

STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF THE UNIVERSITY OF NORTH CAROLINA AT CHARLOTTE

CHARLOTTE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF
THE UNIVERSITY OF NORTH CAROLINA AT CHARLOTTE
CHARLOTTE, NORTH CAROLINA
FOR THE YEAR ENDED JUNE 30, 2004

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Ralph Campbell, Jr.
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STATE OF NORTH CAROLINA
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AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of The University of North Carolina at Charlotte, 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 The University of North Carolina at Charlotte. 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 The University of North Carolina at Charlotte. 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 The University of North Carolina at Charlotte.

Results - The accompanying financial statements present fairly, in all material respects, the amounts and disclosures made in accordance with accounting principles generally accepted in the United States of America. These matters are more fully described in the Independent Auditor's Report on the Financial Statements.

AUDITOR'S TRANSMITTAL (CONCLUDED)

2. **Objective** – To present significant deficiencies, if any, in internal control over financial reporting which could adversely affect the University's ability to record, process, summarize, and report financial data in the financial statements and present instances of noncompliance, if any, with laws, regulations, contracts, or grants.

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



Ralph Campbell, Jr.
State Auditor

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Ralph Campbell, Jr.
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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The University of North Carolina at Charlotte
Charlotte, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Charlotte, 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 of North Carolina at Charlotte'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 Foundation of the University of North Carolina at Charlotte, Inc., which represents 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of The Foundation of the University of North Carolina at Charlotte, Inc., were not audited in accordance with *Government Auditing Standards*. An audit 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 report of other auditors provide a reasonable basis for our opinions.

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 16 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 19, 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 (MD&A), as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the 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 University of North Carolina at Charlotte's basic financial statements. Schedules 1 and 2 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ralph Campbell, Jr.
State Auditor

November 19, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statements and Financial Analysis

The University of North Carolina at Charlotte (UNC Charlotte) is pleased to present its financial statements for fiscal year 2004. The emphasis of discussion about these statements is on current year data and material changes occurring between prior and current years.

There are three financial statements presented:

- Statement of Net Assets.
- Statement of Revenues, Expenses, and Changes in Net Assets.
- Statement of Cash Flows.

This discussion and analysis of the University's financial statements provides an overview of its financial activities for the year.

Statement of Net Assets

The Statement of Net Assets (SNA) presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The SNA is a point-in-time financial statement. The purpose of the SNA is to present to the readers of the financial statements a fiscal snapshot of UNC Charlotte. The SNA presents end-of-year data concerning Assets (current and noncurrent), Liabilities (current and noncurrent), and Net Assets (assets minus liabilities). The distinction between current and noncurrent assets is discussed in the Notes to the Financial Statements.

From the data presented, readers of the SNA are able to determine the assets available to continue the operations of the institution. They are also able to determine how much the institution owes vendors, investors, and lending institutions. Finally, the SNA provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the Institution.

Net assets are divided into three major categories:

- Invested in Capital Assets, net of related debt.
- Restricted Net Assets
- Unrestricted Assets

Invested in capital assets, net of related debt, provides the Institution's equity in property, plant, and equipment owned by the institution.

Restricted net assets are divided into two categories, expendable and nonexpendable. The corpus of nonexpendable restricted resources is available for investment purposes. Expendable restricted net assets are available for expenditure by the Institution but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Unrestricted assets are available to the institution for any lawful purpose of the institution.

Statement of Net Assets June 30, 2004 (dollars in thousands)

	2004	2003	Change	% Change
Assets:				
Currents Assets	\$ 94,724	\$ 70,452	\$ 24,272	34.5%
Capital Assets, Net	360,468	288,815	71,653	24.8%
Other Assets	63,290	73,864	(10,574)	(14.3%)
Total Assets	518,482	433,131	85,351	19.7%
Liabilities:				
Current Liabilities	26,430	18,681	7,749	41.5%
Noncurrent Long-Term Liabilities	108,428	97,961	10,467	10.7%
Total Liabilities	134,858	116,642	18,216	15.6%
Net Assets:				
Invested in Cap. Assets, Net of Related Debt	277,555	221,116	56,439	25.5%
Restricted for:				
Expendable	14,115	16,847	(2,732)	(16.2%)
Nonexpendable	30,856	28,315	2,541	9.0%
Unrestricted	61,098	50,211	10,887	21.7%
Total Net Assets	\$ 383,624	\$ 316,489	\$ 67,135	21.2%

The total assets of the Institution increased by \$85.3 million, the bulk of which was in Capital Assets, Net of related debt.

The total increase in long-term liabilities for the year was mainly due to an \$8 million increase in investments categorized as Funds held for others. The current liability increase resulted from a \$1 million increase in the current portion of Bond payable for refinancing and new debt, \$2.5 million increase in accrued construction and Banner operational software costs, and a \$327,000 increase in compensated absences.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total net assets, as presented on the Statement of Net Assets, are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets (SRECNA). The purpose of this statement is to present the operating and nonoperating revenues received by the institution, and the operating and nonoperating expenses paid by the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

institution. Other revenue, expenses, gains, and losses received or spent by the institution and not classified as operating or nonoperating are presented separately on the statement.

Generally, operating revenues are received for providing goods and services to the various customers and constituencies of the institution. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the institution. Nonoperating revenues are revenues received for which goods and services are not provided. For example, State appropriations are nonoperating because they are provided by the legislature to the institution without the legislature directly receiving commensurate goods and services for those revenues.

