University does not expect any issuers or counterparties to fail to meet their obligation given their high credit ratings. The assets that collateralize these securities, which could be liquidated at market values at the time of non-performance, reduce the credit risk.

As of June 30, 2004, the University was holding \$775,945 in asset-backed securities valued at fair value representing approximately .30% of its total investments.

Indirect Derivative Holdings - The University utilizes external investment managers to identify specific investment funds that meet asset allocation and investment management objectives. These managers and related funds are used to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. These investments generally include equity and bond funds. Certain investments expose the University to market risk by trading or holding derivative instruments and by leveraging the securities in the fund. Derivative holdings are limited by type and duration constraints as well as being backed by liquid assets.

The University's holdings in indirect derivatives are primarily used to decrease risk by managing interest rate and volatility exposure. The indirect derivatives are used by the University's investment managers primarily to hedge underlying positions and to gain exposure to specific markets in an efficient, inexpensive, liquid and diversified manner. The University considers the risk associated with these holdings to be prudent and within acceptable bounds.

As of June 30, 2004, the Long-Term Investment Pool (excluding the Investment Fund investments) was holding \$5,537,877 in mutual and pooled investment funds for which investments in derivatives totaled \$3,111,349 valued at fair value representing approximately 1.22% of the University's total investments.

In addition, the Investment Fund was holding \$84,422,873 in various mutual funds for which investment in derivative instruments totaled \$43,695,826 valued at fair value representing approximately 17.14% of the University's total investments. Of this amount \$18,619,760 or 42.612% was held for the Endowment Fund and \$25,076,066 or 57.388% was held for the participating Foundations.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 pooled endowment funds are determined by applying 4% (the Board approved spending rate) to the average market value of the long-term investment pool divided by the number of investment units in the pool to determine the "average spending amount" per unit of investment. The individual endowment fund payout or spending budget is then determined by applying the "average spending amount" to the number of investment units held by the individual endowment fund. 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. At June 30, 2004, net appreciation of \$95,074,409 was available to be spent, of which \$82,582,473 was restricted to specific purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2004, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 2,906,758	\$ 1,449,838	\$ 1,456,920
Accounts	17,306,819	2,335,349	14,971,470
Intergovernmental	12,709,732		12,709,732
Interest on Loans	327,799	284,807	42,992
Other	1,158,122		1,158,122
Total Current Receivables	\$ 34,409,230	\$ 4,069,994	\$ 30,339,236
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 1,088,798	\$ 12,323	\$ 1,076,475
Institutional Student Loan Programs	207,346	6,355	200,991
Total Notes Receivable - Current	\$ 1,296,144	\$ 18,678	\$ 1,277,466
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 10,143,853	\$ 724,430	\$ 9,419,423
Institutional Student Loan Programs	604,191	149,110	455,081
Total Notes Receivable - Noncurrent	\$ 10,748,044	\$ 873,540	\$ 9,874,504

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2004, is presented as follows:

	Balance July 1, 2003	Adjustments	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:					
Land	\$ 12,048,546	\$ 0	\$ 1,011,079	\$ 0	\$ 13,059,625
Construction in Progress	112,891,020	(43,444,618)	155,297,813		224,744,215
Total Capital Assets, Nondepreciable	<u>124,939,566</u>	<u>(43,444,618)</u>	<u>156,308,892</u>		<u>237,803,840</u>
Capital Assets, Depreciable:					
Buildings	564,397,345	43,044,552	16,901,263	(1,525,060)	622,818,100
Machinery and Equipment	224,080,575		19,756,547	(20,400,923)	223,436,199
General Infrastructure	72,869,629	400,066	5,276,790		78,546,485
Total Capital Assets, Depreciable	<u>861,347,549</u>	<u>43,444,618</u>	<u>41,934,600</u>	<u>(21,925,983)</u>	<u>924,800,784</u>
Less Accumulated Depreciation/Amortization for:					
Buildings	223,908,655		15,152,918	(925,300)	238,136,273
Machinery and Equipment	140,083,084		19,029,460	(18,530,854)	140,581,690
General Infrastructure	15,897,670		1,880,021		17,777,691
Total Accumulated Depreciation	<u>379,889,409</u>		<u>36,062,399</u>	<u>(19,456,154)</u>	<u>396,495,654</u>
Total Capital Assets, Depreciable, Net	<u>481,458,140</u>	<u>43,444,618</u>	<u>5,872,201</u>	<u>(2,469,829)</u>	<u>528,305,130</u>
Capital Assets, Net	<u>\$ 606,397,706</u>	<u>\$ 0</u>	<u>\$ 162,181,093</u>	<u>\$ (2,469,829)</u>	<u>\$ 766,108,970</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2004, were as follows:

	Amount
Accounts Payable	\$ 31,506,048
Accrued Payroll	6,498,881
Contract Retainage	8,506,867
Intergovernmental Payables	1,921,943
Total Accounts Payable and Accrued Liabilities	<u>\$ 48,433,739</u>

NOTE 7 - SHORT-TERM DEBT – COMMERCIAL PAPER PROGRAM

The University has available Commercial Paper Program financing for short-term credit up to \$60,000,000 to finance capital construction projects. The University's available funds are pledged to the Commercial Paper Program financing with the anticipation of converting to general revenue bond financing in the future. As of June 30, 2004, \$15,000,000 in Commercial Paper was outstanding. Of this amount, \$13,000,000 was Tax-Exempt Commercial Paper and \$2,000,000 was Taxable Commercial Paper.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Short-term debt activity for the year ended June 30, 2004, was as follows:

