



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF NORTH CAROLINA CENTRAL UNIVERSITY

DURHAM, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

NORTH CAROLINA CENTRAL UNIVERSITY

DURHAM, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

MOLLY CORBETT BROAD, PRESIDENT

BOARD OF TRUSTEES

MR. ROBERT C. WILLIAMS, CHAIR

MS. VALERIA L. LEE, VICE CHAIR

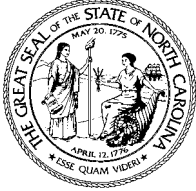
**MR. GLENN B. ADAMS
MR. FRANKLIN R. ANDERSON
MR. KENNETH D. GIBBS, SR.
BISHOP EDDIE LONG
MR. ERIC C. MICHAUX**

**MR. GEORGE W. MILLER, III
MR. W. TRAVIS PORTER
MS. ESTHER SILVER-PARKER
MR. CRESSIE H. THIGPEN, JR.
MRS. KAY T. THOMAS**

ADMINISTRATIVE OFFICERS

DR. JAMES H. AMMONS, CHANCELLOR

MR. CHARLES D. O'DUOR, VICE CHANCELLOR FOR FINANCIAL AFFAIRS



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

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of North Carolina Central University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, for the year ended June 30, 2004. Our audit was made by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

The accounts and operations of the University are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report*. In those reports, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the audit results on the State's internal controls and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs.

As part of the audit work necessary for the CAFR and the *Single Audit Report*, the accounts and operations of the University were subjected to audit procedures as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to North Carolina Central University. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

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

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

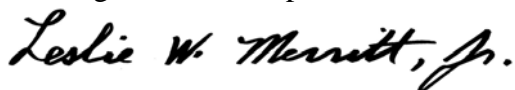
Results - The accompanying financial statements present fairly, in all material respects, the amounts and disclosures made in accordance with accounting principles generally accepted in the United States of America. These matters are more fully described in the Independent Auditor's Report on the Financial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

AUDITOR'S TRANSMITTAL (CONCLUDED)

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

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

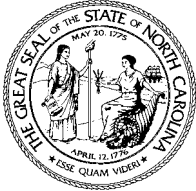
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.



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

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR’S REPORT	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
BASIC FINANCIAL STATEMENTS	
Exhibits	
A-1 Statement of Net Assets	10
A-2 Statement of Revenues, Expenses, and Changes in Net Assets	12
A-3 Statement of Cash Flows	13
B-1 Statement of Financial Position	15
B-2 Statement of Activities	16
Notes to the Financial Statement.....	17
SUPPLEMENTARY INFORMATION	
Schedules	
1 Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures	44
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 <i>GOVERNMENT AUDITING STANDARDS</i>	45
DISTRIBUTION OF AUDIT REPORT	47



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

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
North Carolina Central University
Durham, North Carolina

We have audited the accompanying financial statements of North Carolina Central 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 North Carolina Central 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 NCCU Real Estate Foundation, Inc., which represent 11 percent, 0.1 percent, and zero percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of the NCCU Foundation, Inc. which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the NCCU Real Estate Foundation, Inc. and the NCCU Foundation, Inc. were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 reports of other auditors provide a reasonable basis for our opinions.

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 18, 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 North Carolina Central 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

May 18, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is intended to give the reader an overview of factors that have affected operations and may affect operations in the future. The University is required by the Governmental Accounting Standards Board's (GASB) Statements No. 34/35 to present three basic financial statements. Those statements are the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These statements provide both long-term and short-term financial information for North Carolina Central University.

Brief Institutional Highlights

Fiscal year 2003–2004 presented many opportunities for the University. Specifically, the University secured a \$17.8 million grant to construct the Biomanufacturing Research Institute & Technology Enterprise (BRITE) Center for excellence where students and faculty will learn and develop the latest basic and applied research technology in biomanufacturing (microbiology, analytical chemistry, microbial physiology, etc). With the aid of the State, we successfully rehabilitated and reopened two residence halls that were closed at the start of the academic year due to unhealthy environments. Moreover, the University was approved for reimbursement of expenses incurred for relocating and transporting the displaced students of the two residence halls.

Academically, new degree programs in mass communication and information sciences were approved and a new concentration in broadcast media developed. Accreditations were reaffirmed or received for several departments including Chemistry, Social Work, Theatre, Physical Education and Recreation, and Parks and Recreation. Lastly, the School of Education made great strides in finalizing the Early College High School, which will begin in August 2004. The Early College High School is a partnership with the Durham Public Schools. The program is designed to increase the number of minority and female students who will pursue advanced studies in mathematics, science, engineering, and technology.

The University was allocated \$121 million from the State's Higher Education Bond Referendum in 2001. These bond monies are being used to renovate existing buildings and build new housing and academic structures. During 2003–2004, more than 96 percent of the bond projects were under construction with a total budget of \$115 million.

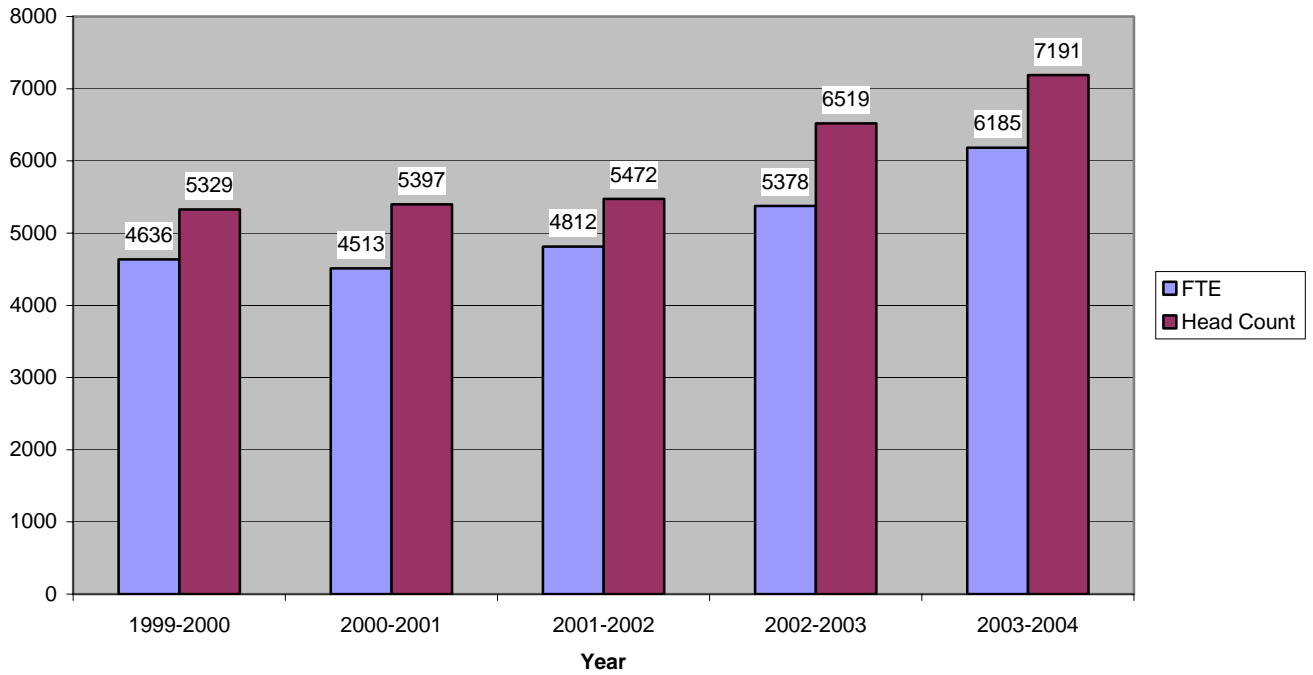
State appropriations, including reversions, were cut by approximately \$2.8 million as compared to \$3.9 million in fiscal year 2003. Despite the budget reduction, the University has managed to protect academic programs, student services, and avoid negative personnel actions. This was made possible through attrition and other non-State funds.

