



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

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THE UNIVERSITY OF NORTH CAROLINA

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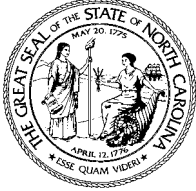
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Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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Office of the State Auditor

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AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of Fayetteville State University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, for the year ended June 30, 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 Fayetteville State University. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is to present the results of our audit on the accompanying financial statements that relate solely to Fayetteville State University. A summary of our reporting objectives and audit results is:

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

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

AUDITOR'S TRANSMITTAL (CONCLUDED)

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

Results - The following significant deficiencies in internal control over financial reporting were noted as a result of our audit:

Finding

1. Internal Control Weaknesses over Payroll Functions
2. Inadequate Controls over Cash Receipts and Deposits
3. Employees have Access Rights Inconsistent with Job Duties

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

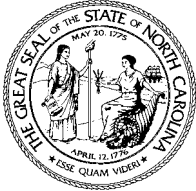
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Leslie W. Merritt, Jr.

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

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the accompanying financial statements of Fayetteville State University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2004, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Fayetteville State University Foundation, Inc. and Subsidiary, 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 Fayetteville State University Foundation, Inc. and Subsidiary, 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our 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 Fayetteville State University and its discretely presented component unit, 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 14 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 April 28, 2005, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Fayetteville State University's basic financial statements. Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



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

April 28, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

This section of the Fayetteville State University (the "University") annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2004, and includes comparative data for the year ended June 30, 2003. The discussion describes important trends and events that have impacted the fiscal health of the University and that may continue to exert influence in future years. This discussion has been prepared by University management along with the financial statements and related notes and should be read in conjunction with and is qualified in its entirety by the financial statements and notes. The financial statements, notes and this discussion are the responsibility of the University management.

Using the Annual Report

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*. These GASB financial statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis for the University as a whole, with resources classified for accounting and reporting purposes into four net assets categories. Previous financial reporting requirements focused on the accountability of individual funds groups rather than on the University as a whole. One of the most important questions asked is whether the University as a whole is better or worse off as a result of the year's activities. The key to understanding this question is the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. These statements present financial information in a form similar to that used by corporations. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used by private-sector companies. The University's supporting organization, the Fayetteville State University Foundation, Inc., and Subsidiary, (the "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. Therefore, the results of its operations are not blended with the University financial statements, but are discretely presented, and are not included in this Management's Discussion and Analysis.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2004. Its combined net assets increased \$5.0 million from the previous year, which is an increase of approximately 10.9 percent.

Summary of Net Assets

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Summary of Net Assets (in thousands)

	<u>2004</u>	<u>2003</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
ASSETS				
Current Assets	\$ 12,687	\$ 10,255	\$ 2,432	23.72 %
Noncurrent Assets				%
Capital	38,622	32,649	5,973	18.29 %
Other	<u>15,655</u>	<u>17,471</u>	<u>(1,816)</u>	(10.39) %
Total Assets	<u>66,964</u>	<u>60,375</u>	<u>6,589</u>	10.91 %
LIABILITIES				
Current Liabilities	4,868	3,258	1,610	49.42 %
Noncurrent Liabilities	<u>11,818</u>	<u>11,795</u>	<u>23</u>	0.19 %
Total Liabilities	<u>16,686</u>	<u>15,053</u>	<u>1,633</u>	10.85 %
NET ASSETS				
Invested in Capital Assets, Net of Related Debt	34,100	27,867	6,233	22.37 %
Restricted:				
Nonexpendable	5,753	2,937	2,816	98.88 %
Expendable	6,728	11,173	(4,445)	(39.78) %
Unrestricted	<u>3,697</u>	<u>3,345</u>	<u>352</u>	10.52 %
Total Net Assets	<u>\$ 50,278</u>	<u>\$ 45,322</u>	<u>\$ 4,956</u>	10.39 %

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

As of June 30, 2004, total University assets were \$67.0 million. The University's largest asset is its net investment in capital assets of \$38.6 million, representing 57.7 percent of total assets at June 30, 2004. Current assets increased by 2.4 million primarily due to an increase in cash and cash equivalents of \$7.2 million and a decrease in intergovernmental receivable of \$5.3 million.

Noncurrent capital assets increased by \$6.0 million primarily due to the increase in construction in progress relating to capital expenditures funded by proceeds from the sale of North Carolina general obligation bonds. Noncurrent other assets decreased by \$1.8 million primarily due to a decrease in restricted cash and cash equivalents of \$4.6 million and an increase in the amount due from primary government of \$2.0 million.

University's liabilities totaled \$16.7 million at June 30, 2004. Noncurrent long-term liabilities of \$8.6 million, consisting of \$6.4 million bonds payable and \$2.2 million compensated absences, are the largest liabilities. Other liabilities consist of contracts and retainage payables of \$2.2 million, U. S. government grants refundable of \$2.1 million and funds held for others of \$1.2 million.