Statement of Revenues, Expenses, and Changes in Net Assets

June 30, 2004

(dollars in thousands)

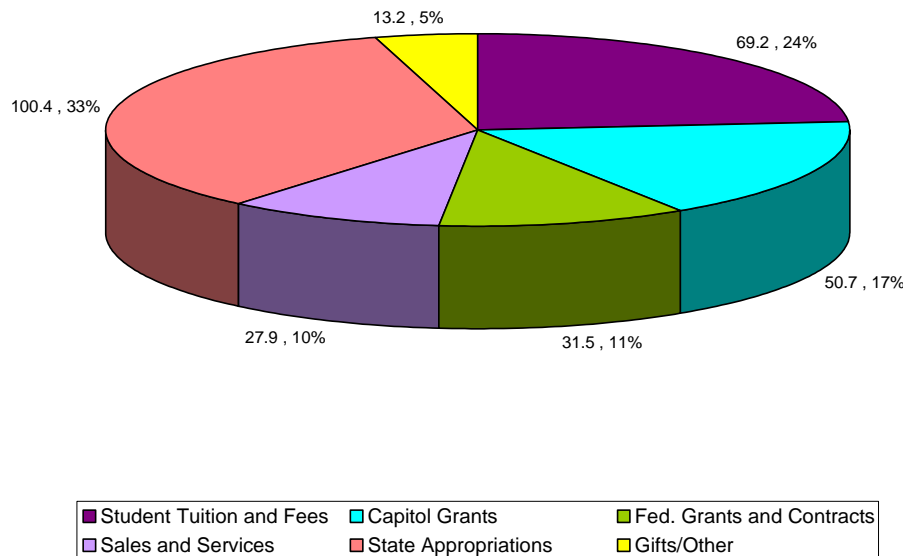
	2004	2003	Change	% Change
Operating Revenues:				
Student Tuition and Fees	\$ 69,284	\$ 61,285	\$ 7,999	13.1%
Federal Contracts and Grants	31,523	24,231	7,292	30.1%
Sales and Services	27,871	27,362	509	1.9%
Other Operating Revenues	6,596	5,411	1,185	21.9%
Total Operating Revenues	135,274	118,289	16,985	14.4%
Nonoperating Revenues:				
State Appropriations	100,397	95,881	4,516	4.7%
Noncapital Gifts	3,120	5,321	(2,201)	(41.4%)
Other Nonoperating Revenues	6,806	3,863	2,943	76.2%
Total Nonoperating Revenues	110,323	105,065	5,258	5.0%
Total Revenue	245,597	223,354	22,243	10.0%
Operating Expenses	224,827	213,818	11,009	5.1%
Nonoperating Expenses	4,218	4,101	117	2.9%
Capital Appropriations	227		227	100%
Capital Contributions	51,199	34,043	17,156	50.4%
Additions to Endowment	137	1,282	(1,145)	(89.3%)
Increase in Net Assets	68,115	40,760	27,355	67.1%
Net Assets at Beginning of Year, as Originally Reported	316,489	276,905	39,584	
Net Asset Restatements	(980)	(1,176)	196	
Net Assets at Beginning of Year - Restated	315,509	275,729	39,780	14.4%
Net Assets at End of Year	\$ 383,624	\$ 316,489	\$ 67,135	21.2%

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Some highlights of the information presented on the SRECNA are as follows:

- Federal Grants and Contracts increased 30% over the same period last year because the University was granted two new federal awards appropriated for Optoelectronics research. These awards were \$4.2 and \$1.8 million and can be expended over a period of 1 year.
- The increase in Capital Contributions is related to a \$17 million increase in construction improvement support from the state fund by state issued bonds.
- The net increase in Net Assets on the SRECNA is primarily the result of Capital contributions, an increase in Federal Grants, and increased State Appropriations.
- Tuition and State Appropriations continue to be the primary sources funding the University's operations, with state appropriations providing 33% and tuition 24% of total income.

2004 Total income by source (in millions)



Statement of Cash Flows

The final statement presented by The University of North Carolina at Charlotte is the Statement of Cash Flows. This statement presents detailed information about the cash activity of the institution during the year. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities of the institution. The second section reflects cash flows from noncapital financing activities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

This section reflects the cash received spent for nonoperating, noninvesting, and noncapital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fourth section reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received from investing activities. The fifth section reconciles the net cash used to the operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

Cash Flows for the Fiscal Year ended June 30, 2004 (dollars in thousands)

	<u>2004</u>
Cash Provided/(Used) By:	
Operating Activities	\$ (67,865)
Noncapital Financing Activities	102,893
Capital and Related Financing Activities	(27,072)
Investing Activities	<u>6,339</u>
Net Change in Cash	14,295
Cash, Beginning of Year	<u>80,506</u>
Cash, End of Year	<u><u>\$ 94,801</u></u>

Capital Asset and Debt Administration

The University continues to expand its facilities to meet the increasing student enrollment and advances in information technology. In fiscal year 2003-04 the University completed projects valued at \$55.9 million. These included parking decks, additions to buildings, renovation and new construction to academic and administrative facilities. Construction in progress totals \$67.8 million, an increase of \$18.6 million over fiscal year 2002-03, and outstanding commitments on construction contracts were \$43.9 million. There have been no significant changes in credit ratings or debt limitations that may affect future financing for the University.

Banner Project

The University is in the process of converting its financial system from the current one to the Banner system. This implementation will require funding for employee re-training, ITS support personnel, system software and hardware along with other operating costs. The estimated project total as of August 2004 is \$12.3 million of which \$3.3 million was expended from institutional funds. \$2.9 million of noncapitalizable operating and miscellaneous expenditures remain to be paid, with the remaining \$6 million to be financed through Variable Rate Certificates of Participation, (COPS). RFP's (Request for Proposal)

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

for Underwriter/Letter Of Credit Bank have been submitted to the University of North Carolina – Office of the President. However, as of this date no specific details have been received by this University.

Economic Outlook

The University's enrollment continues to grow, and its net assets continue to increase moderately. There are no known immediate existing conditions that will significantly impact the financial position of the University in the next fiscal year. Management is committed to making sound fiscal decisions to maintain the University's financial position and its ability to withstand future economic uncertainties.