Sponsored research dollars remain strong; by the end of fiscal year 2004, the University's total research and other grant awards was \$43.9 million. The Office of Institutional Advancement raised \$3.3 million in cash gifts, which was a slight increase from fiscal year 2003.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Student enrollment increased 10.3%. The University continues to strive to recruit talented students. In the fall of 2003, the University enrolled three National Achievement finalists and two semifinalists, a first for the University.

FTE and Head Count from 2000 to 2004



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Financial Highlights

North Carolina Central University Condensed Statement of Net Assets

	2004	2003
Assets		
Current Assets	\$ 58,251,405	\$ 27,967,854
Capital Assets, Net	122,107,018	90,718,062
Other Assets	20,911,468	25,770,898
Total Assets	201,269,891	144,456,814
Liabilities		
Current Liabilities	11,454,622	8,401,860
Noncurrent Liabilities	38,464,719	16,141,985
Total Liabilities	49,919,341	24,543,845
Net Assets		
Invested in Capital Assets, Net of Related Debt	98,568,213	78,085,571
Restricted - Expendable	22,265,357	17,399,301
Restricted - Nonexpendable	10,050,042	9,779,636
Unrestricted	20,466,938	14,648,461
Total Net Assets	\$ 151,350,550	\$ 119,912,969

The Statement of Net Assets reports all assets and liabilities of the University; additionally, the statement classifies those assets and liabilities as current and noncurrent depending on the availability of the assets or satisfaction of the obligation within 12 months (current) or longer. This statement also reports the net assets, which is the difference between the total assets and total liabilities. The reader may use the net assets to gauge the financial position of the University as of June 30, 2004.

As of June 30, 2004, the University's total assets were \$201.3 million as compared to \$144.5 million in the prior year, an increase of \$56.8 million. This increase is attributable to the growth in net capital assets, wherein construction in progress (CIP) increased \$25.7 million and buildings \$6.4 million. This increase is consistent with the greater number of bond projects being fully under construction. Pursuant to GASB Statement No. 33 (*Accounting and Financial Reporting for Nonexchange Transactions*), the University recognized a grant account receivable in the amount of \$17.8 million. Lastly, current restricted investments increased \$8.1 million as a result of the NCCU Real Estate Foundation bond proceeds being held, as of June 30, in investment accounts until needed for their intended purposes.

The University's liabilities totaled \$49.9 million in 2004 and \$24.5 million in 2003 with the debt service on housing and stadium bonds comprising \$31.6 million (current and noncurrent

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

portions). The total liabilities increased by \$25.4 million in 2004. The bulk of the increase is due to the NCCU Real Estate Foundation having sold bonds in the amount of \$21.5 million.

The total current liability of \$11.5 million is well covered (5.1 times) by current assets of \$58.3 million, which indicates the University's ability to pay current liabilities as they become due. Total net assets are \$151.4 million, which is an increase of \$31.5 million from the prior year.

North Carolina Central University Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2004	2003
Operating Revenues		
Student Tuition and Fees, Net	\$ 19,226,865	\$ 14,472,220
Contracts and Grants	19,365,773	16,371,525
Sales and Services, Net	11,416,880	16,628,953
Other Operating Revenues	923,998	292,658
Total Operating Revenues	50,933,516	47,765,356
Operating Expenses	121,047,154	101,764,811
Operating Loss	(70,113,638)	(53,999,455)
Nonoperating Revenues and Expenses		
State Appropriations	48,006,532	44,008,436
Noncapital Grants	14,929,707	4,964,033
Noncapital Gifts	112,812	4,077,643
Investment Income, Net	1,732,939	(666,024)
Other Nonoperating Revenues (Expenses)	(1,138,434)	(213,519)
Loss before Other Revenues	(6,470,082)	(1,828,886)
Capital Appropriations	181,500	
Capital Grants	37,726,163	13,291,605
Capital Gifts	4,500	4,500
Total Other Revenues	37,907,663	13,296,105
Increase in Net Assets	31,437,581	11,467,219
Net Assets - Beginning of Year	119,912,969	108,445,750
Net Assets - End of Year	\$ 151,350,550	\$ 119,912,969

The Statement of Revenues, Expenses, and Changes in Net Assets reports the revenues earned and expenses incurred during the fiscal year. The increase or decrease of revenues over expenses directly affects (increases/decreases) the total net assets reported on the Statement of Net Assets. These transactions are classified as operating or nonoperating. Operating revenues primarily consist of student tuition and fees reported net of discounts and

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

scholarship allowances, federal and State contracts and grants, and auxiliary sales and services revenues. Operating expenses primarily consist of salaries, supplies, services, scholarships, utilities, and depreciation.

Operating revenues increased by \$3.2 million when compared to 2003. The contributing factors to this increase were the increases in student enrollment coupled with higher tuition (5% increase) and federal contracts and grants revenues.

Operating expenses increased by \$19.3 million when compared to 2003. Services, salaries and benefits for University employees, and supplies and materials were the major components of this increase in the amounts of \$10.8 million, \$5.1 million, and \$3.6 million, respectively. As reported in 2003, the University contended with unhealthy environmental conditions in two residential buildings. The buildings required significant repairs and renovations, which were undertaken by the State of North Carolina; however, the University was required to record an operating expense and corresponding nonoperating revenue for the cost incurred by the State. During this period, the University assumed the responsibility of securing off-campus housing and transportation for the affected students without increasing the costs to the students; therefore, the expenses for services greatly increased.

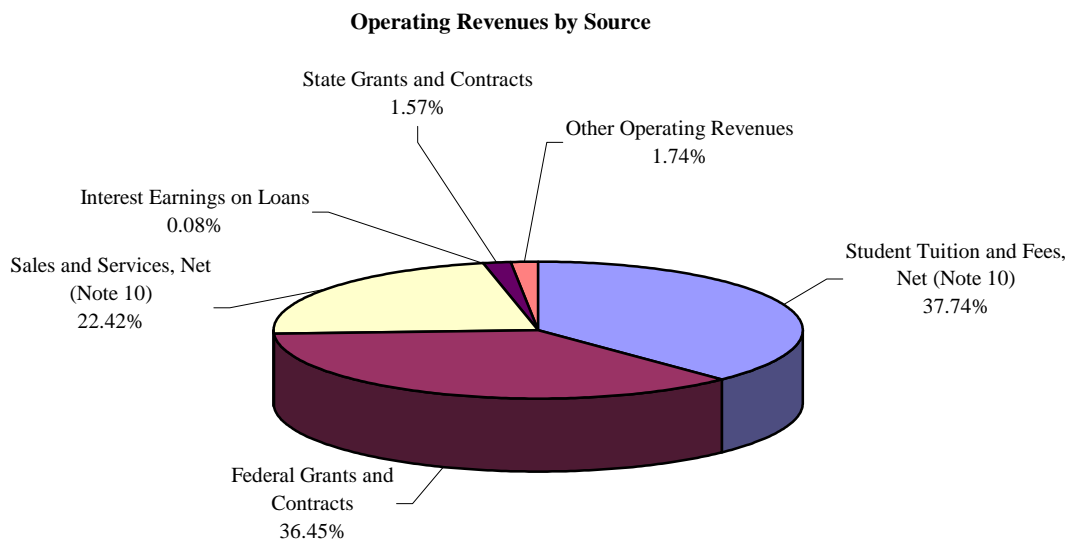
Overall, the University sustained a total operating loss of \$70.1 million in the current fiscal year, which is 30% more than the loss in fiscal year 2003. As explained above, most of the loss was related to the increase in services expenses. Operating losses are likely to continue due, in part, to the accounting requirement to categorize State appropriations (a major source of funding) as nonoperating revenues. In 2004, State appropriations were \$48 million.

