

STATE OF NORTH CAROLINA

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

ASHEVILLE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF
THE UNIVERSITY OF NORTH CAROLINA AT ASHEVILLE
ASHEVILLE, NORTH CAROLINA
FOR THE YEAR ENDED JUNE 30, 2005

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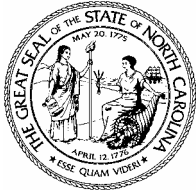
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STATE OF NORTH CAROLINA
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Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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, The University of North Carolina at Asheville

We have completed a financial statement audit of The University of North Carolina at Asheville for the year ended June 30, 2005, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements resulted in no audit findings.

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

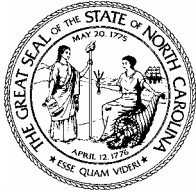
Leslie W. Merritt, Jr.

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

May 23, 2006

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Leslie W. Merritt, Jr., CPA, CFP
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20601 Mail Service Center
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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of The University of North Carolina at Asheville, a constituent institution of the 16-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, 2005, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of The University of North Carolina at Asheville'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 University of North Carolina at Asheville Foundation, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for this entity, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of The University of North Carolina at Asheville 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Asheville and its discretely presented component unit as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2006, 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.



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

March 22, 2006

**THE UNIVERSITY OF NORTH CAROLINA AT ASHEVILLE
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Overview of the Financial Statement Information

The University of North Carolina at Asheville (UNCA) provides this overview and management discussion and analysis to assist in understanding the statements and notes to the financial statements presented herewith. Comparative information for the prior fiscal year is also presented in the condensed financial statements.

The Statement of Net Assets presents the assets, liabilities and net assets (the difference between the assets and liabilities) as of the date of the fiscal year end (June 30). This statement assists in the determination of the financial condition of the university.

Condensed Statement of Net Assets

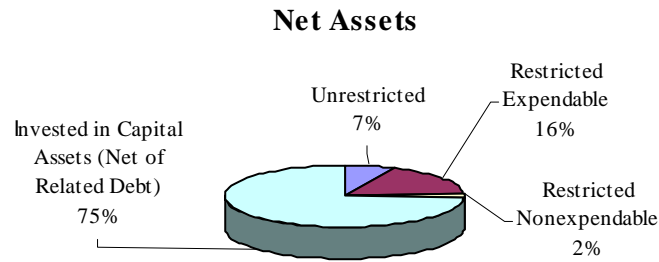
	<u>2005 Fiscal Year</u>	<u>2004 Fiscal Year</u>
Current Assets	\$ 15,049,526.94	\$ 14,477,213.80
Capital Assets	97,967,341.60	95,505,882.35
Other Noncurrent Assets	17,256,443.77	11,056,311.53
	<u>130,273,312.31</u>	<u>121,039,407.68</u>
Total Assets		
Current Liabilities	6,141,688.53	5,114,471.01
Noncurrent Liabilities	30,069,525.01	31,401,551.34
	<u>36,211,213.54</u>	<u>36,516,022.35</u>
Total Liabilities		
Invested in Capital Assets, Net of Related Debt	69,862,844.32	66,067,544.28
Restricted - Nonexpendable	2,254,560.80	2,245,716.74
Restricted - Expendable	15,430,979.29	9,017,244.94
Unrestricted	6,513,714.36	7,192,879.37
	<u>94,062,098.77</u>	<u>84,523,385.33</u>
Total Net Assets		

The University remains in sound financial condition. The sizable increase in total net assets is primarily due to an increase in allotments made by the State for various construction projects, reflected as other noncurrent assets above. As these activities are completed, they will be classified as capital assets.

Restricted nonexpendable net assets are loans and principal portions of endowed gifts that cannot be spent. Restricted expendable net assets are income from endowed funds, grants from others, and gifts with specific restrictions on spending. The University continues to see growth in the area of contracts and grants as noted in the increase in restricted expendable net assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net assets are shown in the graph below.



The Statement of Revenues, Expenses, and Changes in Net Assets presents revenues, expenses and other changes in net assets resulting from the University's financial activity during the fiscal year ending on June 30. GASB Statement No. 35 requires these activities to be classified as either operating or nonoperating, and specifies State appropriations and gifts as nonoperating. With this change in reporting, most public universities will show an operating loss with the State appropriation providing the additional resources to maintain positive net assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2005 Fiscal Year	2004 Fiscal Year
Tuition and Fees	\$ 14,413,408.75	\$ 12,690,774.50
Grants and Contracts	6,642,720.49	4,618,012.26
Sales and Services	9,473,995.41	8,355,537.15
Other Operating Revenues	328,669.33	248,041.06
Total Operating Revenues	30,858,793.98	25,912,364.97
Total Operating Expenses	64,079,077.53	55,910,766.37
Operating Loss	(33,220,283.55)	(29,998,401.40)
State Appropriations	27,087,456.39	25,495,221.37
Noncapital Gifts	1,333,243.15	1,012,966.62
Interest and fees on capital asset-related debt	(1,558,383.25)	(1,068,914.07)
Other Nonoperating Revenues	1,341,453.25	1,333,994.64
Total Nonoperating Revenues	28,203,769.54	26,773,268.56
Capital Grants & Appropriations	14,548,987.45	14,376,537.92
Capital Gifts	6,000.00	627,142.96
Additions to Permanent Endowments	240.00	25,240.00
Increase in Net Assets	9,538,713.44	11,803,788.04
Net Assets, Beginning of Year	84,523,385.33	72,719,597.29
Net Assets, End of Year	\$ 94,062,098.77	\$ 84,523,385.33