Olen B. Smith
Vice Chancellor for Business Affairs

University of North Carolina at Charlotte
Statement of Net Assets
June 30, 2004

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$	60,683,992
Restricted Cash and Cash Equivalents		20,331,012
Short-Term Investments		375,000
Restricted Short-Term Investments		4,232,946
Receivables, Net (Note 4)		7,082,120
Due from Primary Government		348,959
Due from State of North Carolina Component Units		20,000
Inventories		466,311
Notes Receivable, Net (Note 4)		1,175,396
Other Assets		8,988
Total Current Assets		94,724,724

Noncurrent Assets:

Restricted Cash and Cash Equivalents		13,785,600
Restricted Due from Primary Government		4,465,585
Endowment Investments		39,745,169
Other Long-Term Investments		8,763
Notes Receivable, Net (Note 4)		5,284,835
Capital Assets - Nondepreciable (Note 5)		86,033,884
Capital Assets - Depreciable, Net (Note 5)		274,433,862
Total Noncurrent Assets		423,757,698

Total Assets		518,482,422
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)		15,916,682
Due to Primary Government		57,026
Deferred Revenue		4,921,906
Interest Payable		326,386
Long-Term Liabilities - Current Portion (Note 7)		5,208,099
Total Current Liabilities		26,430,099

Noncurrent Liabilities:

Deposits Payable		2,221,117
Funds Held for Others		8,140,825
U. S. Government Grants Refundable		5,469,980
Long-Term Liabilities (Note 7)		92,596,615
Total Noncurrent Liabilities		108,428,537

Total Liabilities		134,858,636
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University of North Carolina at Charlotte**Statement of Net Assets****June 30, 2004****Exhibit A-1****Page 2****NET ASSETS**

Invested in Capital Assets, Net of Related Debt	277,554,731
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,862,395
Endowed Professorships	20,768,341
Departmental Uses	3,420,403
Loans	1,739,839
Other	1,064,991
Expendable:	
Scholarships and Fellowships	2,591,130
Research	73,408
Departmental Uses	750,478
Capital Projects	1,636,926
Debt Service	7,880,893
Other	1,181,828
Unrestricted	61,098,423
Total Net Assets	\$ 383,623,786

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

University of North Carolina at Charlotte
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 9)	\$	69,283,647
Federal Grants and Contracts		31,523,049
State and Local Grants and Contracts		1,495,844
Nongovernmental Grants and Contracts		2,849,184
Sales and Services, Net (Note 9)		27,871,111
Interest Earnings on Loans		89,916
Other Operating Revenues		2,160,933
Total Operating Revenues		135,273,684

EXPENSES

Operating Expenses:

Salaries and Benefits		151,065,140
Supplies and Materials		16,719,477
Services		35,902,567
Scholarships and Fellowships		4,494,506
Utilities		5,941,434
Depreciation		10,704,145
Total Operating Expenses		224,827,269

Operating Loss **(89,553,585)**

NONOPERATING REVENUES (EXPENSES)

State Appropriations		100,396,924
Noncapital Grants		20,000
Noncapital Gifts		3,120,464
Investment Income (Net of Investment Expense of \$333,615)		6,786,378
Interest and Fees on Capital Asset-Related Debt		(4,196,459)
Other Nonoperating Expenses		(21,577)
Net Nonoperating Revenues		106,105,730

Income Before Other Revenues, Expenses, Gains, or Losses **16,552,145**

Capital Appropriations		226,900
Capital Grants		50,771,368
Capital Gifts		427,361
Additions to Endowments		136,585
Increase in Net Assets		68,114,359

NET ASSETS

Net Assets - July 1, 2003, as Restated (Note 17)		315,509,427
Net Assets - June 30, 2004	\$	383,623,786

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

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

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 135,641,129
Payments to Employees and Fringe Benefits	(149,708,499)
Payments to Vendors and Suppliers	(56,994,297)
Payments for Scholarships and Fellowships	(4,650,729)
Loans Issued	(1,280,720)
Collection of Loans	1,002,968
Interest Earned on Loans	108,236
Other Receipts	8,016,657

Net Cash Used by Operating Activities (67,865,255)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	100,396,924
Noncapital Grants	905
Noncapital Gifts	2,359,021
Additions to Permanent and Term Endowments	136,585

Net Cash Provided by Noncapital Financing Activities 102,893,435

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	28,959,605
Capital Grants	52,505,324
Acquisition and Construction of Capital Assets	(78,256,271)
Principal Paid on Capital Debt and Leases	(25,690,063)
Interest and Fees Paid on Capital Debt and Leases	(4,591,013)

Net Cash Used by Capital Financing and Related Financing Activities (27,072,418)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	14,012,346
Investment Income	3,272,070
Purchase of Investments and Related Fees	(10,945,637)

Net Cash Provided by Investing Activities 6,338,779

Net Increase in Cash and Cash Equivalents	14,294,541
Cash and Cash Equivalents - July 1, 2003	80,506,063
Cash and Cash Equivalents - June 30, 2004	\$ 94,800,604

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

Exhibit A-3

Page 2

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

Operating Loss	\$ (89,553,585)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	10,704,145
Allowances, Write-Offs, and Amortizations	7,458
Changes in Assets and Liabilities:	
Receivables (Net)	(827,716)
Due from Primary Government	(287,420)
Notes Receivable (Net)	(277,752)
Inventories	(11,240)
Interest Receivable - Student Loans	18,320
Accounts Payable and Accrued Liabilities	1,464,814
Deferred Revenue	1,380,589
Compensated Absences	1,500,475
Funds Held for Others	8,016,657
Net Cash Used by Operating Activities	<u>\$ (67,865,255)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 60,683,992
Restricted Cash and Cash Equivalents	20,331,012
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	13,785,600
Total Cash and Cash Equivalents - June 30, 2004	<u>\$ 94,800,604</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 31,916,817
Assets Acquired through a Gift	813,804
Change in Fair Value of Investments	(3,857,866)
Change in Receivables related to nonoperating income	20,000
Loss on Disposal of Capital Assets	(108,009)

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

<i>The Foundation of the University of North Carolina at Charlotte, Inc.</i>		
<i>Statement of Financial Position</i>		
<i>June 30, 2004</i>		<i>Exhibit B-1</i>
ASSETS		
Cash and Cash Equivalents		\$ 226
Investments		47,299,135
Interest Receivable		89,338
Accounts Receivable		5,142
Notes Receivable		2,498,559
Pledges Receivable		9,905,664
Cash Surrender Value of Life Insurance		434,340
Equipment, Net		89,058
Leasehold Improvements, Net		176,601
Property Held for Investment		10,284
Prepaid Expenses		2,211
Total Assets		60,510,558
LIABILITIES		
Accounts Payable and Accrued Expenses		120,293
Funds Held for Others		26,837
Other Long-Term Liabilities		262,700
Long-Term Liabilities		3,888,770
Total Liabilities		4,298,600
NET ASSETS		
Unrestricted		10,941,439
Temporarily Restricted		18,979,377
Permanently Restricted		26,291,142
Total Net Assets		\$ 56,211,958
See Note 1 in the Notes to the Financial Statements.		