The University recorded an increase in current liabilities of \$1.6 million. The change was due in large part to the increase in contracts payable associated with bond construction projects.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University's current assets of \$12.7 million covered the current liabilities of \$4.9 million, as the current ratio was \$2.61 in current assets to every \$1 in current liabilities.

At June 30, 2004, the University had outstanding bonds of \$6.9 million. Bonds payable is the University's largest liability at June 30, 2004, representing 41.4% of total University liabilities.

The \$5.0 million overall increase in net assets was largely attributable to the increase in capital assets, net of related debt of \$6.2 million.

Summary of Revenues, Expenses, and Changes in Net Assets

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	2004	2003	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees	\$ 10,152	\$ 9,099	\$ 1,053	11.57 %
Grants and Contracts	9,824	9,048	776	8.58 %
Auxiliary Activities	4,513	4,069	444	10.91 %
Other Educational Activities	60	259	(199)	(76.83) %
Total Operating Revenues	<u>24,549</u>	<u>22,475</u>	<u>2,074</u>	9.23 %
Operating Expenses:				
Salaries and Benefits	40,426	36,303	4,123	11.36 %
Supplies and Services	22,448	18,884	3,564	18.87 %
Student Financial Support	4,616	4,845	(229)	(4.73) %
Utilities	2,007	1,785	222	12.44 %
Depreciation	2,139	2,021	118	5.83 %
Total Operating Expenses	<u>71,636</u>	<u>63,838</u>	<u>7,798</u>	12.22 %
Operating Loss	<u>(47,087)</u>	<u>(41,363)</u>	<u>(5,724)</u>	(13.84) %
Nonoperating Revenues:				
State Appropriations, Operating	37,419	31,797	5,622	17.68 %
Noncapital Grants	7,368	8,438	(1,070)	(12.68) %
Noncapital Gifts	404	443	(39)	(8.80) %
Investment Income	958	701	257	36.66 %
Interest and Fees on Capital Asset - Related Debt	<u>(381)</u>	<u>(442)</u>	<u>61</u>	(13.80) %
Net Nonoperating Revenues	<u>45,768</u>	<u>40,937</u>	<u>4,831</u>	11.80 %
Loss Before Other Revenues	(1,319)	(426)	(893)	(209.62) %
Capital Grants	6,035	4,784	1,251	26.15 %
Permanent Endowment Additions	139		139	100.00 %
Capital Appropriations	<u>102</u>		<u>102</u>	100.00 %
Net Increase in Net Assets	4,957	4,358	599	13.74 %
Net Assets:				
Beginning of Year (As Restated)	<u>45,321</u>	<u>40,963</u>	<u>4,358</u>	10.64 %
End of Year	<u>\$ 50,278</u>	<u>\$ 45,321</u>	<u>\$ 4,957</u>	10.64 %

The Condensed Summary of Revenues, Expenses, and Changes in Net Assets reflects a positive year with an increase in net assets of \$5.0 million at the end of the year.

Total operating loss for fiscal 2004 was \$47.1 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB Statement No. 35, the University will show a significant operating loss.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

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

Operating expenses, including depreciation of \$2.1 million, totaled \$71.6 million. Of this total, \$33.8 million, or 47.1 percent, was used for instruction and student support; \$10.8 million, or 15.1 percent, was used for institutional support; \$7.1 million, or 9.9 percent, was used for operations and maintenance of plant; and \$9.1 million, or 12.7 percent, was used for auxiliary enterprises.

The University's largest source of nonoperating revenue is the State of North Carolina appropriation. This is received in monthly payments, beginning in July of each year, since the State's fiscal year begins on July 1st. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year beginning July 1, 2003, and ending June 30, 2004, the appropriations from the State for the University were \$37.4 million for operations. This appropriation was fully recorded by the University during the University's fiscal year ending June 30, 2004.

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

Summary of Cash Flows

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

	<u>2004</u>	<u>2003</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Cash Provided (Used) by:				
Operating Activities	\$ (39,195)	\$ (42,122)	\$ 2,927	6.95 %
Noncapital Financing Activities	45,784	40,843	4,941	12.10 %
Capital and Related Financing Activities	(4,337)	354	(4,691)	(1,325.14) %
Investing Activities	355	245	110	44.90 %
Net Increase (Decrease) in Cash	2,607	(680)	3,287	483.38 %
Cash - Beginning of the Year	12,256	12,936	(680)	5.26 %
Cash - End of Year	<u>\$ 14,863</u>	<u>\$ 12,256</u>	<u>\$ 2,607</u>	21.27 %

Major sources of funds included in operating activities are received from customers (\$28.2 million). The largest payments in this group were compensation to employees (\$39.8 million) and to suppliers (\$22.8 million).