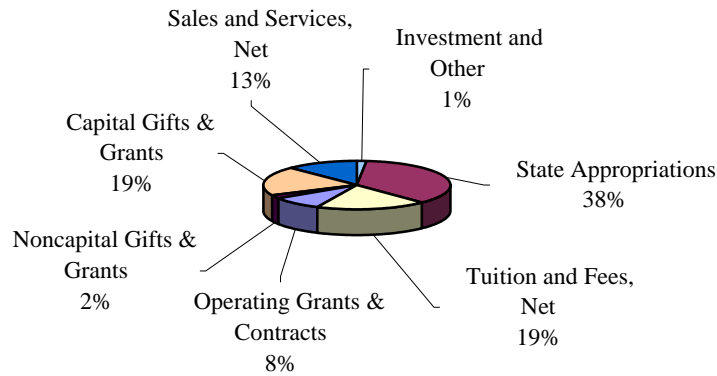
The University continues to see growth in total net assets, due in large part to continued capital investments by the State. These capital grants represent the portion of the Statewide bond proceeds and Certificate of Participation bonds used by UNCA in the 2005 fiscal year. The 1999-2000 Session of the General Assembly of North Carolina authorized these bonds and UNCA will continue to receive grants for capital projects for several more years. Construction on the last three bond projects is expected to begin in the upcoming fiscal year. For additional information on these Statewide bonds, see Note 14C.

Though State Appropriations are now considered nonoperating, they are still a significant part of total University revenues (as shown in the graph below). State appropriations increased \$1.6 million or 6.25% this fiscal year. This amount is expected to increase another \$2.5 million in the next fiscal year.

Total operating revenues increased \$4.9 million and total operating expenses increased \$8.2 million. While this is a disconcerting ratio at first glance, applicable accounting regulations require the University to include certain noncapitalized expenses, funded by capital grants, as operating expenses, somewhat distorting the relationship between current revenues and expenses.

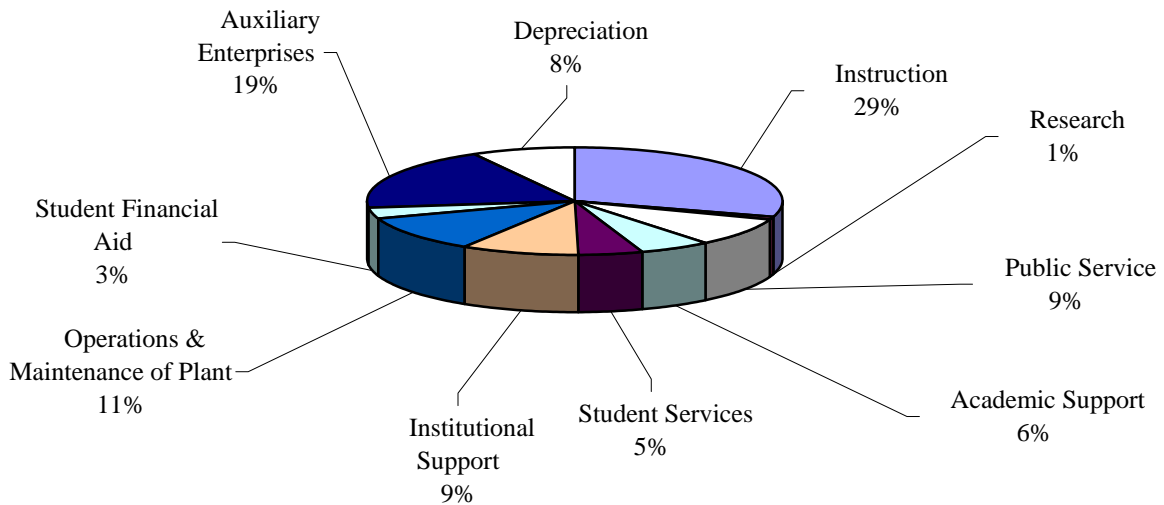
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total Revenues by Source



The expenses by function are shown in the graph below. The increase in operating expense is the result of normal operating expenses, but also includes notable expenses related to capital activities discussed above.