	Balance July 1, 2003	Issued	Redeemed	Balance June 30, 2004
Commercial Paper Program	\$ 0	\$ 15,000,000	\$ 0	\$ 15,000,000

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2004, is presented as follows:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	\$ 153,159,000	\$ 0	\$ (7,522,000)	\$ 145,637,000	\$ 6,367,000
Add/Deduct Premium/Discount	2,450,812	38,634	(209,988)	2,279,458	
Total Bonds Payable	155,609,812	38,634	(7,731,988)	147,916,458	6,367,000
Capital Leases Payable	218,337		(47,582)	170,755	71,492
Compensated Absences	34,258,768	33,776,728	(25,855,861)	42,179,635	2,154,656
Total Long-Term Liabilities	\$ 190,086,917	\$ 33,815,362	\$ (33,635,431)	\$ 190,266,848	\$ 8,593,148

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 06/30/2004	Principal Outstanding 06/30/2004
STUDENT HOUSING SYSTEM						
Dormitory - Sullivan Hall	(1) F	3.625%	09/01/2004	\$ 2,200,000	\$ 2,095,000	\$ 105,000
Dormitory Complex	(1) G	3.00%	09/01/2006	3,225,000	2,820,000	405,000
Avent Ferry Complex	(1) M	5.3-6.1%	09/01/2014	11,820,000	11,285,000	535,000
Refund Housing System Series H, J, & K	(1) N	5-5.8%	09/01/2009	4,110,000	2,390,000	1,720,000
Residence Hall Improvement Project	(1) (A)	3.25-5%	10/01/2010	15,770,000	5,555,000	10,215,000
Housing System Project	(1) (B)	5-5.5%	10/01/2010	3,020,000	750,000	2,270,000
Refund Housing System Series L & M	(9) 2002B	2-5%	10/01/2014	8,800,000	1,290,000	7,510,000
Housing System Projects	(9) 2003A	2-5%	10/01/2018	26,655,000		26,655,000
Housing System Projects	(9) 2003B	Variable	10/01/2027	41,720,000		41,720,000
Total Student Housing System				<u>117,320,000</u>	<u>26,185,000</u>	<u>91,135,000</u>
DINING HALL SYSTEM						
Dining Hall System Refunding Bonds	(2) 1996	4-5.3%	02/01/2012	2,345,000	695,000	1,650,000
STUDENT HEALTH SYSTEM						
Student Health Facility Project	(3) (A)	3.25-5.25%	10/01/2013	5,615,000	1,470,000	4,145,000
PARKING SYSTEM						
Parking System Refunding Bonds	(4) 1996	4-5.1%	06/01/2009	6,530,000	2,970,000	3,560,000
ATHLETIC SYSTEM						
Entertainment and Sports Arena Project	(5) (A)	3.25-5.25%	10/01/2018	6,325,000	1,090,000	5,235,000
Doak Field Project	(9) 2003A	2-5%	10/01/2018	80,000		80,000
Doak Field Project	(9) 2003B	Variable	10/01/2023	3,940,000		3,940,000
Total Athletic System				<u>10,345,000</u>	<u>1,090,000</u>	<u>9,255,000</u>
CENTENNIAL CAMPUS SYSTEM						
Centennial Campus Projects	(6) 1997A	6.55-7.04%	12/15/2010	7,765,000	3,195,000	4,570,000
Centennial Campus Projects	(6) 1997B	5.125%	12/15/2016	7,090,000		7,090,000
Centennial Campus Projects	(6) 1999A	Variable	12/15/2019	13,500,000	400,000	13,100,000
Centennial Campus Projects	(6) 1999B	7.04%	12/15/2004	2,117,000	1,650,000	467,000
Centennial Campus Projects	(9) 2002C	2.75-6.45%	10/01/2013	7,160,000	935,000	6,225,000
Total Centennial Campus System				<u>37,632,000</u>	<u>6,180,000</u>	<u>31,452,000</u>
STUDENT CENTER SYSTEM						
University Student Center	(7) 1996	4.5-5.1%	11/01/2009	2,210,000	825,000	1,385,000
OTHER						
Gymnasium Refunding Bonds	(8) (A)	3.25-4.5%	10/01/2007	1,695,000	1,695,000	
Central Stores Expansion Project	(8) (B)	5-5.75%	10/01/2020	3,370,000	315,000	3,055,000
Total Other				<u>5,065,000</u>	<u>2,010,000</u>	<u>3,055,000</u>
Total Bonds Payable (principal only)				<u>\$ 187,062,000</u>	<u>\$ 41,425,000</u>	<u>145,637,000</u>
Less: Unamortized Discount						(234,539)
Plus: Unamortized Premium						2,513,997
Total Bonds Payable						<u>\$ 147,916,458</u>

(A) The University of North Carolina System Pool Revenue Bonds, Series 1998B

(B) The University of North Carolina System Pool Revenue Bonds, Series 2000

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Designated student fees and revenue streams related to the systems financed above have been pledged for the payment of these bonds. In addition, fund reservations required by the Bond Indentures have been established and recorded as restricted net assets. The following revenues as summarized in Note 10 have been pledged or are security for the bonds.