Nonoperating revenues and expenses stem from transactions that occur outside of the primary scope of the University's existence and for which no goods or services are provided. State appropriations, capital grants, noncapital grants and gifts, investment income/expenses, and capital-related interest primarily represent the nonoperating revenues and expenses.

Of the nonoperating revenues (\$63.6 million), there were noticeable changes in the State appropriations, noncapital grants, and noncapital gifts. State appropriations increased by \$4 million as a result of enrollment growth funds, State health plan and retirement rate adjustments. Noncapital grants increased by \$10 million as a result of recognizing revenue for the repair and renovation cost incurred by the State and increases in nonexchange federal grants.

Capital grants increased by \$24.4 million as a result of the University recognizing \$17.8 million in revenue from a nonprofit foundation to construct the BRITE Center. Additionally, nearly all of the bond-funded projects are well underway with designs, renovations, and/or construction, which increased capital grant revenue by \$6.6 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



North Carolina Central University Condensed Statement of Cash Flows

	2004	2003
Cash Provided (Used) by:		
Operating Activities	\$ (60,285,520)	\$ (49,661,859)
Noncapital Financing Activities	53,939,666	54,240,166
Capital Financing Activities	5,346,142	(250,395)
Investing Activities	(6,445,501)	560,708
Net Increase (Decrease) in Cash and Cash Equivalents	(7,445,213)	4,888,620
Cash and Cash Equivalents - Beginning of Year	26,171,693	21,283,073
Cash and Cash Equivalents - End of Year	<u>\$ 18,726,480</u>	<u>\$ 26,171,693</u>

A very useful measure of financial operations is the Statement of Cash Flows. This statement provides the sources of cash inflows and outflows for four major activities: operating, noncapital financing, capital and related financing, and investing activities. The ending cash and cash equivalents on this Statement correspond directly with the sum of the cash and cash equivalents balances on the Statement of Net Assets.

The net cash from operating activities shows a net outflow of funds of \$60.3 million, which is a 21.4% increase from 2003. The major outflows were payments to employees for services (\$60.4 million), vendors for goods and services (\$46.3 million), and students for educational assistance (\$3 million). The major sources of operating inflows were student tuition and fees (\$19.2 million), auxiliary sales (\$11.4 million), and federal contracts/grants (\$18.6 million).

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

The net cash from noncapital financing activities is an inflow of \$53.9 million, which is a 1% decrease over 2003. State appropriations of \$48 million account for the bulk of this inflow.

Cash flow from capital and related financing activities is a net inflow of \$5.3 million, which is a 2,235% increase over 2003. The net inflow results from proceeds from capital debt of \$21.3 million related to the NCCU Real Estate Foundation 2004 bond sale and \$9 million related to the University refinancing the 1996 Housing Bonds in 2004. Additionally, the University received approximately \$18.7 million of the 2001 State bond funds during fiscal year 2004. The University expended \$32.3 million for capital assets (\$32.3) and debt service (\$2.3). The major capital expenses related to the construction of new dormitories (Eagle Landing and Baynes Hall replacement) in the amount of \$15.2 million and the Science Complex for \$6.3 million. Proceeds of \$7.7 million from refinancing were deposited with an escrow agent.

The University has a net cash outflow from investing activities of \$6.4 million, which is a 1,150% decrease from 2003. This results from \$6.5 million in proceeds from sales and maturities of investments, investment income of \$831,463, and purchases of investments and related fees of \$13.7 million.

In summary, the cash position of the University decreased by \$7.4 million or 28.45%.

Economic Outlook

The outlying years appear to be promising. Student enrollment continues to increase. The enrollment for 2004-2005 reached another all-time high of 7,727. Through renewed recruitment efforts, offerings of attractive curricula, and research opportunities for students with the BBRI (Biomedical Biotechnology Research Institute) and BRITE, we expect enrollment to steadily increase. Additionally, the University has developed partnerships with various external entities. These partnerships will strengthen NCCU's presence in the local community while providing meaningful learning experiences for current students. Moreover, for fiscal year 2004-2005, the State legislature approved a \$225 (in-State) and \$300 (out-of-State) tuition increase; therefore, projected tuition and fee revenues look favorable.

Although State funding increased in fiscal year 2004, it is uncertain as to direction of future funding. However, in 2004-2005, the University will again be eligible to receive "enrollment growth" monies of \$5.6 million resulting from the increase in enrollment in 2003. These "growth" funds will allow the University to continue providing academic and administrative services.

North Carolina Central University's faculty is steadily writing, applying, and receiving research grant funds to augment State funding. Research is one of three components that faculty must strive to accomplish. The Sponsored Research Office works diligently with faculty to provide ongoing training and opportunities for research. Through our dedicated faculty and staff, we will continue to fulfill our mission of serving the State, nation, and the world through teaching, research, and service.

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

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 14,152,225
Restricted Cash and Cash Equivalents	4,574,255
Restricted Short-Term Investments	10,322,560
Receivables, Net (Note 4)	10,772,064
Due from State of North Carolina Component Units	17,965,904
Inventories	242,491
Notes Receivable (Note 4)	221,906
	<hr/>
Total Current Assets	58,251,405

Noncurrent Assets:

Restricted Due from Primary Government	6,354,915
Endowment Investments	10,929,019
Other Long-Term Investments	745,876
Notes Receivable, Net (Note 4)	2,881,658
Capital Assets - Nondepreciable (Note 5)	36,774,793
Capital Assets - Depreciable, Net (Note 5)	85,332,225
	<hr/>
Total Noncurrent Assets	143,018,486

Total Assets	<hr/> <hr/> 201,269,891
--------------	-------------------------

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	9,571,791
Due to Primary Government	64,468
Deferred Revenue	710,453
Interest Payable	118,899
Long-Term Liabilities - Current Portion (Note 8)	989,011
	<hr/>
Total Current Liabilities	11,454,622

Noncurrent Liabilities:

Deposits Payable	400
Funds Held for Others	25,223
U. S. Government Grants Refundable	2,628,913
Long-Term Liabilities (Note 8)	35,810,183
	<hr/>

Total Noncurrent Liabilities	38,464,719
------------------------------	------------

Total Liabilities	<hr/> <hr/> 49,919,341
-------------------	------------------------

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

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	98,568,213
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	4,226,300
Endowed Professorships	5,230,870
Loans	592,872
Expendable:	
Scholarships and Fellowships	232,760
Research	245,187
Endowed Professorships	2,388,680
Departmental Uses	18,000,457
Capital Projects	588,026
Debt Service	516,311
Other	293,936
Unrestricted	20,466,938
Total Net Assets	<u>\$ 151,350,550</u>

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

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

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 10)	\$ 19,226,865
Federal Grants and Contracts	18,565,068
State and Local Grants and Contracts	800,705
Sales and Services, Net (Note 10)	11,416,880
Interest Earnings on Loans	38,682
Other Operating Revenues	885,316
	<hr/>
Total Operating Revenues	50,933,516
	<hr/>

EXPENSES

Operating Expenses:

Salaries and Benefits	61,524,620
Supplies and Materials	18,061,958
Services	31,820,865
Scholarships and Fellowships	3,007,845
Utilities	3,102,706
Depreciation	3,529,160
	<hr/>
Total Operating Expenses	121,047,154
	<hr/>
Operating Loss	(70,113,638)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	48,006,532
Noncapital Grants	14,929,707
Noncapital Gifts	112,812
Investment Income (Net of Investment Expense of \$69,061)	1,732,939
Interest and Fees on Capital Asset-Related Debt	(753,065)
Other Nonoperating Expenses	(385,369)
	<hr/>
Net Nonoperating Revenues	63,643,556
	<hr/>
Loss Before Other Revenues	(6,470,082)
	<hr/>
Capital Appropriations	181,500
Capital Grants	37,726,163
	<hr/>
Increase in Net Assets	31,437,581

NET ASSETS

Net Assets - July 1, 2003	119,912,969
	<hr/>
Net Assets - June 30, 2004	\$ 151,350,550
	<hr/> <hr/>

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

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

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 49,402,099
Payments to Employees and Fringe Benefits	(60,441,798)
Payments to Vendors and Suppliers	(46,336,127)
Payments for Scholarships and Fellowships	(3,007,845)
Loans Issued	(412,977)
Collection of Loans	310,804
Interest Earned on Loans	44,479
Other Receipts	155,845
	<hr/>
Net Cash Used by Operating Activities	(60,285,520)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	48,006,532
Noncapital Grants	6,212,781
Noncapital Gifts	131,742
William D. Ford Direct Lending Receipts	39,108,604
William D. Ford Direct Lending Disbursements	(39,108,604)
Related Activity Agency Disbursements	(26,019)
Other Payments	(385,370)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	53,939,666

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	30,354,753
State Capital Appropriations	181,500
Capital Grants	18,661,273
Proceeds from Sale of Capital Assets	2,567
Acquisition and Construction of Capital Assets	(32,292,285)
Principal Paid on Capital Debt and Leases	(2,289,069)
Interest and Fees Paid on Capital Debt and Leases	(503,744)
Payment to Bond Escrow Agent	(8,768,853)
	<hr/>
Net Cash Provided by Capital Financing and Related Financing Activities	5,346,142

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	6,469,672
Investment Income	831,463
Purchase of Investments and Related Fees	(13,746,636)
	<hr/>
Net Cash Used by Investing Activities	(6,445,501)

Net Decrease in Cash and Cash Equivalents	(7,445,213)
Cash and Cash Equivalents - July 1, 2003	26,171,693
	<hr/>
Cash and Cash Equivalents - June 30, 2004	\$ 18,726,480

North Carolina Central 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	\$	(70,113,638)
Adjustments to Reconcile Operating Loss to Net Cash Provided (Used) by Operating Activities:		
Depreciation Expense		3,529,160
Other Receipts/Payments		155,845
Decrease in Allowances and Write-Offs		1,079,118
Nonoperating Other Income (Expenses)		6,454,911
Changes in Assets and Liabilities:		
Receivables (Net)		(2,487,043)
Inventories		(13,918)
Accounts Payable and Accrued Liabilities		(68,154)
Due to Primary Government		114,440
Deferred Revenue		295,315
Compensated Absences		870,616
Note Principle Repayments		310,804
Notes Issued		(412,977)
		<hr/>
Net Cash Used by Operating Activities	\$	<u>(60,285,521)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	\$	14,152,225
Restricted Cash and Cash Equivalents		4,574,255
		<hr/>
Total Cash and Cash Equivalents - June 30, 2004	\$	<u>18,726,480</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$	8,800
Change in Fair Value of Investments		871,441

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

North Carolina Central University Foundation, Inc.
Statement of Financial Position
June 30, 2004

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	1,364,139
Investments		7,696,495
Cash Surrender Value of Life Insurance		41,770
Accounts Receivable		203,686
Contributions Receivable, Net		767,759
Grants Receivable		1,126,314
Collections of Artwork		197,300
Other Assets		21,281
		<hr/>
Total Assets		11,418,744

LIABILITIES

Accounts Payable and Accrued Expenses		357
Annuities Payable		17,637
		<hr/>
Total Liabilities		17,994

NET ASSETS

Unrestricted		1,830,671
Temporarily Restricted		4,337,344
Permanently Restricted		5,232,735
		<hr/>
Total Net Assets	\$	11,400,750

See Note 1 in the Notes to the Financial Statements

North Carolina Central University Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2004

Exhibit B-2

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUES				
Revenues, Gains and Other Support:				
Contributions	\$ 47,617	\$ 2,330,306	\$ 624,414	\$ 3,002,337
Grants		321,461		321,461
Interest and Dividends	39,872	106,836		146,708
Unrealized Gains on Investments	571,376	32,075		603,451
Realized Gains and Losses on Investments	22,296	(2,531)		19,765
Other Income	38,333	1,288,488		1,326,821
	<u>719,494</u>	<u>4,076,635</u>	<u>624,414</u>	<u>5,420,543</u>
Total Revenues and Gains				
Net Assets Released from Restrictions				
Satisfaction of Program Restrictions	<u>4,728,395</u>	<u>(4,728,395)</u>		
Total Revenues, Gains and Other Support	<u>5,447,889</u>	<u>(651,760)</u>	<u>624,414</u>	<u>5,420,543</u>
EXPENSES				
Program Services:				
Scholarships and Grants	493,538			493,538
Designated Gfts	586,680			586,680
University Support	3,070,353			3,070,353
Management and General	189,096			189,096
Bad Debts	416,587			416,587
	<u>4,756,254</u>			<u>4,756,254</u>
Total Expenses				
Increase (Decrease) in Net Assets Before Transfers	691,635	(651,760)	624,414	664,289
Transfers	<u>(50,000)</u>	<u>50,000</u>		
Increase (Decrease) in Net Assets	641,635	(601,760)	624,414	664,289
NET ASSETS				
Net Assets - Beginning of Year	<u>1,189,036</u>	<u>4,939,104</u>	<u>4,608,321</u>	<u>10,736,461</u>
Net Assets - End of Year	<u>\$ 1,830,671</u>	<u>\$ 4,337,344</u>	<u>\$ 5,232,735</u>	<u>\$ 11,400,750</u>

See Note 1 in the Notes to the Financial Statements.

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. The blended component unit, although legally separate, is, in substance, part of the University's operations and therefore, is reported as if it was part of the University. 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.

Blended Component Unit - Although legally separate, the NCCU Real Estate Foundation, Inc. (Real Estate Foundation), a component unit of the University, is reported as if it was part of the University.

A four-member board governs the Real Estate Foundation. The Real Estate Foundation's purpose is to acquire property and to construct and own residential facilities for students, which it will manage for the University. Because the directors of the Real Estate Foundation are appointed by the Chancellor, and the Real Estate Foundation's sole purpose is to benefit North Carolina Central University, its financial statements have been blended with those of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Separate financial statements for the Real Estate Foundation may be obtained from the University Controller's Office, 1801 Fayetteville Street, Durham, NC 27707, or by calling (919) 530-7432. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

Discretely Presented Component Unit – The NCCU Foundation, Inc. (NCCU Foundation), is a legally separate tax-exempt 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 NCCU Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The NCCU Foundation board consists of 20 members. Although the University does not control the timing or amount of receipts from the NCCU Foundation, the majority of resources, or income thereon, that the NCCU Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the NCCU Foundation can only be used by, or for the benefit of the University, the NCCU 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 NCCU 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 NCCU Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2004, the NCCU Foundation distributed \$4,066,200 to the University for both restricted and unrestricted purposes. The University remitted \$129,802 in payroll deducted employee contributions and \$343,540 in other reimbursements to the NCCU Foundation. Complete financial statements for the NCCU Foundation can be obtained from the University Controller's Office, 1801 Fayetteville Street, Durham, NC 27707, or by calling (919) 530-7432.