<i>The Foundation of the University of North Carolina at Charlotte, Inc.</i>		
<i>Statement of Activities</i>		
<i>For the Fiscal Year Ended June 30, 2004</i>		<i>Exhibit B-2</i>
CHANGES IN UNRESTRICTED NET ASSETS		
Revenue, Support and Gains:		\$
Support-Public Contributions		510,433
Revenue:		
Endowment Income		277,832
Transfer of Endowment Income		(129,671)
Rental and Other Income		1,905,804
Net Gain on Investment		1,431,523
Net Loss on Disposal of Equipment		(18,320)
Other Investment Income		346,455
Subtotal		4,324,056
Net Assets Released from Restrictions		1,262,743
Total Revenue, Support and Gains		5,586,799
Expenses:		
Program Services:		
Contributions to the University of North Carolina at Charlotte		1,484,772
Distributions to Donors		30,822
Capital Project		1,646,799
Total Program Services		3,162,393
Supporting Services:		
Professional Fees		146,328
Other General and Administrative Expenses		582,469
Interest Expense		(8,286)
Total Supporting Services		720,511
Total Expenses		3,882,904
Transfers to Other Funds		(5,491)
Increase in Unrestricted Net Assets		\$ 1,698,404

<i>The Foundation of the University of North Carolina at Charlotte, Inc.</i>		
<i>Statement of Activities</i>		<i>Exhibit B-2</i>
<i>For the Fiscal Year Ended June 30, 2004</i>		<i>Page 2</i>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
Revenue, Support and Gains:		
Support-Public Contributions		2,725,827
Revenue:		
Other Investment and Interest Income		134,135
Endowment Income		538,978
Transfer of Endowment Income		129,671
Rental and Other Income		41,175
Net Gain on Investments		2,668,110
Subtotal		6,237,896
Net Assets Released from Restrictions		(1,262,743)
Total Revenue, Support and Gains		4,975,153
Transfers to Other Funds		(741,644)
Increase in Temporarily Restricted Net Assets		4,233,509
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Revenue, Support and Gains:		
Support-Public Contributions		2,592,186
Revenue:		
Rental and Other Income		5,812
Total Revenue, Support and Gains		2,597,998
Transfers from Other Funds		747,135
Increase in Permanently Restricted Net Assets		3,345,133
Change in Net Assets		9,277,046
Net Assets, Beginning of Year		46,934,912
Net Assets, End of Year		<u>\$ 56,211,958</u>
See Note 1 in the Notes to the Financial Statements.		

THE UNIVERSITY OF NORTH CAROLINA AT CHARLOTTE
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. The University of North Carolina at Charlotte 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 unit is discretely presented in the University's financial statements. The discretely presented component unit's financial data is reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

Discretely Presented Component Unit – The Foundation of The University of North Carolina at Charlotte, Inc. (Foundation), is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University.

The Foundation is a legally separate, tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of fifty-two (52) officers and directors including a five (5) member executive committee. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Foundation can only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University and is reported in separate financial statements because of the difference in its reporting model, as described below.

The Foundation is a private not-for-profit organization that reports its 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 the Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2004, the Foundation distributed \$1,484,773 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Sheila Hamm at The University of North Carolina at Charlotte.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

E. Investments - This classification includes long-term fixed income investments, equity investments, mutual funds, money market funds, real estate, and other asset holdings by the University. Except for money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings, 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 fees charges to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.

G. Inventories – Inventories, consisting of expendable supplies, are valued at last invoice cost. Merchandise for resale is valued using the retail inventory method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 75 years for general infrastructure, 10 to 50 years for buildings, and 2 to 25 years for equipment

The University's Art, Literature and Artifacts collections are capitalized at cost or fair value at the date of donation. These collections are considered inexhaustible and are therefore not depreciated.

- 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 and compensated absences that will not be paid within the next fiscal year.

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

- 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 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

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 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.

P. Internal Sales Activities – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 2 - DEPOSITS AND INVESTMENTS

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

Deposits include cash and cash equivalents totaling \$94,800,604. At year-end, cash on hand was \$3,690,574. The University's portion of the State Treasurer's Investment Pool was \$90,487,831. 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 \$622,199 and the bank balance was \$1,764,391. Of the bank balance, \$200,000 was covered by federal depository insurance and \$1,564,391 was uninsured and uncollateralized.

North Carolina General Statutes 147-69.1(c), applicable to the State's General Fund, and 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

External Investment Pool - The external investment pool sponsored by the University was established in 2002. The pool is utilized to manage the investments for charitable, nonprofit organizations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. Other affiliated organizations not included in

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the University's reporting entity represent the pool's external participants. Fund ownership of the pool is measured using the pro rata method. Under this method, each participating fund's investment balance is determined based on its pro rata share of the fair market value of the investment pool at the beginning of each monthly period. The external portion of the pool is presented in the accompanying financial statements as "Funds Held in Trust for Pool Participants."

The external investment pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the Board of Directors. The Board is responsible for adopting investment objectives and policies, for hiring investment advisors, and for monitoring policy implementation and investment performance. The Board has chosen not to make individual security selection decisions. The Board's primary role is to oversee the allocation of the pool's portfolio among the asset classes, investment vehicles, and investment managers.