The largest inflow of cash in the noncapital financing activities is the State of North Carolina appropriation at \$37.4 million. Cash used in capital and related financing activities during fiscal year 2004 was primarily for the acquisition of capital assets and the repayment of debt.

Capital Assets

With the successful passage of the higher education bond referendum in November 2000, the University received a \$46.0 million allocation to enhance campus facilities. Major capital expenditures through the year ended June 30, 2004, include the Residence Hall (\$2.9 million), Seabrook Renovation (\$2.5 million) and Spaulding Conversion (\$1.2 million). The bond referendum is discussed in detail in Note 13.C to the financial statements. Also, a Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures is presented in Schedule 1 of this report.

Factors Impacting Future Periods

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

A crucial element to the University's future will continue to be our relationship with the State of North Carolina, as we work to manage tuition to make it competitive while providing an outstanding college education for our students. There is a direct relationship between the growth of State support and the University's ability to control tuition growth, as declines in State appropriations generally result in increased tuition levels.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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

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

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

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

Fayetteville State University
Statement of Net Assets
June 30, 2004

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 6,303,142.07
Restricted Cash and Cash Equivalents	3,590,102.85
Receivables, Net (Note 4)	1,830,760.78
Due from Primary Government	142,543.34
Inventories	212,674.25
Notes Receivable (Note 4)	608,218.52

Total Current Assets	12,687,441.81
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Noncurrent Assets:

Restricted Cash and Cash Equivalents	4,969,684.81
Restricted Due from Primary Government	3,762,127.32
Endowment Investments	4,406,041.00
Other Long-Term Investments	415,018.33
Notes Receivable, Net (Note 4)	2,101,862.98
Capital Assets - Nondepreciable (Note 5)	10,983,892.39
Capital Assets - Depreciable, Net (Note 5)	27,637,840.05

Total Noncurrent Assets	54,276,466.88
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Total Assets	66,963,908.69
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	3,559,030.43
Due to Primary Government	72,217.49
Deferred Revenue	342,539.22
Interest Payable	53,891.88
Long-Term Liabilities - Current Portion (Note 7)	839,806.53

Total Current Liabilities	4,867,485.55
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Noncurrent Liabilities:

Funds Held for Others	1,157,870.64
U. S. Government Grants Refundable	2,093,613.22
Long-Term Liabilities (Note 7)	8,566,544.84

Total Noncurrent Liabilities	11,818,028.70
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Total Liabilities	16,685,514.25
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Fayetteville State University
Statement of Net Assets
June 30, 2004

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	34,099,732.44
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,408,727.14
Endowed Professorships	1,632,882.00
Loans	711,093.26
Expendable:	
Scholarships and Fellowships	1,340,483.72
Endowed Professorships	589,373.43
Departmental Uses	122,004.52
Capital Projects	3,595,694.46
Debt Service	1,081,374.76
Unrestricted	<u>3,697,028.71</u>
Total Net Assets	<u><u>\$ 50,278,394.44</u></u>

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

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

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 8)	\$ 10,152,117.09
Federal Grants and Contracts	9,782,348.89
State and Local Grants and Contracts	40,821.51
Sales and Services, Net (Note 8)	4,513,430.84
Interest Earnings on Loans	7,424.94
Other Operating Revenues	52,651.75
	<hr/>
Total Operating Revenues	24,548,795.02

EXPENSES

Operating Expenses:

Salaries and Benefits	40,426,134.71
Supplies and Materials	9,665,272.44
Services	12,782,630.85
Scholarships and Fellowships	4,616,077.94
Utilities	2,006,445.79
Depreciation	2,139,248.32
	<hr/>
Total Operating Expenses	71,635,810.05

Operating Loss (47,087,015.03)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	37,418,310.33
Noncapital Grants	7,368,206.37
Noncapital Gifts	404,244.96
Investment Income (Net of Investment Expense of \$15,893.26)	957,492.34
Interest and Fees on Capital Asset-Related Debt	(380,695.06)
	<hr/>
Net Nonoperating Revenues	45,767,558.94

Loss Before Other Revenues (1,319,456.09)

Capital Appropriations	102,700.00
Capital Grants	6,034,866.00
Additions to Endowments	138,611.49
	<hr/>
Increase in Net Assets	4,956,721.40

NET ASSETS

Net Assets - July 1, 2003, as Restated (Note 15)	<hr/> 45,321,673.04
Net Assets - June 30, 2004	<u>\$ 50,278,394.44</u>