- | | |
|-----------------------------------------|------------------------------------------------------------------------|
| (1) Residential Life Revenues (Housing) | (6) Other Revenues (Centennial Campus) |
| (2) Dining Revenues | (7) Student Center Revenues |
| (3) Student Health Revenues | (8) Other Sales and Service Revenues
(Central Stores and Gymnasium) |
| (4) Parking Revenues | (9) Available Funds (General Revenue Bonds) |
| (5) Athletic Revenues | |

Available funds, as defined in the General Indenture dated October 1, 2001, are any funds of NC State in each fiscal year remaining after satisfying debt obligations excluding (1) state appropriations, (2) tuition payments, (3) funds restricted by gift, grant, or payee, (4) revenues from Special Facilities, and (5) funds restricted by law. Available funds are not pledged to the trustee, but rather are the source from which principal and interest on the Bonds will be paid.

- C. Demand Bonds** - Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a “put” feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the University’s remarketing or paying agents.

With regards to the following demand bonds, the University has entered into legal agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

The North Carolina State University at Raleigh Variable Rate Revenue Bonds (Centennial Campus Projects), Series 1999A: On September 22, 1999, the University issued tax-exempt variable rate revenue demand bonds in the amount of \$13,500,000 that have a final maturity date of December 15, 2019. The bonds are subject to mandatory sinking fund redemption that began on December 1, 2000. The University’s proceeds of this issuance were used to (i) discharge a portion of a loan from First Union National Bank, the proceeds from which were used for the construction and equipping of a building known as the Partners II Building located on the Centennial Campus of NC State, (ii) paying the cost of relocating utility easements on the Centennial Campus of NC State, and (iii) paying the costs incurred in connection with the issuance of the 1999A Bonds.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, Lehman Brothers, Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and First Union National Bank, a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.20% of the available commitment, payable quarterly in arrears, beginning on October 1, 1999, and on each January 1, April 1, and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the Bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2004, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility has been extended and is scheduled to expire on September 15, 2008, unless otherwise extended based on the terms of the agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 20 quarterly installments, beginning the first business day that is at least 180 days following such expiration date or termination date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of \$13,100,000 of demand bonds was "put" and not resold, the University would be required to pay \$2,742,020 a year for 5 years under this agreement assuming a 1.75% interest rate.

Effective October 1, 1999, the University entered into an interest rate swap contractual agreement with Lehman Brothers, Inc., on \$9,000,000 of these demand bonds. Under this agreement, the University will pay interest at a fixed rate of 4.574%. On a monthly basis the difference between 67% of the weighted average of the weekly LIBOR (London

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Interbank Offered Rates) rate and the fixed rate will be calculated. If the fixed rate is greater than the LIBOR calculated rate, the University will pay the difference to Lehman Brothers, Inc. If the LIBOR rate is greater, Lehman Brothers will refund the difference to the University. During the fiscal year the University paid Lehman Brothers \$343,907 under this agreement.

The North Carolina State University at Raleigh Variable Rate General Revenue Bonds, Series 2003B: On June 20, 2003, the University issued tax-exempt variable rate revenue demand bonds in the amount of \$45,660,000 that have a final maturity date of October 1, 2027. The bonds are subject to mandatory sinking fund redemption that begins on October 1, 2004. The University's proceeds of this issuance were used to pay a portion of the costs of certain improvements on the campus of the University, to refund certain debt previously incurred for that purpose, and to pay the costs incurred in connection with the issuance of the 2003B bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, UBS Financial Services Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Bayerische Landesbank, a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.20% of the available commitment, payable quarterly in arrears, beginning on July 1, 2003, and on each October 1, January 1, April 1, and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the Bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2004, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Facility is scheduled to expire on June 19, 2008, unless otherwise extended based on the terms of the Agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 20 quarterly installments, beginning the first business day of January, April, July, or October, whichever first occurs on or following the Purchase Date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of \$45,660,000 of demand bonds was “put” and not resold, the University would be required to pay \$9,557,300 a year for 5 years under this agreement assuming a 1.75% interest rate.

Effective June 20, 2003, the University entered into an interest rate swap contractual agreement with Bank of America, Inc., on \$24,655,000 of these demand bonds. Under this agreement the University will pay interest at a fixed rate of 3.54%. On a monthly basis the difference between the weighted average of the weekly BMA (the Bond Market Association Municipal Swap Index) rate and the fixed rate will be calculated. If the fixed rate is greater than the BMA calculated rate, the University will pay the difference to Bank of America, Inc. If the BMA rate is greater, Bank of America will refund the difference to the University. During the fiscal year the University paid Bank of America \$631,365 under this agreement.

Effective June 20, 2003, the University entered into an interest rate swap contractual agreement with Bank of America Inc., on \$21,005,000 of these demand bonds. Under this agreement the University will pay interest at a fixed rate of 1.19%. On a monthly basis the difference between the weighted average of the weekly BMA (the Bond Market Association Municipal Swap Index) rate and the fixed rate will be calculated. If the fixed rate is greater than the BMA calculated rate, the University will pay the difference to Bank of America, Inc. If the BMA rate is greater, Bank of America will refund the difference to the University. During the fiscal year the University paid Bank of America \$44,278 under this agreement.

Interest Rate Swaps

Objective: In order to protect against the potential of rising interest rates, the University entered into three separate pay-fixed, receive-variable interest rate swaps at a cost anticipated to be less than what the University would have paid to issue fixed-rate debt.

Terms, fair values, and credit risk: The University’s swap agreements contain scheduled reductions to outstanding notional amounts that are

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

expected to approximately follow scheduled or anticipated reductions in the associated “bonds payable” category. The terms, fair values, and credit ratings of the outstanding swaps as of June 30, 2004, were as follows.