Expenses by Function



The University's primary areas of expense continue to be instruction, academic support and student support. Activities at the North Carolina Arboretum make up the majority of the public service expenditures.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The Statement of Cash Flows presents information about the cash activity of the University during the year ending June 30, 2005. A reconciliation of the change in cash on the Statement of Net Assets is provided in the full statement. A condensed version of the statement is shown below.

Condensed Statement of Cash Flows

	<u>2005 Fiscal Year</u>	<u>2004 Fiscal Year</u>
Cash Provided (Used) by:		
Operating Activities	\$ (27,287,763.86)	\$ (24,954,807.30)
Noncapital Financing Activities	28,749,895.01	26,662,443.30
Capital Financing Activities	(2,008,951.87)	(3,658,494.78)
Investing Activities	787,448.87	580,157.64
	<u>240,628.15</u>	<u>(1,370,701.14)</u>
Net Increase (Decrease) in Cash		
	240,628.15	(1,370,701.14)
Cash - Beginning of the Year	<u>13,633,688.48</u>	<u>15,004,389.62</u>
Cash - End of the Year	<u>\$ 13,874,316.63</u>	<u>\$ 13,633,688.48</u>

Cash flows from operating activities include receipts from sales and services, tuition and fees, and other operating revenues and disbursements such as salaries, payments for supplies and services and other operating expenses. State appropriations received are shown in the noncapital financing activities as a source of cash, and remain the largest inflow of cash on the statement. Other noncapital financing activities include noncapital gifts, nonoperating grants, and receipts and disbursements in funds held for others. Capital financing activities include receipts and disbursements related to building projects and related financing.

Debt Administration and Capital Assets

UNCA has several capital projects in various stages of planning and construction. Current projects are funded through capital appropriations and Statewide bond issues (considered capital grants for statement presentation). Projects include new and renovated classroom space as well as a new facilities management building and the Health and Wellness building approved by the General Assembly in 2004.

The University had \$28,104,497.28 in outstanding debt at June 30, 2005, and continues to make all of its debt payments in a timely manner. The University also took advantage of favorable market conditions to defease \$7.39 million in outstanding bonds, realizing a net economic gain of \$213,667. More detailed information about UNC Asheville's debt obligations is provided in Note 7 of the Notes to the Financial Statements.

The capital assets, net of accumulated depreciation, at June 30, 2005, were \$97,967,341.60. For more detailed information about asset holdings, see Note 5 of the Notes to the Financial Statements.

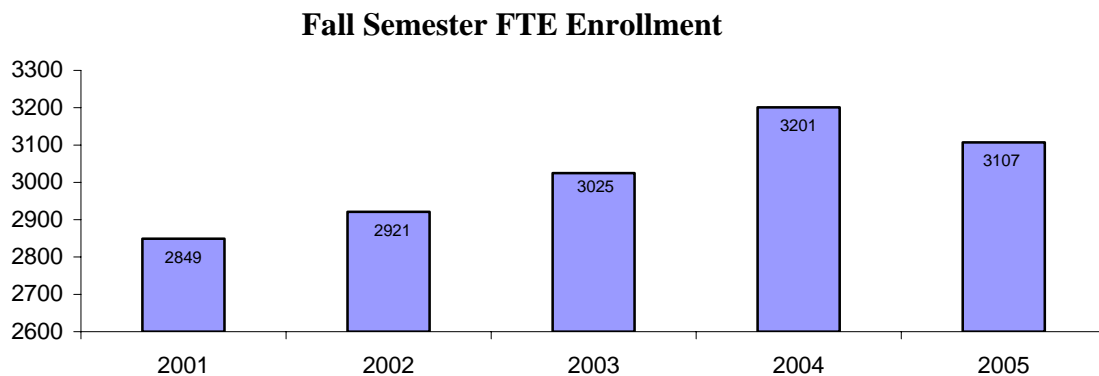
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Economic Outlook

The financial condition of the University is expected to remain stable for the foreseeable future. This expectation is grounded in North Carolina's history of support for higher education. The State has once again placed a high priority on funding the university system during a difficult budget year; including funding of \$500,000 of the University's special needs request. Nevertheless, the University is actively, and strategically, seeking alternative funding sources through increased contract and grant funding as well as private fundraising. In fact, during the year ending June 30, 2005, the University saw the largest amount of contract and grant funding in its history and the UNCA Foundation, Inc. saw the single largest gift in its history, \$3 million from Steve and Frosene Zeis.

While enrollment decreased by a modest amount in the fall of 2005, this change comes on the heels of historic levels of enrollment and growth. The unanticipated increase in enrollment yield in the fall of 2004 was so great that the University had to lease off campus housing to accommodate the demand. This increased demand caused the University to change from a rolling admission policy to a fixed deadline enrollment policy, common to other schools of first choice, and also led to campus wide discussions as to its proper student body size.