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

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

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES	
Received from Customers	\$ 28,230,960.18
Payments to Employees and Fringe Benefits	(39,802,725.23)
Payments to Vendors and Suppliers	(22,796,203.67)
Payments for Scholarships and Fellowships	(4,616,277.94)
Loans Issued	(815,801.36)
Collection of Loans	437,011.41
Interest Earned on Loans	5,391.10
US Government Grants Refundable Receipts (Net of disbursements of \$12.94)	162,356.00
	<hr/>
Net Cash Provided (Used) by Operating Activities	(39,195,289.51)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State Appropriations	37,418,310.33
Noncapital Grants	7,368,206.37
Noncapital Gifts	404,244.96
Additions to Permanent and Term Endowments	138,611.49
William D. Ford Direct Lending Receipts	14,667,773.95
William D. Ford Direct Lending Disbursements	(14,387,698.95)
Related Activity Agency Receipts	174,300.95
	<hr/>
Net Cash Provided (Used) by Noncapital Financing Activities	45,783,749.10
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES	
Capital Appropriations	102,700.00
Capital Grants	4,055,574.51
Acquisition and Construction of Capital Assets	(7,599,637.79)
Principal Paid on Capital Debt and Leases	(510,000.00)
Interest and Fees Paid on Capital Debt and Leases	(385,792.53)
	<hr/>
Net Cash Provided (Used) by Capital Financing and Related Financing Activities	(4,337,155.81)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales and Maturities of Investments	827,710.36
Investment Income	357,509.74
Purchase of Investments and Related Fees	(830,015.57)
	<hr/>
Net Cash Provided (Used) by Investing Activities	355,204.53
Net Increase (Decrease) in Cash and Cash Equivalents	2,606,508.31
Cash and Cash Equivalents - July 1, 2003	12,256,421.42
	<hr/>
Cash and Cash Equivalents - June 30, 2004	<u>\$ 14,862,929.73</u>

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

Exhibit A-3

Page 2

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

Operating Loss	\$ (47,087,015.03)
Adjustments to Reconcile Operating (Loss) to Net Cash Provided (Used) by Operating Activities:	
Depreciation Expense	2,139,248.32
Allowances, Write-Offs, and Amortizations	1,204,374.56
Changes in Assets and Liabilities:	
Receivables (Net)	4,390,505.41
Due from Primary Government	(33,610.27)
Inventories	107,683.69
Accounts Payable and Accrued Liabilities	333,487.92
US Government Grants Refundable	162,356.00
Due to Primary Government	38,463.97
Deferred Revenue	(580,225.99)
Compensated Absences	508,231.86
Student Loans Issued	(815,801.36)
Student Loan Principal Repayments	437,011.41
	<hr/>
Net Cash Provided (Used) by Operating Activities	<u>\$ (39,195,289.51)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 6,303,142.07
Restricted Cash and Cash Equivalents	3,590,102.85
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	4,969,684.81
	<hr/>
Total Cash and Cash Equivalents - June 30, 2004	<u>\$ 14,862,929.73</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 8,663.54
Assets Acquired through a Gift	603,552.45

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

Fayetteville State University Foundation, Inc. and Subsidiary
Statement of Financial Position
June 30, 2004

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$ 2,746,398.00
Investments	1,933,091.00
Receivables, Net	71,840.00
Prepaid Expenses	14,833.00
Property and Equipment, Net	<u>13,829,296.00</u>
Total Assets	<u>18,595,458.00</u>

LIABILITIES

Accounts Payable and Accrued Expenses	17,771.00
Deferred Revenue	80,767.00
Deposits Payable	42,932.00
Bonds Payable	<u>14,825,000.00</u>
Total Liabilities	<u>14,966,470.00</u>

NET ASSETS

Unrestricted	668,791.00
Permanently Restricted	<u>2,960,197.00</u>
Total Net Assets	<u>\$ 3,628,988.00</u>

See Note 1 in the Notes to the Financial Statements

Fayetteville State University Foundation, Inc. and Subsidiary
Statement of Activities
For the Fiscal Year Ended June 30, 2004

Exhibit B-2

CHANGES IN UNRESTRICTED NET ASSETS

Revenues and Gains:

Contributions	\$ 23,773.00
Other Investment Income	14,094.00
Rental and Lease Income	<u>1,514,934.00</u>
Total Unrestricted Revenues and Gains	1,552,801.00

Net Assets Released from Restrictions:

Satisfaction of Program Restrictions	<u>15,125.00</u>
Total Unrestricted Revenues, Gains, and Other Support	<u>1,567,926.00</u>

Expenses and Losses:

Fayetteville State University Housing Foundation, LLC	1,966,692.00
Management and General	21,725.00
Fund Raising	<u>8,433.00</u>
Total Expenses	<u>1,996,850.00</u>

Decrease in Unrestricted Net Assets	<u>(428,924.00)</u>
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CHANGES IN PERMANENTLY RESTRICTED NET ASSETS

Contributions	60,059.00
Income on Long-Term Investments	66,555.00
Net Unrealized and Realized Gains on Long-Term Investments	238,976.00
Net Assets Released from Restrictions	<u>(15,125.00)</u>

Increase in Permanently Restricted Net Assets	<u>350,465.00</u>
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Decrease in Net Assets	(78,459.00)
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Net Assets at Beginning of Year	<u>3,707,447.00</u>
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Net Assets at End of Year	<u>\$ 3,628,988.00</u>
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See Note 1 in the Notes to the Financial Statements

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FAYETTEVILLE STATE UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements present all funds belonging to the University 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 its use of different GAAP reporting models and to emphasize its legal separateness.