Wachovia Corporation is the custodian for the pool for funds invested by Bank of America, Wachovia, and Cohen, Klingenstein, & Marks, and provides the University with monthly statements defining income and fair value information, which is then allocated among the fund's participants. Westwood, Academy Ventures, and UNC Management Company provide similar information. There are no involuntary participants in the pool. The University has not provided or obtained any legally binding guarantees during the period to support the value for the pool's investments. The participants holding assets in the endowment pool as of June 30, 2004, were the University Endowment Fund, The Foundation of the University of North Carolina at Charlotte, Inc., and the University of North Carolina at Charlotte Athletic Foundation, and were therefore not consolidated with the University endowment's proportionate share of other investments.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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:

External Investment Pool

	Fair Value			
	Risk Category			Total
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 13,120	\$ 0	\$ 0	\$ 13,120
Corporate Stocks		3,356,157		3,356,157
Total Categorized Investments	\$ 13,120	\$ 3,356,157	\$ 0	3,369,277
Investments Not Categorized:				
Money Market Funds				2,408,879
Mutual Funds				24,401,771
Total Investments Not Categorized				26,810,650
Total External Investment Pool				\$ 30,179,927

Non-Pooled Investments

	Fair Value			
	Risk Category			Total
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 356,267	\$ 0	\$ 0	\$ 356,267
Collateralized Mortgage Obligations	285,981			285,981
Corporate Bonds		251,355		251,355
Corporate Stocks		2,174,450		2,174,450
Total Categorized Investments	\$ 642,248	\$ 2,425,805	\$ 0	3,068,053
Investments Not Categorized:				
Money Market Funds				4,311,752
Real Estate				6,793,383
Other Investments				8,763
Total Investments Not Categorized				11,113,898
Total Non-Pooled Investments				\$ 14,181,951

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments

	Fair Value			Total
	Risk Category			
	1	2	3	
Total Categorized Investments	\$ 655,368	\$ 5,781,962	\$ 0	\$ 6,437,330
Total Investments Not Categorized				37,924,548
Total Investments				\$ 44,361,878

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

The external investment pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2004 are as follows:

Statement of Net Assets June 30, 2004

	Amount
Assets:	
Cash in Bank	\$ 6,067,395
Interest Receivable	56,147
Reserve for FMV	767,232
Investments	69,262,250
Total Assets	\$ 76,153,024
Net Assets:	
Internal Portion	30,202,194
External Portion	45,950,830
Total Net Assets	\$ 76,153,024

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Statement of Operations and Changes in Net Assets For the Fiscal Year Ended June 30, 2004

	Amount
Increase in Net Assets from Operations:	
Revenues:	
Investment Income	\$ 1,650,279
Additions to Investments	6,653,942
Net gains on investments	8,263,307
Expenditures:	
Investment Management	(355,672)
Net Increase in Net Assets Resulting from Operations	16,211,856
Distributions to Participants:	
Distributions Paid and Payable	1,799,215
Total Increase in Net Assets	14,412,641
Net Assets:	
Beginning of Year	61,740,383
End of Year	\$ 76,153,024

The major investment classifications of the external investment pool had the following attributes at June 30, 2004:

Investment Classification	Fair Value
U.S. Government Securities	\$ 33,081
Corporate Stocks	8,462,346
Mutual Funds	61,534,056
Money Market Funds	6,067,394
	\$ 76,096,877

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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, certain trusts, and private corporations (including REMIC issuers). In addition, nontraditional mortgage pass-

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

through securities, such “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 \$354,557 in mortgage-backed securities valued at fair value representing approximately 1.1% of its total investments. Of this amount, \$285,982 represents investments in CMOs.

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 nonperformance by the issuers or counterparties to these instruments. 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 nonperformance, reduce the credit risk.

As of June 30, 2004, the University held no asset-backed securities classified as other.

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University’s endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University’s endowment funds are based on a preset rate as approved by the Board of trustees of the Endowment fund. The payout rate for the period ended

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

June 30, 2004 was 4% of a twelve-quarter rolling average of the fair market value of the fund. To the extent that the total return for the current year exceeds the payout, the excess is added to the 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 \$2,791,222 was available to be spent, of which \$577,672 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2004 were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 5,097,197	\$ 94,327	\$ 5,002,870
Accounts	342,949		342,949
Local Government	101,980		101,980
Federal Agencies	1,187,627		1,187,627
Investment Earnings	155,473		155,473
Other	291,221		291,221
Total Current Receivables	<u>\$ 7,176,447</u>	<u>\$ 94,327</u>	<u>\$ 7,082,120</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	<u>\$ 1,483,914</u>	<u>\$ 308,518</u>	<u>\$ 1,175,396</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 4,858,329	\$ 0	\$ 4,858,329
Institutional Student Loan Programs	<u>454,494</u>	<u>27,988</u>	<u>426,506</u>
Total Notes Receivable - Noncurrent	<u>\$ 5,312,823</u>	<u>\$ 27,988</u>	<u>\$ 5,284,835</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2003	Adjustments	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:					
Land	\$ 4,717,707	\$ 632,913	\$ 0	\$ 0	\$ 5,350,620
Art, Literature, and Artifacts	12,483,731		351,486		12,835,217
Construction in Progress	49,181,344	(55,829,498)	74,496,201		67,848,047
Total Capital Assets, Nondepreciable	66,382,782	(55,196,585)	74,847,687		86,033,884
Capital Assets, Depreciable:					
Buildings	224,487,987	44,724,987			269,212,974
Machinery and Equipment	45,216,629		7,812,762	1,050,824	51,978,567
General Infrastructure	51,057,338	10,471,598			61,528,936
Total Capital Assets, Depreciable	320,761,954	55,196,585	7,812,762	1,050,824	382,720,477
Less Accumulated Depreciation for:					
Buildings	62,240,497		5,079,039		67,319,536
Machinery and Equipment	26,181,004		4,681,747	954,725	29,908,026
General Infrastructure	10,115,695		943,358		11,059,053
Total Accumulated Depreciation	98,537,196		10,704,144	954,725	108,286,615
Total Capital Assets, Depreciable, Net	222,224,758	55,196,585	(2,891,382)	96,099	274,433,862
Capital Assets, Net	\$ 288,607,540	\$ 0	\$ 71,956,305	\$ 96,099	\$ 360,467,746