Associated Bond Issue	Notional Amounts	Effective Date	Fixed Rate Paid	Variable Rate Received	Fair Values	Swap Termination Date	Counterparty Credit Rating
Centennial Campus1999A	\$ 9,000,000	10/1/1999	4.574%	67% of LIBOR ¹	\$ (851,229)	12/01/2019	A1/A+/A+
General Revenue 2003B	24,655,000	6/20/2003	3.54%	BMA ^{2,3}	1,826,789	10/01/2027	Aa1/AA-/AA-
General Revenue 2003B	<u>21,005,000</u>	6/20/2003	1.19%	BMA	<u>123,229</u>	7/1/2005 ⁴	Aa1/AA-/AA-
Total	<u>\$ 54,660,000</u>				<u>\$ 1,098,789</u>		

¹ London Interbank Offered Rate

² The Bond Market Association Municipal Swap Index™

³ Variable rate received is BMA Municipal Swap Index from 6/20/03 to 7/1/06, thereafter, the variable rate received will be 75% of LIBOR

⁴ Counterparty has the option to extend the swap to July 1, 2007

Because rates have declined since 1999, the Centennial Campus swap has a negative fair value as of June 30, 2004. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University’s variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the market values as of June 30, 2004.

As of June 30, 2004, the University was exposed to credit risk in the amount of the positive fair value on the General Revenue 2003B derivatives’ fair value. The swap agreements do not contain a requirement for collateral, although the General Revenue 2003B swaps require termination should the University’s or the counterparty’s credit rating fall below either Baa2 as issued by Moody’s Investors Services or BBB as issued by Standard & Poors or Fitch Ratings. Also, under the terms of the swap agreements, should one party become insolvent or otherwise default on its obligations, provisions permit the nondefaulting party to accelerate and terminate all outstanding transactions. Of the three agreements entered into by the University, two swaps, approximating 83% of the notional amount of the swaps outstanding, are held with one counterparty. All the counterparties are rated A1 or better.

Basis risk: The University is exposed to basis risk on the swaps when the variable payment received is based on an index other than BMA. Should the relationship between LIBOR and BMA move to convergence, the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

expected cost savings may not be realized. As of June 30, 2004, the BMA rate was 1.05 percent, whereas 67% of LIBOR was .91 percent.

Termination risk: The University or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. If any of the swaps are terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the University would be liable to the counterparty for that amount.

Swap payments and associated debt: Using rates as of June 30, 2004, debt service requirements of the University's outstanding variable-rate debt and net swap payments are as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Fiscal Year Ending June 30	Variable-Rate Bonds			
	Principal	Interest	Interest Rate Swaps, Net	Total
2005	\$ 395,000	\$ 586,930	\$ 957,386	\$ 1,939,316
2006	900,000	580,420	913,765	2,394,185
2007	915,000	571,285	899,138	2,385,423
2008	925,000	562,025	880,854	2,367,879
2009	1,040,000	552,135	862,570	2,454,705
2010-2014	5,265,000	2,600,515	4,002,024	11,867,539
2015-2019	6,365,000	2,316,720	3,373,059	12,054,779
2020-2024	23,050,000	1,628,682	2,951,272	27,629,954
2025-2028	19,905,000	408,775	770,032	21,083,807
Total	<u>\$ 58,760,000</u>	<u>\$ 9,807,487</u>	<u>\$ 15,610,100</u>	<u>\$ 84,177,587</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- D. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2004, are as follows:

<u>Fiscal Year</u>	<u>Annual Requirements</u>	
	<u>Bonds Payable</u>	
	<u>Principal</u>	<u>Interest</u>
2005	\$ 6,367,000	\$ 4,685,468
2006	6,730,000	4,388,072
2007	7,025,000	4,096,146
2008	7,200,000	3,795,024
2009	7,395,000	3,474,896
2010-2014	36,145,000	12,669,217
2015-2019	31,300,000	5,359,398
2020-2024	23,570,000	1,593,772
2025-2029	19,905,000	408,775
Total Requirements	\$ 145,637,000	\$ 40,470,768

Interest on the variable rate 1999A is calculated at 1.010% and the 2003B revenue bonds is calculated at 1.00%, the rates in effect at June 30, 2004 for each series.

The variable rate is changed weekly every Wednesday by the Remarketing agent with a maximum rate of 12%. In addition, the University has entered into interest rate swaps to synthetically fix a portion of the 1999A and 2003B bonds. See Note 8C for more information on the demand bonds and the interest rate swaps

- E. Bond Defeasance** - The University has extinguished long-term debt obligations by the issuance of new long-term debt instruments or by advance cash payout as follows:

In fiscal year 2002, the University defeased \$7,520,000 of outstanding North Carolina State University at Raleigh Housing System Revenue Bonds of 1994, Series M. An irrevocable trust was established with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2004, the outstanding balance of the defeased Housing System Revenue Bonds was \$7,520,000.

On January 16, 2004, the University defeased \$935,000 of outstanding University of North Carolina System Pool Revenue Bonds, Series 1998B (original issue amount \$1,695,000). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

for the defeased bonds are not included in the University's Statement of Net Assets. As a result, the University reduced its debt service requirements by \$1,014,362 over the next four years and obtained an economic gain of \$19,468. At June 30, 2004, the outstanding balance of the defeased University of North Carolina System Pool Revenue Bonds, Series 1998B was \$935,000.