- 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).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

- D. Cash and Cash Equivalents** – This classification includes petty cash, cash on deposit with private bank accounts, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - This classification includes long-term fixed income investments, equity investments, mutual funds, and money market funds held by the University. Except for money market funds, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 20 to 50 years for general infrastructure, 50 years for buildings, and 5 to 15 years for equipment.

Art collections are capitalized at cost or fair value at the date of donation. These collections are considered inexhaustible and are therefore not depreciated.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002, and as of July 1, 2003. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

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

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

- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

N. Revenue and Expense Recognition – The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all 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*

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.

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

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

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** – Unless specifically exempt, the University is required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to General Statute 116-36.1, requires the University to deposit its institutional trust funds with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, and debt service funds 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 \$18,724,580. At year end, cash on hand was \$1,900. The University's portion of the State Treasurer's Investment Pool was \$18,722,767. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University's deposits not with the State Treasurer was \$1,813 and the bank balance was \$1,813. Of the bank balance, \$1,813 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 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 in the same manner as the State Treasurer is required to invest, as previously discussed.

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

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

Investments of the University's component units, Real Estate Foundation and NCCU Foundation, are subject to and restricted by General

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Statute 36B “Uniform Management of Institutional Funds Act” (UMIFA) and any requirements placed on them by contract or donor agreements.

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The University utilizes investment funds to manage investments and distribute investment income. Purchases in the investment funds are allowed at the beginning of each month. Fund ownership is measured based on the participating funds purchases and accumulated gain/loss reinvestment. The investment strategy, including the selection of investment managers is based on the directives of the University’s Endowment Board.

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

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

	Fair Value			Total
	Risk Category			
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 999,460	\$ 0	\$ 0	\$ 999,460
Corporate Bonds	1,813,809			1,813,809
Corporate Stocks	4,751,417			4,751,417
Total Categorized Investments	\$ 7,564,686	\$ 0	\$ 0	7,564,686
Investments Not Categorized:				
Money Market Funds				8,328,778
Mutual Funds				6,103,991
Total Investments Not Categorized				14,432,769
Total Investment Pool				\$ 21,997,455

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. Derivative and Similar Transactions - A derivative is a financial instrument created from, or whose value depends on (is derived from), the value of one or more underlying assets, reference rates, or indexes of asset values. These instruments may include forwards, futures, currency and interest rate swaps, options, floaters/inverse floaters, and caps/floors/collars. Investment transactions similar to a derivative may include securitized assets, such as mortgage-backed securities and other asset-backed securities. As required by accounting principles generally accepted in the United States of America, the nature of derivative or similar transactions entered into by the University and the reasons for entering into those transactions follow:

Indirect Derivative Holdings - The University identifies various external investment funds (mutual funds) that meet asset allocation and investment management objectives. The University invests in these funds to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. Fund investments generally include equity and bond funds. Certain funds expose the University to significant amounts of market risk by trading or holding derivative instruments and by leveraging the securities in the fund.

The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes. The asset class of the investment fund that utilized derivative securities for the fiscal year ending June 30, 2004, are summarized in the chart below. The amounts shown in the chart represent the market value of the investment fund invested in the asset class and the market value and percent of holdings held in derivatives in that classification. The investment fund Indirect Derivative Analysis for Fiscal Year Ending June 30, 2004:

	Total Market Value	% Invested Derivative	Amount
Hedge Fund	\$ 380,159	2.40%	\$ 9,124
Total Market Value of Investment			\$ 21,997,455
Total % of Market Value for Indirect Derivative Exposure			0.04%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are determined by 5.5% of the five-year moving average of the fund's market value. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2004, net appreciation of \$1,714,131 was available to be spent, of which \$610,745 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2004, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 5,016,666	\$ 2,037,395	\$ 2,979,271
Accounts	517,972		517,972
Intergovernmental	7,125,805		7,125,805
Pledges	32,750		32,750
Investment Earnings	27,668		27,668
Interest on Loans	88,598		88,598
Total Current Receivables	<u>\$ 12,809,459</u>	<u>\$ 2,037,395</u>	<u>\$ 10,772,064</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	<u>\$ 465,593</u>	<u>\$ 243,687</u>	<u>\$ 221,906</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 5,968,656</u>	<u>\$ 3,086,998</u>	<u>\$ 2,881,658</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2003	Adjustments	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:					
Land	\$ 4,121,651	\$ 0	\$ 1,196,680	\$ 0	\$ 5,318,331
Art, Literature, and Artifacts	498,740		8,800		507,540
Construction in Progress	5,238,820	(798,000)	26,508,102		30,948,922
Total Capital Assets, Nondepreciable	9,859,211	(798,000)	27,713,582		36,774,793
Capital Assets, Depreciable:					
Buildings	114,945,763	798,000	6,696,724	1,055,663	121,384,824
Machinery and Equipment	10,032,610		1,543,713	22,674	11,553,649
General Infrastructure	14,238,148		6,500		14,244,648
Total Capital Assets, Depreciable	139,216,521	798,000	8,246,937	1,078,337	147,183,121
Less Accumulated Depreciation/Amortization for:					
Buildings	47,082,770		2,047,634	21,808	49,108,596
Machinery and Equipment	5,424,120		876,804	14,126	6,286,798
General Infrastructure	5,850,780		604,722		6,455,502
Total Accumulated Depreciation	58,357,670		3,529,160	35,934	61,850,896
Total Capital Assets, Depreciable, Net	80,858,851	798,000	4,717,777	1,042,403	85,332,225
Capital Assets, Net	\$ 90,718,062	\$ 0	\$ 32,431,359	\$ 1,042,403	\$ 122,107,018

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 6,467,169
Accrued Payroll	2,061,273
Contract Retainage	802,644
Intergovernmental Payables	168,682
Other	72,023
Total Accounts Payable and Accrued Liabilities	\$ 9,571,791

NOTE 7 - SHORT-TERM DEBT - LINE OF CREDIT

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

	Balance July 1, 2003	Draws	Repayments	Balance June 30, 2004
Line of Credit	\$ 1,939,069	\$ 118,142	\$ 2,057,211	\$ 0

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The NCCU Real Estate Foundation, a component unit of the University, used a revolving line of credit to be drawn upon as needed. This line of credit was necessary to finance the acquisition, construction, and equipping of a residential facility, which will be capitalized in the applicable asset categories upon completion. This line of credit was paid off in October of 2003.

NOTE 8 - LONG-TERM LIABILITIES

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

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	\$ 10,720,000	\$ 30,245,000	\$ 8,040,000	\$ 32,925,000	\$ 450,000
Add/Deduct Premium/Discount	(91,977)	(214,024)	(65,417)	(240,584)	
Deduct Deferred Charge on Refunding		(1,064,658)		(1,064,658)	
Total Bonds Payable	10,628,023	28,966,318	7,974,583	31,619,758	450,000
Capital Leases Payable	67,933	695,486	38,820	724,599	106,891
Compensated Absences	3,584,221	3,991,542	3,120,926	4,454,837	432,120
Total Long-Term Liabilities	\$ 14,280,177	\$ 33,653,346	\$ 11,134,329	\$ 36,799,194	\$ 989,011

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

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2004	Principal Outstanding 06/30/2004
Stadium System Revenue Bonds	1998	4.4% to 5.0%	4/1/2023	\$ 3,320,000	\$ 640,000	\$ 2,680,000
NCCU Real Estate Foundation, Inc. Housing System						
Student Housing Facilities Revenue Bonds	2003A	Variable	10/1/2034	21,475,000		21,475,000
Taxable Student Housing Facilities Revenue Bonds	2003B	Variable	10/1/2005	100,000		100,000
Total Student Housing Facilities System				21,575,000		21,575,000
The University of North Carolina System Pool Revenue Bonds	2004B	3.0% to 5%	4/1/2023	8,670,000		8,670,000
Total Bonds Payable (principal only)				\$ 33,565,000	\$ 640,000	32,925,000
Less: Unamortized Loss on Refunding						(1,064,658)
Less: Unamortized Discount						(240,584)
Total Bonds Payable						\$ 31,619,758