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 9,598,725
Accrued Payroll	719,766
Contract Retainage	5,595,318
Other	2,873
Total Accounts Payable and Accrued Liabilities	\$ 15,916,682

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

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

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	\$ 87,259,000	\$ 27,940,000	\$ 25,331,000	\$ 89,868,000	\$ 4,071,000
Add/Deduct Premium/Discount	(63,754)	1,730,788	111,160	1,555,874	
Deduct Deferred Charge on Refunding		112,476	2,091,166	(1,978,690)	
Total Bonds Payable	<u>87,195,246</u>	<u>29,783,264</u>	<u>27,533,326</u>	<u>89,445,184</u>	<u>4,071,000</u>
Compensated Absences	<u>6,859,056</u>	<u>4,834,735</u>	<u>3,334,260</u>	<u>8,359,530</u>	<u>1,137,099</u>
Total Long-Term Liabilities	<u>\$ 94,054,302</u>	<u>\$ 34,617,999</u>	<u>\$ 30,867,586</u>	<u>\$ 97,804,714</u>	<u>\$ 5,208,099</u>

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 6/30/2004	Accretion on Capital Appreciation Bonds	Principal Outstanding 6/30/2004
<u>Housing and Dining</u>							
Sanford and Moore Halls	B	3.0%-3.0%	1/1/2008	\$ 1,650,000	\$ 1,370,000	\$ 0	\$ 280,000
Scott Hall	C	5.875%-5.875%	1/1/2007	2,200,000	1,750,000		450,000
Holshouser Hall	D	5.2%-5.2%	1/1/2007	2,200,000	1,750,000		450,000
Martin Village	F	3.0%-3.0%	1/1/2018	2,175,000	1,100,000		1,075,000
Energy Conversation	G	3.0%-3.0%	1/1/2007	152,000	133,000		19,000
Phase III	H	3.0%-3.0%	1/1/2019	1,568,000	774,000		794,000
Total Housing and Dining				<u>9,945,000</u>	<u>6,877,000</u>		<u>3,068,000</u>
<u>Cone Student Center</u>							
Cone Center Addition	C	6.9%-7.0%	7/1/2009	2,300,000	1,485,000		815,000
Total Cone Student Center				<u>2,300,000</u>	<u>1,485,000</u>		<u>815,000</u>
<u>Student Activity Center</u>							
Barnhardt Student Activity Center	1995	5.0%-5.5%	5/1/2021	26,295,000	13,580,000	13,580,000	12,715,000
Total Student Activity Center				<u>26,295,000</u>	<u>13,580,000</u>	<u>13,580,000</u>	<u>12,715,000</u>
<u>Parking System</u>							
Parking Deck F	2002	3.5%-5.125%	1/1/2027	10,900,000	770,000		10,130,000
Total Parking System				<u>10,900,000</u>	<u>770,000</u>		<u>10,130,000</u>
<u>The University of North Carolina System Pool Revenue Bonds</u>							
Phase VII Apartments	1998-B	4.0%-5.25%	9/25/2023	15,875,000	1,920,000		13,955,000
Recreational Playing Fields	1998-B	4.0%-4.5%	9/25/2008	1,105,000	495,000		610,000
Phase 8 Apartments	2002-A	4.0%-5.375%	3/25/2027	21,115,000			21,115,000
Brocker Health Center	2003-A	2.0%-5.0%	4/1/2028	6,055,000	165,000		5,890,000
Partial SAC Refinance	2003-A	2.0%-5.25%	4/1/2016	8,770,000	265,000		8,505,000
Refinancing of H&D Series M	2003-A	2.0%-5.0%	4/1/2015	8,635,000	50,000		8,585,000
Refiance Parking Series 1996	2004-A	3.0%-4.0%	4/1/2021	4,480,000			4,480,000
Total The University of North Carolina System Pool Revenue Bonds				<u>66,035,000</u>	<u>2,895,000</u>		<u>63,140,000</u>
Total Bonds Payable (principal only)				<u>\$ 115,475,000</u>	<u>\$ 25,607,000</u>	<u>\$ 13,580,000</u>	89,868,000
Less: Unamortized Loss on Refunding							(1,978,690)
Less: Unamortized Discount							(276,032)
Plus: Unamortized Premium							1,831,906
Total Bonds Payable							<u>\$ 89,445,184</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

<u>Fiscal Year</u>	Bonds Payable	
	Principal	Interest
2005	\$ 4,071,000	\$ 4,216,308
2006	4,213,000	4,060,558
2007	4,400,000	3,898,168
2008	4,245,000	3,721,473
2009	4,345,000	3,551,281
2010-2014	21,585,000	14,709,885
2015-2019	22,194,000	9,385,844
2020-2024	17,940,000	4,001,720
2025-2030	6,875,000	730,700
Total Requirements	\$ 89,868,000	\$ 48,275,937

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

Housing and Dining: On October 29, 2003, the University defeased \$8,650,000 of outstanding Series M Revenue Bonds. 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 and Dining Series M Revenue Bonds was \$8,650,000.

Parking: On March 31, 2004, the University defeased \$4,035,000 of outstanding Series 1996 Revenue Bonds. 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 Parking Series 1996 Revenue Bonds was \$4,035,000.

Student Activity Center: On October 29, 2003, the University defeased \$8,415,000 a portion of the outstanding Student Activity Center Bonds, Series 1995 (original issue amount \$26,295,000). 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 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 Student Activity Center Revenue Bonds was \$8,415,000. The

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

amount of the original issue not refunded, and included in the University's Statement of Net Assets, is \$12,715,000.

NOTE 8 - Operating Lease Obligations

The University entered into operating leases for \$945,589. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2004:

<u>Fiscal Year</u>	<u>Amount</u>
2005	\$ 201,000
2006	206,025
2007	211,176
2008	216,455
2009	110,933
Total Minimum Lease Payments	\$ 945,589

Rental expense for all operating leases during the year was \$145,651.