NOTE 9 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2004:

<u>Fiscal Year</u>	<u>Amount</u>
2005	\$ 83,378
2006	83,742
2007	17,733
2008	<u>4,485</u>
Total Minimum Lease Payments	189,338
Amount Representing Interest (8.74% wgt. Rate of Interest)	<u>18,583</u>
Present Value of Future Lease Payments	<u><u>\$ 170,755</u></u>

Machinery and equipment acquired under capital lease amounted to \$338,317 at June 30, 2004.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Operating Lease Obligations – The University entered into operating leases for equipment and property rental. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2004:

<u>Fiscal Year</u>	<u>Amount</u>
2005	\$ 2,234,379
2006	1,682,884
2007	1,462,473
2008	809,798
2009	522,240
Total Minimum Lease Payments	\$ 6,711,774

Rental expense for all operating leases during the year was \$2,766,772.

NOTE 10 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Less Allowance for Uncollectibles</u>	<u>Net Revenues</u>	<u>Revenues Pledged as Security for Debt</u>
Operating Revenues:						
Student Tuition and Fees	\$ 143,005,932	\$ 0	\$ 30,196,693	\$ 463,355	\$ 112,345,884	\$ 17,619,701 (D,E,F,G)
Other Revenues	\$ 14,506,246	\$ 3,246,349	\$ 0	\$ 0	\$ 11,259,897	\$ 3,715,752 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 24,751,996	\$ 381,114	\$ 4,380,497	\$ (30,488)	\$ 20,020,873	\$ 24,751,996 (B)
Dining	17,972,520	1,649,476	1,401,953	(5,257)	14,926,348	17,972,520 (C)
Bookstore	13,999,129	758,087			13,241,042	
Athletics	28,599,808	303,335			28,296,473	28,599,808 (D)
Parking	5,620,197	604,573		(31,940)	5,047,564	5,620,197 (E)
Student Center	560,684	108,073			452,611	560,684 (F)
Student Health	3,106,690	193,850	599,454		2,313,386	3,106,690 (G)
Other	12,639,424	8,564,703	1,439,768	6,227	2,628,726	1,648,675 (H)
Sales and Services of Education and Related Activities	55,398,174	18,880,462		(63,637)	36,581,349	
Total Sales and Services	\$ 162,648,622	\$ 31,443,673	\$ 7,821,672	\$ (125,095)	\$ 123,508,372	\$ 82,260,570

Revenue Bonds Secured by Pledged Revenues:

- | | |
|------------------------------|---------------------------|
| (A) Centennial Campus System | (E) Parking System |
| (B) Student Housing System | (F) Student Center System |
| (C) Dining System | (G) Student Health System |
| (D) Athletics System | (H) Other |

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - 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	\$ 200,503,782	\$ 17,061,910	\$ 20,632,227	\$ 0	\$ 4,325	\$ 0	\$ 238,202,244
Research	122,752,330	18,633,883	34,990,374		469,687		176,846,274
Public Service	68,944,572	8,149,855	20,936,575		250,457		98,281,459
Academic Support	34,045,173	13,656,635	13,333,920		40,750		61,076,478
Student Services	9,275,688	1,033,680	3,913,649		4		14,223,021
Institutional Support	40,546,820	4,619,948	5,800,351				50,967,119
Operations and Maintenance of Plant	18,419,549	9,467,843	5,148,016		19,529,413		52,564,821
Student Financial Aid	1,573,241	263,633	1,153,769	14,896,493			17,887,136
Auxiliary Enterprises	33,723,808	26,870,174	29,545,844		3,127,389		93,267,215
Depreciation						36,062,399	36,062,399
Total Operating Expenses	\$ 529,784,963	\$ 99,757,561	\$ 135,454,725	\$ 14,896,493	\$ 23,422,025	\$ 36,062,399	\$ 839,378,166

NOTE 12 - 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, 2004, these rates were set at .22% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2004, the University had a total payroll of \$469,481,129, of which \$240,421,653 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

contributions for pension benefits for the year were \$14,425,299 and \$528,928, respectively. The University made one hundred percent of its annual required contributions for the years ended June 30, 2004, 2003, and 2002, which were \$528,928, \$0, and \$4,628,371, 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 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, 2004, 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, 2004, the University had a total payroll of \$469,481,129, of which \$139,493,020 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$8,369,581 and \$9,541,323, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$1,253,485 for the year ended June 30, 2004.

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, 2004, were \$108,474. The voluntary contributions by employees amounted to \$2,755,924 for the year ended June 30, 2004.

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 \$8,118,238 for the year ended June 30, 2004.

C. Federal Employment Retirement - The Federal Retirement System is a multiple-employer retirement system and is composed of three retirement programs: the Civil Service Retirement System (CSRS) for participants

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

employed prior to January 1, 1987, the Federal Employees Retirement System (FERS) for participants employed after January 1, 1987, and the Civil Service Retirement Offset System (Offset) for reemployed CSRS employees.

North Carolina Cooperative Extension employees with federal appointments prior to January 1, 1987, participate in the Civil Service Retirement System. Currently, 183 employees participate in CSRS. Participating employees are required by federal statute to contribute 7% of salary or .8% of salary if covered by the Offset and the University 7% of salary to CSRS. In addition, the employees may contribute up to 9% of salary to the Thrift Savings Plan (a defined contribution plan managed by the Federal Retirement Thrift Investment Board). Total employee and employer contributions to CSRS for the year ended June 30, 2004, was \$879,687 and \$905,657 respectively. Employees covered under CSRS contributed \$57,273 to the Thrift Savings Plan.