C. Demand Bonds - Included in bonds payable are two variable rate demand bond issues. Demand bonds are securities that contain a "put" feature that allows bondholders to demand payment before the maturity of the debt

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

upon proper notice to the Real Estate Foundation remarketing or paying agents. With regards to the following demand bonds, the Real Estate Foundation has not entered into legal agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

In October 2003, the North Carolina Capital Facilities Finance Agency issued Student Housing Facilities Revenue Bonds (\$21,475,000 Variable Rate Revenue Bonds, Series 2003A) and Taxable Student Housing Facilities Revenue Bonds (\$100,000 Variable Rate Revenue Bonds, Series 2003B) that have a maturity date of October 1, 2034, and October 1, 2005, respectively. North Carolina Capital Facilities Finance Agency loaned the proceeds of the Series 2003 Bonds to the Real Estate Foundation. The Real Estate Foundation used the proceeds to finance the costs of building a student housing facility at North Carolina Central University, to fund a debt service reserve fund for the 2003A Bonds, to pay a portion of the interest on the bonds during construction of the project, and to pay certain costs of issuance of the bonds. The 2003A Bonds are subject to mandatory sinking fund redemption at the principal amount on the interest payment dates or immediately preceding October 1, 2005.

The Student Housing Facilities Revenue Bonds (Series 2003) has an Irrevocable Letter of Credit (LOC) for \$21,819,518. The LOC is to secure the payment of the principal and purchase price of interest on the Series 2003 Bonds. The LOC was issued by Wachovia Bank, National Association and expires on October 15, 2006. The LOC may be extended by request from the Real Estate Foundation by delivering a notice of extension to the Trustee with a new expiration date. At June 30, 2004, the LOC rate for the bonds was 1.4000% and the total amount drawn on it was \$139,459. The Real Estate Foundation's LOC as of June 30, 2004, through June 30, 2039, is listed in the SWAPS 1 and 2 Schedule below.

The Real Estate Foundation paid Wachovia Bank a commitment fee of \$109,098 for the letter of credit on the date the bonds were issued. Additionally, the Real Estate Foundation paid credit facility fees in the amount of \$222,256 during the fiscal year. If the Real Estate Foundation terminates the letter of credit on or before August 1, 2006, then the Real Estate Foundation must pay a termination fee of \$25,000. The Bonds are not under a take out agreement, however, in the event of termination one hundred percent of the unpaid principal will be due and payable plus any unpaid and accrued interest.

Under the LOC agreement, the proceeds of each drawing under the LOC to pay the portion of the purchase price of Series 2003 bonds allocable to

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

principal will constitute a Tender Advance and must be reimbursed as provided in the agreement. The Real Estate Foundation is required to repay each Tender Advance to Wachovia Bank plus an interest rate of Prime plus 1.0%. The amount of any tender advance made is repaid based on the earliest to occur of the date the credit provider bonds purchased pursuant to such tender advances are remarketed, the close of business on the date that 180 days after the tender was made and/or the termination date. At June 30, 2004, no tender advances had been made under the letter of credit.

The Student Housing Facilities Revenue Bonds (Series 2003) has remarketing fees. The remarketing fee is an upfront charge to reset the interest rates on a weekly basis. The remarketing agent is Wachovia Bank, Nation Association for the Series 2003A Bonds and Wachovia Capital Markets, LLC for the Series 2003B Bonds. At June 30, 2004, the remarketing fee rate for the bonds was 0.125%. The Real Estate Foundation's remarketing fee as of June 30, 2004 through June 30, 2039, is listed in the SWAPS 1 and 2 Schedule below.

Interest Rate Swaps

Objective: As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance in October 2003, effective March 24, 2004, the Real Estate Foundation entered into two interest rate swaps with Wachovia Bank in connection with its \$21,475,000 Variable Rate Student Housing Revenue Bonds, Series 2003A and \$100,000 Variable Rate Student Housing Revenue Bond, Series 2003B. The intention of the swap agreements was to effectively change the interest rate on the bonds to a synthetic fixed rate of 3.515% (Swap 1) and 2.71% (Swap 2).

Terms: The bonds and the related swap agreements mature on October 1, 2024, (Swap 1) and April 1, 2009, (Swap 2) and the combined swaps' notional amount of \$17,180,000 hedges 80% of the \$21,575,000 variable rate bonds. Starting in fiscal year 2006, the combined notional value of the swaps and the combined principal amount of the associated debt decline. Under the swaps, the Real Estate Foundation pays Wachovia Bank a fixed rate of 3.515% (Swap 1) and 2.71% (Swap 2) and receives a monthly variable rate at 70% of London Interbank Offered Rate (LIBOR) and Bond Market Association (BMA), respectively. The bonds' variable rate coupons are closely associated with the BMA.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Swap 1	Terms	Rates (%)
Fixed Payment to Wachovia Bank	Fixed	3.515
Variable Payment from Wachovia Bank	70% LIBOR	0.958
Net Interest Rate Swap Payments		2.557
Swap 2	Terms	Rates (%)
Fixed Payment to Wachovia Bank	Fixed	2.710
Variable Payment from Wachovia Bank	BMA	1.050
Net Interest Rate Swap Payments		1.660

Fair Value: Because interest rates have risen since execution of the swaps, the swaps have positive fair values of \$213,437 (Swap 1) and \$136,521 (Swap 2) as of June 30, 2004. The swaps' positive fair value may be countered by an increase in total anticipated future interest payments required under the variable rate bonds, creating a higher replacement interest rate. Because the coupons on the Real Estate Foundation's variable rate bonds are adjusted every seven days to changing interest rates, the bonds do not have a corresponding fair value increase. The fair values were established by market quotations from Wachovia Bank.

Credit Risk: As of June 30, 2004, the Real Estate Foundation was exposed to credit risk because the swaps had a positive fair value. The exposed credit risk is in the amount of the derivatives' fair value. Swap 1 and Swap 2's counterparty (Wachovia Bank) was rated Aa2 by Moody's Investors Service (Moody's), A+ by Standard and Poor's (S&P) and AA- by Fitch Ratings (Fitch).

Basis Risk: The swaps expose the Real Estate Foundation to basis risk when the variable payment received is based on an index other BMA. Should the relationship between LIBOR and BMA converge, the synthetic rate on the debt would change. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 3.515% and 2.71% and the actual rate of 3.647% and 2.75% at June 30, 2004.

Termination Risk: The swap contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the Real Estate Foundation being required to make an unanticipated termination payment. The swap agreements are terminated

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

if the Real Estate Foundation or Wachovia Bank fails to perform under terms of the contracts.

Market-Access/Rollover Risk: The Real Estate Foundation is exposed to market-access/rollover risk when the swaps mature on October 1, 2024, and April 1, 2009, respectively. When Swap 1 and Swap 2 mature, the interest rate on the underlying debt will return to a variable rate.