NOTE 9 - 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>	
Operating Revenues:						
Student Tuition and Fees	\$ 81,966,941	\$ 0	\$ 12,627,439	\$ 55,855	\$ 69,283,647	
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 13,205,941	\$ 362,431	\$ 2,075,859	\$ 14,425	\$ 10,753,226	(A)
Dining	9,911,398		1,145,535	6,326	8,759,537	(B)
Student Union Services	166,244	49,068			117,176	(B)
Health, Physical Education, and Recreation Services	30,496			565	29,931	(C)
Parking	4,036,374	103,133		4,549	3,928,692	(D)
Other	13,239,496	9,079,460		3,071	4,156,965	(D)
Sales and Services of Education and Related Activities	2,110,539	1,984,955			125,584	
Total Sales and Services	\$ 42,700,488	\$ 11,579,047	\$ 3,221,394	\$ 28,936	\$ 27,871,111	

Revenue Bonds Secured by Pledged Revenues:
 (A) Housing and Student Center System
 (B) Student Union Center
 (C) Recreation Services
 (D) Parking

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 88,280,899	\$ 5,746,447	\$ 7,100,183	\$ 226,757	\$ 214	\$ 0	\$ 101,354,500
Research	6,593,066	1,638,535	3,889,194	564,649	1,980		12,687,424
Public Service	2,656,807	233,852	922,596	32,491			3,845,746
Academic Support	10,063,439	4,173,319	3,336,112	219,944	13		17,792,827
Student Services	7,115,100	261,990	1,622,379	7,462	2,049		9,008,980
Institutional Support	11,321,245	927,997	3,137,859	400			15,387,501
Operations and Maintenance of Plant	9,367,437	583,614	1,227,678	0	3,985,679		15,164,408
Student Financial Aid	411,033	6,084	136,940	1,564,364			2,118,421
Auxiliary Enterprises	15,256,114	3,147,639	14,529,626	1,878,439	1,951,499		36,763,317
Depreciation						10,704,145	10,704,145
Total Operating Expenses	<u>\$ 151,065,140</u>	<u>\$ 16,719,477</u>	<u>\$ 35,902,567</u>	<u>\$ 4,494,506</u>	<u>\$ 5,941,434</u>	<u>\$ 10,704,145</u>	<u>\$ 224,827,269</u>

NOTE 11 - PENSION PLANS

A. Retirement Plans - Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 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 \$126,105,257, of which \$53,411,544 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 \$3,204,694 and \$117,505, respectively. The University made one hundred percent of its annual required contributions for the years ended June 30, 2004, 2003, and 2002, which were \$117,505, \$0, and \$943,693, 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 \$126,105,257, of which \$54,219,920 was covered under the Optional Retirement Program. Total employee and employer contributions for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

pension benefits for the year were \$3,253,195 and \$3,708,643, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$228,262 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 \$64,347. The voluntary contributions by employees amounted to \$734,177 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 \$2,592,755 for the year ended June 30, 2004.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - 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 \$3,444,207. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Long-Term Disability -** The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. 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 13 - RISK MANAGEMENT

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

liability insurance from \$11,000,000 to \$5,000,000, there have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$5,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

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

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

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

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. This coverage includes: Equipment Floaters (Master Music, Fine Arts), Boiler and Machinery coverage, Student Nursing & Physician Liability coverage, Bonds (Postal, Employee Dishonesty, Computer Fraud), Robbery and Burglary, General Liability, and various other commercial applications.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. 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 14 - 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 \$43,924,654 and on other purchases were \$4,659,841 at June 30, 2004.
- B. **Pending Litigation and Claims** – The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.
- C. **University Improvement General Obligation Bonds** – The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of two billion five hundred million dollars of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA),

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization of \$75,237,087 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 15 - RELATED PARTIES

There are two separately incorporated nonprofit foundations associated with the University. These foundations are The Foundation of the University of North Carolina at Charlotte, Inc. and The Athletic Foundation of The University of North Carolina at Charlotte.

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. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundations, except for support from each organization to the University. This support approximated \$1,822,682 for the year ended June 30, 2004.

NOTE 16 - 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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

NOTE 17 - NET ASSET RESTATEMENTS

As of July 1, 2003, net assets as previously reported was restated as follows:

	<u>Amount</u>
July 1, 2003 Net Assets as Previously Reported	\$ 316,488,790
Restatements:	
Correct gifts capitalized in prior year.	(353,925)
Capital assets purchased in prior year.	146,208
Reclassify Fed. Portion of Perkins Loan	(20,460)
Adjust net assets for prior year carry forward.	<u>(751,187)</u>
July 1, 2003 Net Assets as Restated	<u>\$ 315,509,427</u>

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

Schedule 1

	Original Projected Start Date	Revised/ Actual Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Original Expected Completion Date	Revised/ Actual Completion Date
<i>Projects Started</i>									
Academic Facilities-Humanities Building	04/02/99	04/02/99	\$ 25,410,365	\$ 8,041,836	\$ 33,452,201	\$ 29,295,229	87.57%	04/30/04	9/10/2004
Science & Technology Building	11/08/00	12/01/98	33,853,736	316,264	34,170,000	24,979,290	73.10%	08/25/04	12/30/2004
Classroom & Office Building	01/21/01	01/12/01	20,758,610		20,758,610	9,318,822	44.89%	11/22/04	6/15/2005
College of Education Building/CID	01/12/01	01/12/01	32,350,311	305,341	32,655,652	23,446,544	71.80%	11/30/04	6/20/2005
College of Nursing & Health Professions Building	01/12/01	01/12/01	30,467,216		30,467,216	1,850,281	6.07%	10/04/06	7/12/2006
Graduate Engineering Complex	01/12/01	01/12/01	24,513,651		24,513,651	4,479,357	18.27%	01/04/05	7/5/2005
Central Heating Plant Improvements	11/08/00	11/08/00	5,245,083		5,245,083	4,906,304	93.54%	08/29/03	6/22/2004
Physical Plant & Campus Public Safety Facilities	01/02/01	02/22/01	5,525,329	198,000	5,723,329	2,636,524	46.07%	10/01/04	1/31/2005
Rowe Classroom Building Renovations	06/03/02	06/03/02	4,091,175		4,091,175	425,508	10.40%	07/01/05	7/29/2005
McEniry Classroom Building Renovations	10/09/02	10/09/02	3,261,350		3,261,350	189,269	5.80%	01/02/06	12/12/2005
Chiller Replacement	04/02/99	03/22/01	1,824,200	125,000	1,949,200	1,949,102	99.99%	07/18/03	6/24/2003
Technology Infrastructure Expansion	04/02/01	04/02/01	2,345,500		2,345,500	2,345,036	99.98%	06/16/03	6/13/2003
Effective Project Management	04/12/02	04/12/02	386,975		386,975	160,056	41.36%	10/04/06	7/28/2006
Total All Projects			\$ 190,033,501	\$ 8,986,441	\$ 199,019,942	\$ 105,981,322			