Discretely Presented Component Unit – Fayetteville State University Foundation, Inc., and Subsidiary 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 Fayetteville State University Foundation, Inc., and Subsidiary ("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 40 directors. 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 Foundation can only be used by, or for the benefit of the University, the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$8,103.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Fayetteville State University Foundation, Inc. and Subsidiary at (910) 672-1151.

- 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, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - This classification includes mutual funds and United States Government Securities held by the University. These investments are accounted for at fair value, as determined by quoted market prices. The net increase in the fair value of investments is recognized as a component of investment income.
- F. Receivables** – Receivables consist of tuition and fees charges to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of expendable supplies, postage, fuel oil, and merchandise for resale are valued at the lower of cost or market value using the first-in, first-out method.
- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 25 years for general infrastructure, 30 years for buildings, and 3 to 11 years for equipment.

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

- I. **Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.
- J. **Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable and compensated absences that will not be paid within the next fiscal year.

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

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

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 method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

L. Net Assets – The University’s net assets are classified as follows:

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

Restricted Net Assets – Nonexpendable – Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

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

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

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

M. Scholarship Discounts – Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students’ behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- N. Revenue and Expense Recognition** – The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

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

- O. Internal Sales Activities** – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as central stores and printing. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$14,748,530.23. At year end, cash on hand was \$114,399.50. The University's portion of the State Treasurer's Investment Pool was \$14,649,448.49. 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 \$99,081.74 and the bank balance was \$114,556.59. Of the bank balance, \$114,556.59 was covered by federal depository insurance.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

A summary of the University's investments at June 30, 2004, is presented below:

	Fair Value			Total
	Risk Category			
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 415,018.33	\$ 0.00	\$ 0.00	\$ 415,018.33
Investments Not Categorized:				
Mutual Funds				4,406,041.00
Total Non-Pooled Investments				\$ 4,821,059.33

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated under classical trust doctrines. Unless the donor has stipulated otherwise, capital gains and losses are accounted for as part of the endowment principal and are not available for expenditure. The University's endowment spending policy governs the rate at which funds are released to the operating budget from the endowment. The University uses a disciplined spending rate with a long-term spending rule. The target rate for spending is set between 4% and 6% of the endowment's three-year average year end market value. In order to preserve the purchasing power of the endowment, the portfolio is invested with the expectation of generating a long-term rate of return at least equal to the payout plus the rate of inflation. At June 30, 2004, there was no net appreciation available to be spent.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2004, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 852,493.78	\$ 440,349.47	\$ 412,144.31
Accounts	761,635.89		761,635.89
Intergovernmental	507,285.44		507,285.44
Investment Earnings	24,407.97		24,407.97
Interest on Loans	70,650.67		70,650.67
Other	54,636.50		54,636.50
Total Current Receivables	\$ 2,271,110.25	\$ 440,349.47	\$ 1,830,760.78
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 605,031.62	\$ 0.00	\$ 605,031.62
Institutional Student Loan Programs	3,186.90		3,186.90
Total Notes Receivable - Current	\$ 608,218.52	\$ 0.00	\$ 608,218.52
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 2,486,773.21	\$ 384,910.23	\$ 2,101,862.98

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	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:				
Land	\$ 1,043,860.87	\$ 0.00	\$ 105,217.65	\$ 938,643.22
Construction in Progress	2,437,765.02	7,607,484.15		10,045,249.17
Total Capital Assets, Nondepreciable	3,481,625.89	7,607,484.15	105,217.65	10,983,892.39
Capital Assets, Depreciable:				
Buildings	64,124,288.94		21,521.67	64,102,767.27
Machinery and Equipment	6,113,962.62	698,555.89	1,678,294.10	5,134,224.41
General Infrastructure	2,693,400.77			2,693,400.77
Total Capital Assets, Depreciable	72,931,652.33	698,555.89	1,699,815.77	71,930,392.45
Less Accumulated Depreciation/Amortization for:				
Buildings	38,445,265.30	1,497,663.96		39,942,929.26
Machinery and Equipment	3,961,511.75	559,116.04	1,611,212.95	2,909,414.84
General Infrastructure	1,357,739.98	82,468.32		1,440,208.30
Total Accumulated Depreciation	43,764,517.03	2,139,248.32	1,611,212.95	44,292,552.40
Total Capital Assets, Depreciable, Net	29,167,135.30	(1,440,692.43)	88,602.82	27,637,840.05
Capital Assets, Net	\$ 32,648,761.19	\$ 6,166,791.72	\$ 193,820.47	\$ 38,621,732.44