Under the Federal Employees Retirement System (FERS), employees are required to contribute .8% of salary and the University 10.7%. Currently, 15 employees participate in FERS. The University is also required to contribute 1% of participant's salary to the Thrift Savings Plan, plus up to an additional 4% depending upon employee's contribution, which can range from 0% to 14% of their salary. Total employee and employer contributions for the year ended June 30, 2004, were \$8,107 and \$108,444 respectively. For employees covered under FERS the total employee and employer contributions to the Thrift Savings Plan for the year ended June 30, 2004, were \$94,974 and \$51,483 respectively.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that 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 3.2% 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, 2004, the University's total contribution to the Plan was \$12,157,270. The University assumes no liability for retiree health care

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. Employer contributions are established in the Appropriations Bill by the General Assembly. The University was not required to contribute to the DIPNC for the fiscal year ended June 30, 2004. 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 14 - 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. Except for a reduction in the public officers' and employees' liability insurance from \$11,000,000 to \$5,000,000 per occurrence, there have been no significant reductions in insurance coverage from the previous year and, with the exception of one automobile liability claim, settled claims have been within coverage limits 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 \$5,000,000, per occurrence, 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, except for the peril of theft with an applicable \$1,000 per occurrence deductible.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University departments, as an individual business decision, may also purchase through the Fund primary extended coverage for buildings and contents. Coverage may also be purchased through the Fund for theft, vandalism, sprinkler leakage, or all-risk perils. University departments also have the option to purchase all-risk coverage for specific computers and “miscellaneous equipment” on a scheduled basis or retain the risk.

All State-owned vehicles are covered by liability insurance through a private insurance company as administered 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 North Carolina Department of Insurance for the coverage. While liability coverage is required by Statute for all University vehicles, departments may also individually opt to purchase collision and comprehensive physical damage coverage.

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is administered by the North Carolina Department of Insurance. The University is charged a premium by the private insurance company. Coverage limit is \$1,000,000 per occurrence with a \$25,000 deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance and the State’s Agent of Record. The types of insurance policies purchased include: Medical Professional Liability, Veterinary Professional Liability, Fine Arts Property, Master Crime, Inland Marine Property for Musical Instruments, Campers Accident and Sickness, Athletic Accident, Boiler and Machinery, Watercraft, Oceanographic Equipment, and Nuclear Energy Liability

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Treasurer and funded via employer contributions. There were no employer contributions required 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.

NOTE 15 - 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 \$124,573,119 at June 30, 2004.

B. Pending Litigation and Claims - As previously reported, the Environmental Protection Agency (EPA) filed a civil action against the University pursuant to the Comprehensive Environmental Response, Compensation and Liability Act. The complaint sought relief that would cause the University to enter into remediation of a hazardous waste site known as "Lot 86." The University is involved in ongoing discussions and negotiations with the EPA concerning the appropriate means for addressing the remediation. A Consent Decree executed by North Carolina State University and the EPA has been approved by the Court. Remedial clean-up pursuant to the Consent Decree continues. The remediation costs paid by the University for the year ended June 30, 2004, totaled \$126,771.

As previously reported, litigation is still pending in Superior Court between NC School Boards Association, et. al. V. Harlan Boyles, et. al. which involves various State officials in their official capacity which seeks a judicial determination as to whether the State Constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. The complaint alleges in part that the monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations and library fines are "civil penalties" which the State Constitution requires to be paid to the school fund in the county where they are collected. The lawsuit seeks declaratory judgment that the State Civil Penalty and Forfeiture Fund, the State School Technology Fund, and the Public Settlement Reserve Fund are unconstitutional. The Wake County Superior Court ruled in favor of the Plaintiffs. The order is retroactive for a three-year statute of limitations from the date the civil action was filed to include all affected civil fines and penalties collected by State agencies since December 1995. The court has stayed enforcement of this ruling, pending the State's appeal. The record was

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

filed with the court on April 16, 2002. The Court of Appeals reversed the trial court's decision that held that the library, traffic and parking fines are payable to the public schools but held in favor of the Plaintiff on certain other fines and penalties affecting other State agencies. The Department of Transportation, however, has appealed as of right on the overweight penalties, a decision that went against them in the majority opinion of the court and the School Board has filed an appeal covering all issues decided adversely to the Board, including the fines and penalties that affect the University. The North Carolina Supreme Court must now rule on whether to accept the discretionary issues and set a timetable for briefing. Thus, the matter remains pending until the Supreme Court renders a decision regarding the appeals that have been filed. If the Supreme Court reverses the Appeals Court decision, the University may be required to pay Wake County School Boards parking and library fines amounting to approximately \$7,173,131 since 1995 and approximately \$700,000 annually.

The University is a party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the 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 \$2,500,000,000 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University's remaining authorization of \$284,295,477 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

NOTE 16 - RELATED PARTIES

Foundations - There are eleven separately incorporated non-profit foundations associated with the University. These foundations are the North Carolina Agricultural Foundation, Inc., North Carolina State University Foundation, Inc., North Carolina Tobacco Foundation, Inc., Pulp and Paper Foundation, Inc., North Carolina State University Physical and Mathematical Sciences Foundation, Inc., North Carolina Engineering Foundation, Inc., North Carolina Veterinary Medical Foundation, Inc., The North Carolina Forestry Foundation, Inc., North Carolina Textile Foundation, Inc., North Carolina State University Student Aid Association, Inc., and the North Carolina State Alumni Association, Inc. Subsequent to year-end the North Carolina Dairy Foundation, Inc. merged and became part of the North Carolina Agricultural Foundation, Inc.