Swap Payments and Associated Debt: As rates vary, variable rate bond interest payments and net swaps payments will vary. Using rates of June 30, 2004, debt service requirements of the University's outstanding variable rate debt and net swap payments assuming current interest rates remain the same, are as follows:

SWAP 1 and 2 Variable Rate Bond						
Fiscal Year	Principal	Interest	Letter of Credit	Remarketing	Interest Rate Swaps, Net	Total
2005	\$ 0	\$ 234,406	\$ 304,057	\$ 27,216	\$ 362,976	\$ 928,655
2006	290,000	229,862	302,783	27,103	362,562	1,212,310
2007	310,000	228,112	296,978	26,583	354,859	1,216,532
2008	325,000	226,119	292,376	26,243	350,401	1,220,139
2009	345,000	221,121	287,492	25,734	310,987	1,190,334
2010-2014	2,040,000	1,045,464	1,353,994	121,264	985,900	5,546,622
2015-2019	2,680,000	919,638	1,183,310	105,980	863,977	5,752,905
2020-2024	3,515,000	755,312	959,321	85,964	704,293	6,019,890
2025-2029	4,610,000	537,800	665,741	59,621	31,179	5,904,341
2030-2034	6,040,000	254,001	280,908	25,158		6,600,067
2035-2039	1,420,000	9,379				1,429,379
Total	\$ 21,575,000	\$ 4,661,214	\$ 5,926,960	\$ 530,866	\$ 4,327,134	\$ 37,021,174

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

<u>Fiscal Year</u>	Annual Requirements	
	Bonds Payable	
	Principal	Interest
2005	\$ 450,000	\$ 1,340,597
2006	755,000	1,317,588
2007	800,000	1,285,313
2008	830,000	1,255,738
2009	800,000	1,224,863
2010-2014	4,610,000	5,616,545
2015-2019	5,915,000	4,534,050
2020-2024	6,695,000	3,124,500
2025-2029	4,610,000	1,973,000
2030-2034	6,040,000	914,400
2035-2039	1,420,000	28,400
Total Requirements	\$ 32,925,000	\$ 22,614,994

Interest on the variable rate University of North Carolina System Pool Revenue Bonds is calculated at 3.0% to 5.0% at June 30, 2004.

Interest on the variable rate Stadium System Revenue Bonds is calculated at 4.4 to 5.0% at June 30, 2004.

Interest on the variable rate Student Housing Facilities Revenue Bonds is calculated at 4.0% at June 30, 2004.

This schedule also includes the debt service requirements for debt associated with interest rate swaps. More detailed information about interest rate swaps is presented in Note 8C.

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

Housing Revenue: On March 31, 2004, the University defeased \$7,690,000 of outstanding Housing Revenue Bonds, Series 1996 (original issue amount \$8,890,000). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. As a result, the University reduced its debt service requirements by \$194,133 over the next 19 years and obtained an economic gain of \$280,533. At June 30, 2004, the outstanding balance of the defeased Housing Revenue Bonds, Series 1996 bonds was \$7,690,000.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Dormitory System: On March 2, 1995, the University defeased \$1,020,000 of outstanding Dormitory Series A, B & C Revenue Bonds. An irrevocable trust was established with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2004, the outstanding balance of the defeased Dormitory System Revenue Bonds was \$34,000.

NOTE 9 - LEASE OBLIGATIONS

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

<u>Fiscal Year</u>	<u>Amount</u>
2005	\$ 173,018
2006	139,097
2007	139,097
2008	139,097
2009	139,098
Total Minimum Lease Payments	729,407
Amount Representing Interest (6% Rate of Interest)	4,808
Present Value of Future Lease Payments	<u>\$ 724,599</u>

Machinery and equipment acquired under capital lease amounted to \$889,582 at June 30, 2004.

- B. Operating Lease Obligations** – Rental expense for all operating leases during the year was \$5,422,479.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - 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 Change in Allowance for Uncollectibles	Net Revenues	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	\$ 24,802,028	\$ 0	\$ 5,285,464	\$ 289,699	\$ 19,226,865	\$ 562,220 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 6,034,258	\$ 17,343	\$ 1,614,832	\$ 132,250	\$ 4,269,833	\$ 0
Dining	4,132,798	67,424	1,091,747	63,250	2,910,377	
Student Union Services	1,166,773		287,299	17,384	862,090	
Health, Physical Education, and Recreation Services	277,038				277,038	
Bookstore	123,155	23,247			99,908	
Parking	1,267,773			24,183	1,243,590	
Athletic	183,702				183,702	
Other	1,671,106	324,875		16,131	1,330,100	
Sales and Services of Education and Related Activities	240,242				240,242	
Total Sales and Services	<u>\$ 15,096,845</u>	<u>\$ 432,889</u>	<u>\$ 2,993,878</u>	<u>\$ 253,198</u>	<u>\$ 11,416,880</u>	<u>\$ 0</u>

Revenue Bonds Secured by Pledged Revenues:
(A) Stadium System

NOTE 11 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 32,260,448	\$ 2,225,171	\$ 4,000,226	\$ 0	\$ 3,165	\$ 0	\$ 38,489,010
Research	3,055,917	1,081,347	957,849				5,095,113
Public Service	1,280,052	158,618	1,369,209				2,807,879
Academic Support	6,210,881	3,235,868	1,167,008				10,613,757
Student Services	1,959,251	143,196	648,314				2,750,761
Institutional Support	7,604,196	762,502	2,348,276				10,714,974
Operations and Maintenance of Plant	3,570,783	8,879,238	9,506,728		2,784,164		24,740,913
Student Financial Aid	631,314		2,322	3,007,845			3,641,481
Auxiliary Enterprises	4,951,778	1,576,018	11,820,933		315,377		18,664,106
Depreciation						3,529,160	3,529,160
Total Operating Expenses	<u>\$ 61,524,620</u>	<u>\$ 18,061,958</u>	<u>\$ 31,820,865</u>	<u>\$ 3,007,845</u>	<u>\$ 3,102,706</u>	<u>\$ 3,529,160</u>	<u>\$ 121,047,154</u>

NOTE 12 - PENSION PLANS

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$51,662,914, of which \$37,828,757 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$2,269,725 and \$83,223, respectively. The University made one hundred percent of its annual required contributions for the years ended June 30, 2004, 2003, and 2002, which were \$83,223, \$0, and \$664,527, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(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 \$51,622,914, of which \$10,780,575 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$646,834 and \$737,391, 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 \$91,756 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).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$49,285. The voluntary contributions by employees amounted to \$174,359 for the year ended June 30, 2004.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$728,806 for the year ended June 30, 2004.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2004, the University's total contribution to the Plan was \$1,555,499. 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-

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. Employer contributions are established in the Appropriations Bill by the General Assembly. The University was not required to contribute to the DIPNC for the fiscal year ended June 30, 2004. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 14 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. Except for a reduction in the public officers' and employees' liability insurance from \$11,000,000 to \$5,000,000, 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, vandalism and "all risk" for certain 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance.

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

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

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. There were no employer contributions required for the current fiscal year.

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

NOTE 15 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$40,780,932 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

matters will not have a material adverse effect on the financial position of the University.

- C. Violations of Finance-Related Legal or Contractual Provisions** - In August 2003, the University discovered that two residential buildings and other academic buildings were not environmentally safe. Due to these safety concerns, a decision was made by the University to close the residential facilities. As a result, the University encountered additional expenses to remedy unhealthy building environments, acquire off-campus housing, and to transport students during the 2003-2004 fiscal year.

The University's Housing System experienced a significant increase in expenses due to the two dormitories not being environmentally safe. This situation caused the two dormitories to be uninhabitable and required the University to acquire off-campus housing at area hotels. The cost of the off-campus housing was the primary factor contributing to increased expenses and to the zero percent bond coverage ratio for the Housing Revenue Bonds, Series 1996, during the 2003-2004 fiscal year. The Housing Revenue Bonds, Series 1996, were defeased on March 31, 2004, so at June 30, 2004, NCCU was not in violation of a revenue bond coverage requirement.