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 2,490,274.39
Accrued Payroll	706,626.83
Contract Retainage	359,137.23
Intergovernmental Payables	456.00
Other	2,535.98
Total Accounts Payable and Accrued Liabilities	\$ 3,559,030.43

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	\$ 7,422,000.00	\$ 0.00	\$ 510,000.00	\$ 6,912,000.00	\$ 535,000.00
Compensated Absences	1,986,119.50	3,870,002.99	3,361,771.12	2,494,351.37	304,806.53
Total Long-Term Liabilities	\$ 9,408,119.50	\$ 3,870,002.99	\$ 3,871,771.12	\$ 9,406,351.37	\$ 839,806.53

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2004	Principal Outstanding 06/30/2004
Dormitory System						
Dormitory System Revenue Bond	A	3.0%-3.625%	10/01/2005	\$ 920,000.00	\$ 858,000.00	\$ 62,000.00
Dormitory System Revenue Bond	B	8.0%-10.0%	10/01/2009	1,750,000.00	1,090,000.00	660,000.00
Total Dormitory System				2,670,000.00	1,948,000.00	722,000.00
Dining System						
Dining System Facility Fee Revenue Bond	1997	4.1%-5.7%	01/01/2023	3,040,000.00	425,000.00	2,615,000.00
The University of North Carolina System Pool Revenue Bonds						
Refunding of U.S. Department of Education Notes Payable	2002B	3.50%-5.375%	04/01/2022	1,245,000.00	60,000.00	1,185,000.00
Stadium Renovation	2002B	3.50%-5.00%	04/01/2012	2,735,000.00	345,000.00	2,390,000.00
Total The University of North Carolina System Pool Revenue Bonds				3,980,000.00	405,000.00	3,575,000.00
Total Bonds Payable (principal only)				\$ 9,690,000.00	\$ 2,778,000.00	\$ 6,912,000.00

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

<u>Fiscal Year</u>	Annual Requirements	
	Bonds Payable	
	Principal	Interest
2005	\$ 535,000.00	\$ 353,335.01
2006	512,000.00	328,121.26
2007	525,000.00	304,141.26
2008	545,000.00	279,011.26
2009	570,000.00	251,711.26
2010-2014	2,005,000.00	851,326.88
2015-2019	1,150,000.00	473,913.78
2020-2024	1,070,000.00	121,995.00
Total Requirements	\$ 6,912,000.00	\$ 2,963,555.71

NOTE 8 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees	\$ 15,866,564.05	\$ 0.00	\$ 5,459,490.22	\$ 254,956.74	\$ 10,152,117.09
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 2,625,161.06	(A) \$ 0.00	\$ 844,768.55	\$ 0.00	\$ 1,780,392.51
Dining	1,958,956.11	(B)	694,544.46		1,264,411.65
Bookstore	302,420.68		66,507.46		235,913.22
Other	1,080,778.98	440,173.32	19,288.89		621,316.77
Sales and Services of Education and Related Activities	611,396.69				611,396.69
Total Sales and Services	\$ 6,578,713.52	\$ 440,173.32	\$ 1,625,109.36	\$ 0.00	\$ 4,513,430.84

Revenue Bonds Secured by Pledged Revenues:
 (A) Dormitory System Revenue Bonds A and B
 (B) Dining System Facility Fee Revenue Bond

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 20,508,597.44	\$ 1,474,131.53	\$ 998,274.81	\$ 21,322.40	\$ 0.00	\$ 0.00	\$ 23,002,326.18
Research	248,088.07	60,850.94	93,681.77	54,821.75			457,442.53
Public Service	1,981,280.92	120,200.91	1,708,985.17	30,935.46			3,841,402.46
Academic Support	4,404,433.68	2,608,246.38	795,747.65	13,600.00			7,822,027.71
Student Services	2,275,347.42	260,367.95	392,105.59				2,927,820.96
Institutional Support	5,271,889.26	997,887.70	3,118,025.44		1,440,844.98		10,828,647.38
Operations and Maintenance of Plant	2,915,152.29	3,226,457.79	926,583.59				7,068,193.67
Student Financial Aid	326,595.12		29,446.14	4,084,380.83			4,440,422.09
Auxiliary Enterprises	2,494,750.51	917,129.24	4,719,780.69	411,017.50	565,600.81		9,108,278.75
Depreciation						2,139,248.32	2,139,248.32
Total Operating Expenses	<u>\$ 40,426,134.71</u>	<u>\$ 9,665,272.44</u>	<u>\$ 12,782,630.85</u>	<u>\$ 4,616,077.94</u>	<u>\$ 2,006,445.79</u>	<u>\$ 2,139,248.32</u>	<u>\$ 71,635,810.05</u>

NOTE 10 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 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 \$33,591,645.81, of which \$23,380,127.90 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$1,402,807.67 and \$51,436.28, respectively. The University made one hundred percent of its annual required contributions for the years ended June 30, 2004, 2003, and 2002, which were \$51,436.28, \$0.00, and \$431,900.98 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 \$33,591,645.81, of which \$6,602,884.53 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 \$396,173.07 and \$451,637.30, 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 \$139,107.36 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 \$23,886.57. The voluntary contributions by employees amounted to \$123,549.95 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

contributions by employees amounted to \$565,882.50 for the year ended June 30, 2004.