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

The University of North Carolina at Charlotte
Intercollegiate Athletics Program
Statement of Revenues and Expenses
Year Ended June 30, 2004

Schedule 2

	Men's Basketball	Women's Basketball	Other Sports	Nonprogram Specific	Total
REVENUES					
Operating Revenues:					
Student Fees Net (Note 2)	\$ 791,379	\$ 990,514	\$ 2,841,487	\$ 740,620	\$ 5,364,000
Ticket Sales	612,234	5,384	14,775	3,433	635,826
Program Sales				170,613	170,613
Radio and T.V. Rights	20,000			155,147	175,147
Tournament Revenues	99,790	8,586	22,230	29,495	160,101
Other Sources		36	1,130	1,207,018	1,208,184
Total Operating Revenues	1,523,403	1,004,520	2,879,622	2,306,326	7,713,871
EXPENSES					
Operating Expenses:					
Coaches' Salaries	416,910	306,139	692,054	84,278	1,499,381
Other Salaries	48,872	20,433	66,062	1,276,179	1,411,546
Travel:					
Team	235,256	146,946	498,095		880,297
Recruiting	113,898	74,214	85,265		273,377
Other				185,853	185,853
Financial Aid	221,923	257,643	1,239,182	72,712	1,791,460
Maintenance and General Administration	127,707	13,680	27,158	286,011	454,556
Supplies and Uniforms	59,153	32,579	182,366	90,617	364,715
Equipment Purchases	5,088	10,402	6,844	15,700	38,034
Publicity		31		43,205	43,236
Insurance	1,297	1,257	1,229	74,298	78,081
Communications	36,355	65,199	34,995	42,586	179,135
Contracted Services	158,071	15,263	21,102	156,647	351,083
Officials	75,235	47,322	73,237	1,683	197,477
tournaments	53,320	18,240	4,465	32,000	108,025
Miscellaneous	37,308	22,012	53,061	389,376	501,757
Total Operating Expenses	1,590,393	1,031,360	2,985,115	2,751,145	8,358,013
Operating Income Loss	(66,990)	(26,840)	(105,493)	(444,819)	(644,142)
NONOPERATING REVENUES					
Gifts:					
Noncapital	26,099	21,310	75,823	411,001	534,233
Deficiency of Revenues over Expenses	\$ (40,891)	\$ (5,530)	\$ (29,670)	\$ (33,818)	\$ (109,909)
The accompanying notes are an integral part of this statement.					

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Organization and Purpose** - The University of North Carolina at Charlotte is a constituent institution of The 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 University of North Carolina at Charlotte is classified as a Division I institution by the National Collegiate Athletic Association (NCAA).
- B. Basis of Presentation** - The preceding Statement of Revenues and Expenses presents the University's Intercollegiate Athletic Program's activity in accordance with the National Collegiate Athletic Association Financial Audit Guidelines. Those guidelines issued on May 2, 1996 require only a presentation of the current funds revenues and expenses by major program. This Statement has been updated for Governmental Accounting Standards Board 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*, and Statement No. 38, *Certain Financial Statement Note Disclosures*. This presentation is not intended to provide a complete presentation of the program's financial position or its changes in net assets and cash flows.
- C. Basis of Accounting** - The preceding Statement of Revenues and Expenses was prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.
- D. Nonmonetary Transactions** - The University reports goods and services received either by donation or in an exchange transaction at fair value at the date of receipt.

During the year, leased vehicles and coaching services were provided at no charge to the University. The values of these donations have been recorded as gifts in the preceding Statement of Revenues and Expenses.

NOTE 2 - 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 and Expenses. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues and Expenses. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount. The amount of tuition discounting applicable to athletics was \$1,205,477.

NOTE 3 - RELATED PARTIES

The Athletic Foundation of the University of North Carolina at Charlotte (Foundation) is a separate and legal entity established to promote and support the University's Intercollegiate Athletics Program. During the fiscal year, the University received \$337,909 in direct support from the Foundation, as well as \$194,443 in indirect support through payments made on behalf of the University by the Foundation. These amounts are reported as contributions and expenses in the preceding Statement of Revenues and Expenses.



Ralph Campbell, Jr.
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
The University of North Carolina at Charlotte
Charlotte, North Carolina

We have audited the financial statements of The University of North Carolina at Charlotte, 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 19, 2004. We did not audit the financial statements of The Foundation of the University of North Carolina at Charlotte, Inc., which represents 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for The Foundation of the University of North Carolina at Charlotte, Inc., is based on the report of the other auditors.

As discussed in Note 16 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 opinions on the financial statements and not to provide an opinion on the internal control

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

over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a 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.



Ralph Campbell, Jr.
State Auditor

November 19, 2004

DISTRIBUTION OF AUDIT REPORT

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

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The Honorable Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Ms. Molly Corbett Broad	President, The University of North Carolina
Dr. James H. Woodward	Chancellor, The University of North Carolina at Charlotte
Mr. Olen B. Smith, Jr.	Vice Chancellor for Business Affairs
	The University of North Carolina at Charlotte
Mr. Malcolm E. Everett, III	Chairman, Board of Trustees
	The University of North Carolina at Charlotte

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January 14, 2005

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