These organizations serve 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. As described in Note 1 to the financial statements, the North Carolina State University Foundation, Inc. and the North Carolina Student Aid Association, Inc. are considered component units of the University for reporting purposes and their financial statements are presented separately as part of the University's financial statements. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the other foundations, except for support from each organization to the University. This support of the foundations, excluding amounts from the North Carolina State University Foundation, Inc. and the North Carolina Student Aid Association, Inc., approximated \$20,127,895 for the year ended June 30, 2004, for noncapital purposes.

Nonprofit Corporation – The Centennial Authority (Authority) was created by the 1995 General Assembly (Senate Bill 606) for the purpose of studying, designing, planning, constructing, owning, promoting, financing, and operating a regional facility on land owned by the State. Prior to this act, the General Assembly authorized the construction by the University of a facility to be known as the "Entertainment and Sports Arena" (ESA). This facility serves as

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

a regional sports entertainment center and is available for cultural performances, sporting events and other activities of the University or of other entities (the centennial center project). With the 1995 legislation, the centennial center project was transferred to the Authority.

The Authority entered into a Ground Lease with the State of North Carolina to lease land for the ESA for a period of 99 years at an annual rent of \$1. The University entered into a Use Agreement with the Authority. Both parties agreed that the University shall be the primary and preferred user of all areas of the ESA. The University is required to pay the greater of 10% of gross ticket revenues or \$42,549 for each men's and \$18,334 for each women's basketball game to compensate the Authority for facility rental and operating expenses. Rent and expense payments for miscellaneous events will be negotiated on an event by event basis based on the availability of the ESA and the anticipated attendance.

In fiscal year 2003 a naming rights agreement was executed to change the name of the ESA to the "RBC Center." As a result of this agreement, the University will receive \$13,184,000 over a ten-year period beginning in fiscal year 2003.

NOTE 17 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2004, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

North Carolina State University
Schedule of General Obligation Bond Project Authorizations,
Budgets, and Expenditures
For Project-to-Date as of June 30, 2004