NOTE 11 - 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 \$959,456.40. 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 12 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. Except for a reduction in the public officers' and employees' liability insurance from \$11,000,000 to \$5,000,000, 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 sprinkler leakage, business interruption, vandalism, theft, and "all risks" for all buildings and contents.

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

University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

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

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. 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 13 - COMMITMENTS AND CONTINGENCIES

- A. **Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$12,380,915.00 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 \$2.5 billion 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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA), establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization of \$34,602,056.00 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

NOTE 14 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

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

NOTE 15 - NET ASSET RESTATEMENT

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	\$ 47,163,027.84
Restatements: Correction of prior years' errors	<u>(1,841,354.80)</u>
July 1, 2003 Net Assets as Restated	<u>\$ 45,321,673.04</u>

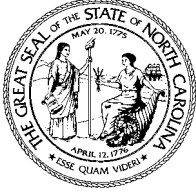
Correction of prior years' errors include correction of overstatement of construction in progress for items that should have been expensed and correction of depreciation not recorded for a building that was not properly reclassified to a depreciable asset when completed.

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

Schedule 1

Capital Improvement Projects	Original Projected Start Date	Revised/ Actual Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Original Expected Completion Date	Revised/ Actual Completion Date
<i>Projects Started</i>									
Residence Hall	Feb 2001	Jan 2001	\$ 6,528,685.00	\$ 0.00	\$ 6,528,685.00	\$ 2,932,911.30	44.92%	Dec 2004	May 2005
Lyons Science Renovation	Feb 2001	May 2001	14,389,555.00	1,350,000.00	15,739,555.00	995,777.03	6.33%	May 2005	Feb 2006
Seabrook Renovation	Mar 2001	Aug 2001	6,647,950.00	500,000.00	7,147,950.00	2,506,045.86	35.06%	Dec 2004	Mar 2005
Campus Improvements	Apr 2001	Jul 2001	1,363,250.00		1,363,250.00	904,957.13	66.38%	Dec 2004	Aug 2004
Spaulding Conversion	Nov 2000	Dec 2000	977,645.00	443,200.00	1,420,845.00	1,244,045.17	87.56%	Feb 2004	Sep 2004
Technology Infrastructure	Mar 2001	Sep 2001	1,080,720.00		1,080,720.00	535,079.33	49.51%	Oct 2003	Mar 2005
Science Annex Renovation	Mar 2002	Jul 2002	1,653,475.00		1,653,475.00	120,034.12	7.26%	Oct 2004	Jul 2005
Chestnut Library Renovation	Apr 2003	Apr 2003	832,105.00		832,105.00	279,909.68	33.64%	Dec 2004	Jul 2005
Taylor Gym Conversion	Mar 2002	Jul 2002	3,192,000.00		3,192,000.00	312,640.00	9.79%	Aug 2005	Apr 2006
Cook Dining Hall	Mar 2003	Feb 2003	1,684,825.00	228,907.00	1,913,732.00	841,431.65	43.97%	May 2004	Dec 2004
Continuing Education Renovation	Mar 2003	Apr 2003	410,970.00		410,970.00	71,034.00	17.28%	Mar 2004	Aug 2004
Lilly Gym Renovation	Jun 2003	Oct 2003	3,093,580.00		3,093,580.00	7,235.00	0.23%	Oct 2005	Nov 2006
Residence Hall Fire Department	Jul 2001	Sep 2001	581,115.00		581,115.00	580,257.87	99.85%	Aug 2003	Aug 2003
Taylor Building Renovation	Nov 2003	Mar 2004	840,085.00		840,085.00	31,010.00	3.69%	Jun 2006	Aug 2006
Reserve EFF Pro MGT			2,136,870.00	200,000.00	2,336,870.00	449,346.05	19.23%		
<i>Projects Not Started - To Be Funded in Future Years</i>									
Collins Building Renovation	Sep 2004	Sep 2004	608,570.00		608,570.00			Sep 2008	Nov 2006
Total All Projects			\$ 46,021,400.00	\$ 2,722,107.00	\$ 48,743,507.00	\$ 11,811,714.19			

Note: The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of \$2.5 billion 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.



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

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

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the financial statements of Fayetteville State University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, 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 April 28, 2005. We did not audit the financial statements of the Fayetteville State University Foundation, Inc., and Subsidiary, which represent 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 Fayetteville State University Foundation, Inc. and Subsidiary, is based on the report of the other auditors.