The State of North Carolina has budgeted funds to reimburse the NCCU Housing System for the off-campus housing costs. As of June 30, 2004, the facilities were approved for occupancy and students will inhabit the facilities as of the Fall Semester 2004. The University anticipates net operating income to reflect normal operations in the 2004-2005.

- D. 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 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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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 \$82,907,025 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

NOTE 16 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

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

North Carolina Central 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>									
Eagleson Hall	Oct 2001	Feb 2002	\$ 6,526,025	\$ 0	\$ 6,526,025	\$ 233,296	3.57%	Aug 2005	May 2006
Rush Residential Hall	Sep 2001	Feb 2002	1,984,930		1,984,930	187,784	9.46%	Aug 2003	Aug 2005
Student Housing	Mar 2001	Feb 2002	1,478,770	250,000	1,728,770	1,392,824	80.57%	Sep 2003	Aug 2004
Old Senior Dorm	Mar 2001	Jul 2001	124,165		124,165	81,552	65.68%	Dec 2003	Aug 2004
Science Complex	Nov 2000	Dec 2001	34,941,000		34,941,000	13,215,484	37.82%	Aug 2004	Jun 2005
Baynes Hall Replacement	Mar 2001	Jul 2001	14,336,545		14,336,545	5,780,893	40.32%	Nov 2004	Jun 2005
Pearson Cafeteria	Mar 2001	Jun 2001	8,700,420		8,700,420	166,429	1.91%	Aug 2003	Jul 2007
Technology Infrastructure	May 2001	May 2001	1,350,900		1,350,900	1,265,119	93.65%	Nov 2002	Jun 2003
Campus Infrastructure	Jan 2001	Jan 2001	6,750,610		6,750,610	3,947,579	58.48%	Jan 2004	Sep 2004
Renovate Public Safety	Nov 2000	May 2001	798,000		798,000	798,000	100.00%	Sep 2003	Feb 2004
Land Acquisition	Nov 2000	Nov 2000	2,600,000		2,600,000	1,996,708	76.80%	Nov 2005	Jan 2006
McLean Residential Hall	Nov 2000	Oct 2000	305,800	225,000	530,800	530,800	100.00%	Jan 2003	Nov 2002
Shepard Residential Hall	Dec 2000	May 2001	4,139,910	2,663,395	6,803,305	2,665,030	39.17%	Feb 2005	Dec 2004
Latham Residential Hall	Sep 2001	Jul 2002	3,241,020		3,241,020	228,018	7.04%	Aug 2004	Jul 2005
Student Residential Hall Fire Safety & Security	Feb 2002	Feb 2003	1,463,950		1,463,950	440,661	30.10%	May 2003	Mar 2005
Turner Law Building	Sep 2001	Jul 2002	6,677,360		6,677,360	357,737	5.36%	Oct 2004	Jul 2005
Shepard Library	Sep 2001	May 2001	4,156,060		4,156,060	278,303	6.70%	Aug 2004	Sep 2005
Alexander Dunn	Sep 2002	Sep 2003	1,690,335		1,690,335	129,537	7.66%	Sep 2005	Jul 2005
Code Compliance	Aug 2002	Aug 2002	158,522		158,522	151,049	95.29%	Mar 2005	Mar 2005
Health and Safety Repair 2000	Nov 2000	Jul 2001	1,809,003		1,809,003	122,822	6.79%	Feb 2004	Nov 2004
Mold Remediation		Aug 2003	10,457,043		10,457,043	3,346,172	32.00%	Feb 2004	Aug 2004
C I Bond 2000 Administration			5,719,570		5,719,570	3,541,001	61.91%	Jan 2007	Jan 2007
Farrison-Newton, Classroom Building	Jun 2005	Aug 2004	1,096,265		1,096,265	1,621	0.15%	Jul 2008	Aug 2006
B. N. Duke Auditorium Addition	Mar 2002	Mar 2002	740,000		740,000	725,251	98.01%	Aug 2003	Feb 2004
Total All Projects			\$ 121,246,203	\$ 3,138,395	\$ 124,384,598	\$ 41,583,670			

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

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

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

Board of Trustees
North Carolina Central University
Durham, North Carolina

We have audited the financial statements of North Carolina Central 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 May 18, 2005. We did not audit the financial statements of the NCCU Real Estate Foundation, Inc., which represent 11 percent, 0.1 percent, and zero percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of the NCCU Foundation, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the NCCU Real Estate Foundation, Inc., and the NCCU Foundation, Inc., is based on the reports of the other auditors.

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The financial statements of the NCCU Real Estate Foundation, Inc. and the NCCU Foundation, Inc., were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to the NCCU Real Estate Foundation, Inc., nor the NCCU Foundation, Inc.

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

**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)**

over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Leslie W. Merritt, Jr.

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

May 18, 2005

DISTRIBUTION OF AUDIT REPORT

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

EXECUTIVE BRANCH

The Honorable Michael F. Easley
The Honorable Beverly M. Perdue
The Honorable Richard H. Moore
The Honorable Roy A. Cooper, III
Mr. David T. McCoy
Mr. Robert L. Powell
Ms. Molly Corbett Broad
Dr. James H. Ammons
Mr. Charles D. O'Dour

Governor of North Carolina
Lieutenant Governor of North Carolina
State Treasurer
Attorney General
State Budget Officer
State Controller
President, The University of North Carolina
Chancellor, North Carolina Central University
Vice Chancellor for Financial Affairs
North Carolina Central University
Chairman, Board of Trustees
North Carolina Central University

Mr. Robert C. Williams

LEGISLATIVE BRANCH

Appointees to the Joint Legislative Commission on Governmental Operations

President Pro Tempore
Senator Marc Basnight, Co-Chair
Senator Charles W. Albertson
Senator Thomas M. Apodaca
Senator Daniel G. Clodfelter
Senator Walter H. Dalton
Senator Charlie S. Dannelly
Senator James Forrester
Senator Linda Garrou
Senator Kay R. Hagan
Senator Fletcher L. Hartsell, Jr.
Senator David W. Hoyle
Senator John H. Kerr, III
Senator Ellie Kinnaird
Senator Jeanne H. Lucas
Senator Anthony E. Rand
Senator R. C. Soles, Jr.
Senator Richard Y. Stevens
Senator A. B. Swindell, IV
Senator Scott Thomas

Speaker of the House
Representative James B. Black, Co-Chair
Representative Alma S. Adams
Representative Martha B. Alexander
Representative Harold J. Brubaker
Representative Lorene T. Coates
Representative E. Nelson Cole
Representative James W. Crawford, Jr.
Representative William T. Culpepper, III
Representative W. Pete Cunningham
Representative Beverly M. Earle
Representative Pryor A. Gibson, III
Representative Joe Hackney
Representative R. Phillip Haire
Representative Dewey L. Hill
Representative Lindsey H. Holliman
Representative Julia C. Howard
Representative Howard J. Hunter, Jr.
Representative Margaret M. Jeffus
Representative Daniel F. McComas
Representative Charles L. McLawhorn
Representative Henry M. Michaux, Jr.
Representative Richard T. Morgan
Representative Edd Nye
Representative William C. Owens, Jr.
Representative Deborah K. Ross
Representative Drew P. Saunders
Representative Wilma M. Sherrill
Representative Joe P. Tolson
Representative Edith D. Warren
Representative Thomas E. Wright
Representative Douglas Y. Yongue

Other Legislative Officials

Mr. James D. Johnson

Director, Fiscal Research Division

July 7, 2005

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Internet: <http://www.ncauditor.net>

Telephone: 919/807-7500

Facsimile: 919/807-7647