Schedule 1

Capital Improvement Projects	Original Projected Start Date	Revised/ Actual Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Expected Completion Date	Actual Completion Date
<i>Projects Started</i>									
40074-301/339 Undergraduate Science Teaching Lab Ph 1	07/01	04/01	\$ 27,857,987.00	\$ 1,897,500.00	\$ 29,755,487.00	\$ 28,643,421.00	96.26%	04/04	06/04
40074-302 Withers Hall conversion to academic use	04/02	09/05	10,963,068.00		10,963,068.00	522,299.00	4.76%	06/06	10/06
40074-303/336 College of Engineering Complex Phase 1	11/00	09/02	34,885,022.00	1,925,000.00	36,810,022.00	25,029,271.00	68.00%	07/04	09/04
40074-304/324/335 College of Vet Med Research Lab Bldg.	07/00	12/02	19,460,905.00	15,620,550.00	35,081,455.00	19,107,829.00	54.47%	01/05	03/05
40074-305 College of Engineering Complex Phase II	12/00	12/16	32,995,163.00	8,000,000.00	40,995,163.00	7,141,191.00	17.42%	05/05	08/05
40074-306 David Clark & Undergrad Sci Teach Lab Ph II	01/01	10/03	22,743,767.00		22,743,767.00	6,561,560.00	28.85%	11/04	05/05
40074-308 South Gardner Hall Laboratory Renovation	01/03	11/05	13,790,000.00		13,790,000.00	114,605.00	0.83%	12/07	02/07
40074-309 1911 Building Comprehensive Renovation	05/02	11/06	6,516,228.00		6,516,228.00	422,555.00	6.48%	06/08	05/08
40074-310 Park Shops Comprehensive Renovation	03/07	12/06	6,010,190.00		6,010,190.00	90,000.00	1.50%	09/08	06/08
40074-311 Riddick Labs Comprehensive Renovation	05/01	01/05	24,304,009.00		24,304,009.00	1,723,917.00	7.09%	03/06	07/06
40074-312 Harrelson Classroom Building Renovation	05/03	09/06	12,509,562.00		12,509,562.00	46,367.00	0.37%	11/09	09/08
40074-313 Clark Hall Conversion & Renovation	01/01	03/02	1,630,459.00		1,630,459.00	1,617,655.00	99.21%	06/03	01/03
40074-314 Schaub Food Science Building Renovation	01/02	06/04	10,826,961.00		10,826,961.00	895,957.00	8.28%	05/06	09/05
40074-315 Williams Hall Laboratory Building Renovation	12/02	09/05	11,930,357.00	96,815.00	12,027,172.00	371,056.00	3.09%	01/08	11/06
40074-316 Polk Hall Laboratory Renovation	05/03	09/06	13,734,770.00		13,734,770.00	398,712.00	2.90%	10/08	09/08
40074-317 Leazar Hall Laboratory Building Renovation	02/02	06/05	7,817,885.00		7,817,885.00	476,151.00	6.09%	07/06	08/06
40074-318 Daniels Hall Laboratory Building Renovation	06/01	03/04	7,339,360.00		7,339,360.00	1,408,384.00	19.19%	11/06	06/06
40074-319 Jordan Hall Lab & Classroom Addition	06/01	07/05	12,389,621.00		12,389,621.00	1,143,885.00	9.23%	11/04	09/06
40074-320 Library Addition	05/02	01/05	8,672,117.00	100,000.00	8,772,117.00	582,810.00	6.64%	05/06	06/06
40074-321 Support Services Center	01/01	07/03	8,505,819.00	2,686,534.00	11,192,353.00	6,857,148.00	61.27%	10/04	09/04
40074-321 Visitor's Center	05/01	04/04	899,541.00	5,895,000.00	6,794,541.00	536,006.00	7.89%	07/04	05/05
40074-322 Field Research Labs & Outlying Res. Facilities	01/01	01/01	2,207,004.00	40,000.00	2,247,004.00	1,356,693.00	60.38%	05/05	06/06
40074-323 Hort. Classroom @ Arboretum Ed. Ctr.	09/97	01/01	476,190.00	3,713,957.00	4,190,147.00	4,161,011.00	99.30%	07/02	08/02
40074-324 Partners III	05/01	03/03	9,126,082.00	14,032,982.00	23,159,064.00	16,078,964.00	69.43%	10/04	11/04
40074-324 Flex Building	10/01	04/02	5,629,467.00		5,629,467.00	5,617,378.00	99.79%	12/02	03/03
40074-324 Environmental Research Lab - Broughton	05/01	11/04	1,500,000.00		1,500,000.00	112,048.00	7.47%	01/05	04/05
40074-325 Public Safety Facility	02/01	04/03	4,300,053.00		4,300,053.00	3,069,317.00	71.38%	06/04	07/04
40074-326 CVM Mech & Elec System Improvements	01/01	02/05	13,233,261.00	225,000.00	13,458,261.00	586,615.00	4.36%	09/07	01/08
40074-327 Technology Infrastructure Expansion	07/01	01/03	2,424,100.00		2,424,100.00	1,379,462.00	56.91%	06/03	06/05
40074-328 Chilled Water Central Plant - North Campus	03/01	02/02	48,715,137.00	464,984.00	49,180,121.00	20,942,679.00	42.58%	05/09	11/05
40074-330 Steam Dist & Capacity Improv. (Sullivan)	03/01	02/03	3,042,387.00	48,050.00	3,090,437.00	2,100,223.00	67.96%	03/04	09/05
40074-331 Backflow Preventors	02/01	06/03	1,768,708.00		1,768,708.00	747,926.00	42.29%	06/05	12/05
40074-331 Wayfinding	02/01	03/03	1,963,022.00		1,963,022.00	235,978.00	12.02%	06/05	11/04
40074-331 Pedestrian Tunnel	02/01	05/05	2,778,192.00		2,778,192.00	59,400.00	2.14%	06/05	03/06
40074-332 College of Vet. Med. Infrastructure	01/01	03/03	17,469,758.00	561,000.00	18,030,758.00	13,554,462.00	75.17%	12/03	10/04
40074-333 Centennial Campus Infrastructure	03/01	08/02	15,886,570.00	890,189.00	16,776,759.00	15,768,921.00	93.99%	02/04	10/04
40074-334 Land Acquisition	01/01	01/01	2,100,000.00		2,100,000.00	1,377,975.00	65.62%	12/01	07/05
40074-337 Animal and Food Science Facility	06/02	07/05	6,217,245.00	94,763.00	6,312,008.00	159,540.00	2.53%	03/04	07/06
40074-338 Research & Teaching Feed Mill	01/01	08/01	2,582,000.00	288,200.00	2,870,200.00	2,246,786.00	78.28%	12/02	01/03
40074-340 Beef Herd Relocation	09/01	04/02	1,315,177.00	150,000.00	1,465,177.00	1,465,177.00	100.00%	10/02	12/02
40074-340 Land Acquisition Lake Wheeler	01/01	12/02	1,701,200.00	1,548,800.00	3,250,000.00	1,526,149.00	46.96%	01/03	10/04
40074-350 Project Management Costs			19,040,392.00		19,040,392.00	4,657,103.00	24.46%		

North Carolina State University
Schedule of General Obligation Bond Project Authorizations,
Budgets, and Expenditures
For Project-to-Date as of June 30, 2004

Schedule 1
Page 2

<u>Capital Improvement Projects</u>	<u>Original Projected Start Date</u>	<u>Revised/ Actual Start Date</u>	<u>General Obligation Bonds Authorized</u>	<u>Other Sources</u>	<u>Total Project Budget</u>	<u>Amount Expended</u>	<u>Percent Completed</u>	<u>Expected Completion Date</u>	<u>Actual Completion Date</u>
<i>Projects Not Started - To Be Funded in Future Years</i>									
40074-360 Inflation			8,997,919.00		8,997,919.00				
Total All Projects			<u>\$ 468,256,655.00</u>	<u>\$ 58,279,324.00</u>	<u>\$ 526,535,979.00</u>	<u>\$ 200,894,586.00</u>			

Note: The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of \$2,500,000,000 of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The projects listed on this schedule are those funded or to be funded by bond proceeds from the general obligation bonds authorized by Senate Bill 912.

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Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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

Board of Trustees
North Carolina State University
Raleigh, North Carolina

We have audited the financial statements of North Carolina 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, and its discretely presented component units, as of and for the year ended June 30, 2004, which collectively comprise the University's basic financial statements and have issued our report thereon dated November 15, 2004. We did not audit the financial statements of the North Carolina State University Foundation, Inc. and the NCSU Student Aid Association, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the North Carolina State University Foundation, Inc. and the NCSU Student Aid Association, Inc., is based on the reports of the other auditors.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 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. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to the discretely presented component units.

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 an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

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.



Leslie W. Merritt, Jr., CPA. CFP
State Auditor

November 15, 2004

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Director, Fiscal Research Division

March 28, 2005

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