As discussed in Note 14 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 unit was not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to the discretely presented component unit.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions.

**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 (CONTINUED)**

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions noted as a result of our audit are described in the Audit Findings and Recommendations section of this report.

Finding

1. Internal Control Weaknesses over Payroll Functions
2. Inadequate Controls over Cash Receipts and Deposits
3. Employees have Access Rights Inconsistent with Job Duties

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

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*.

**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 (CONCLUDED)**

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

Leslie W. Merritt, Jr.

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

April 28, 2005

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting

The following findings and recommendations were identified during the current audit and describe conditions that represent significant deficiencies in internal control.

1. INTERNAL CONTROL WEAKNESSES OVER PAYROLL FUNCTIONS

The University did not have adequate review and approval procedures in place for certain payroll functions. One employee in payroll had the ability to make adjustments to payroll without the review and approval of another individual. The lack of an adequate review and approval process in place resulted in the following errors in our payroll samples:

- Based on a ruling by the North Carolina Office of State Personnel related to overtime payments for the University's police telecommunicators, five University employees were due back-pay for overtime. The five back-pay payments totaling \$82,535.88 were based on an erroneous calculation resulting in an overpayment of approximately \$15,000. The calculation of the back-pay was not reviewed and approved by an individual separate from the person performing the calculation;
- A terminated employee was granted severance pay in accordance with the guidelines of the UNC system and Fayetteville State University's policies and procedures allowing a maximum of three months. An employee calculated the amount using 90 working days instead of three months resulting in an overpayment of \$6,600.57. The employee's calculation of severance pay was not reviewed;
- An employee with two lump-sum employment contracts to design online courses was paid twice for one of the contracts. The University paid one contract payment earlier than the payment date in the contract. The following month, when payment was due based on the contract date, a second payment was made because the University had failed to adjust its records. This error resulted in an overpayment of \$7,000;
- A new employee beginning employment during the month was incorrectly paid for the entire month. When the payroll technician processed the payment for the first paycheck the proper adjustment for the partial month was not made. The payroll calculation was not reviewed and approved. This error resulted in an overpayment of \$700.

Recommendation: The University should strengthen internal controls over its payroll process to assure proper review and approval of transactions prior to payment. The University should consider pursuing recovery of the overpayments in accordance with *North Carolina General Statute 143-64.80*.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

University's Response: The University concurs with the audit finding. Based on the Office of the State Controller's guideline for internal control and payroll, the University enhanced the payroll process to assure proper review and approval of transactions prior to payment. Effective May 1, 2005, the payroll department reports to the Controller. Letters were mailed to the employees receiving an overpayment requesting that they remit the overpayment. In addition, the University will review and revise the payroll policies and procedures to strengthen internal controls. Management oversight and internal verification will be increased to assure proper review, approval, and compliance with all payroll policies and procedures.

2. INADEQUATE CONTROLS OVER CASH RECEIPTS AND DEPOSITS

The University did not have adequate controls in place over the cash receipts and deposits to assure proper segregation of duties and proper review and approval procedures. The cashiering supervisor had the ability to collect cash, prepare and submit the deposit, certify the deposit, void receipts, and make journal entries. All cashiers had the ability to void receipts, but there was no written documentation of any review and approval by another individual.

Segregation of duties is a basic internal control that requires assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties.

Recommendation: The University should strengthen internal controls over cash receipts and deposits to assure no one individual controls all key aspects of a transaction or event. Also, the University should implement review and approval procedures over voided receipts.

University's Response: The University concurs with the audit finding. Based on the Office of the State Controller's guideline for internal control and cash management, the University revised the procedures for cash receipts, deposits, and voided transactions to ensure segregation of duties, proper review, and approval over all key aspects of a transaction or event. Currently, the Treasurer/Bursar reviews and approves all voided receipts. Management oversight and internal verification will be increased to assure proper review, approval, and compliance with all cash management policies and procedures.

3. EMPLOYEES HAVE ACCESS RIGHTS INCONSISTENT WITH JOB DUTIES

The University did not have adequate procedures in place to assure that employees only had information systems access rights necessary to perform their jobs. Employees had access rights inconsistent with the responsibilities of their jobs that would allow them to

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

perform functions incompatible with their assigned duties. Adequate access controls over information systems are necessary to prevent unauthorized or inappropriate transactions.

Recommendation: The University should design policies and procedures to assure that employees are only assigned access rights necessary to perform their jobs.

University's Response: The University concurs with the audit finding. Based on the Office of the State Controller's guideline for internal control, in April 2005, the University reviewed employees' access rights and removed inconsistent access rights from those employees who did not need such rights to perform their jobs. The University will develop a policy to assure employees are only assigned access rights necessary to perform their job functions. Management oversight and internal verification will be increased to assure compliance with system access policies and procedures.

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June 28, 2005

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