The following table compares fall semester enrollment of full-time equivalent (FTE) students for recent years, illustrating a pattern of measured growth, consistent with university goals:



The change in admission policy also resulted in a significant increase in average SAT scores and class rank for fall 2005. The University expects the current dip in enrollment to reverse itself as applicants adjust to the new admissions policy. Higher retention rates are expected as a result of the policy changes due to a more committed and motivated applicant pool. The University continues to receive high rankings in several national publications for its educational quality and value.

The University of North Carolina at Asheville
Statement of Net Assets
June 30, 2005

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 9,986,481.60
Restricted Cash and Cash Equivalents	3,149,388.63
Restricted Short-Term Investments	71,586.52
Receivables, Net (Note 4)	1,149,036.99
Inventories	381,825.91
Notes Receivable, Net (Note 4)	311,207.29
	<hr/>
Total Current Assets	15,049,526.94

Noncurrent Assets:

Restricted Cash and Cash Equivalents	738,446.40
Restricted Due from Primary Government	10,389,221.64
Endowment Investments	5,365,158.80
Notes Receivable, Net (Note 4)	763,616.93
Capital Assets - Nondepreciable (Note 5)	13,755,770.70
Capital Assets - Depreciable, Net (Note 5)	84,211,570.90
	<hr/>
Total Noncurrent Assets	115,223,785.37

Total Assets

130,273,312.31

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	2,653,016.82
Due to Primary Government	28,699.85
Due to University Component Unit	37,500.00
Deferred Revenue	1,599,283.59
Interest Payable	158,693.92
Long-Term Liabilities - Current Portion (Note 7)	1,664,494.35
	<hr/>
Total Current Liabilities	6,141,688.53

Noncurrent Liabilities:

Deposits Payable	179,752.81
Funds Held for Others	144,389.62
U. S. Government Grants Refundable	1,155,746.63
Long-Term Liabilities (Note 7)	28,589,635.95
	<hr/>
Total Noncurrent Liabilities	30,069,525.01

Total Liabilities

36,211,213.54

The University of North Carolina at Asheville
Statement of Net Assets
June 30, 2005

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	69,862,844.32
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	534,181.23
Endowed Professorships	1,502,500.00
Departmental Uses	25,000.00
Loans	192,879.57
Expendable:	
Scholarships and Fellowships	1,699,995.62
Research	310,296.95
Endowed Professorships	1,443,346.88
Departmental Uses	424,810.43
Capital Projects	10,467,036.93
Debt Service	1,056,306.66
Other	29,185.82
Unrestricted	<u>6,513,714.36</u>
Total Net Assets	<u>\$ 94,062,098.77</u>

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

***The University of North Carolina at Asheville
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2005***

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 14,413,408.75
Federal Grants and Contracts	4,039,877.64
State and Local Grants and Contracts	751,651.62
Nongovernmental Grants and Contracts	1,851,191.23
Sales and Services, Net (Note 9)	9,473,995.41
Interest Earnings on Loans	2,754.37
Other Operating Revenues	325,914.96
	<hr/>
Total Operating Revenues	30,858,793.98
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	36,554,156.89
Supplies and Materials	8,849,450.70
Services	9,463,053.51
Scholarships and Fellowships	2,060,046.01
Utilities	1,943,236.63
Depreciation	5,209,133.79
	<hr/>
Total Operating Expenses	64,079,077.53
	<hr/>
Operating Loss	(33,220,283.55)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	27,087,456.39
Noncapital Grants	410,629.93
Noncapital Gifts	1,333,243.15
Investment Income (Net of Investment Expense of \$8,786)	1,027,335.74
Interest and Fees on Debt	(1,558,383.25)
Other Nonoperating Expenses	(96,512.42)
	<hr/>
Net Nonoperating Revenues	28,203,769.54
	<hr/>
Loss Before Other Revenues	(5,016,514.01)
	<hr/>
Capital Appropriations	792,100.00
Capital Grants	13,756,887.45
Capital Gifts	6,000.00
Additions to Endowments	240.00
	<hr/>
Increase in Net Assets	9,538,713.44

NET ASSETS

Net Assets - July 1, 2004	84,523,385.33
	<hr/>
Net Assets - June 30, 2005	\$ 94,062,098.77
	<hr/> <hr/>

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

The University of North Carolina at Asheville
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2005

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 31,351,563.09
Payments to Employees and Fringe Benefits	(36,563,545.42)
Payments to Vendors and Suppliers	(20,025,902.07)
Payments for Scholarships and Fellowships	(2,060,046.01)
Loans Issued	(275,450.24)
Collection of Loans	310,676.99
Interest Earned on Loans	2,586.60
Student Deposits Received	74,218.20
Student Deposits Returned	(101,865.00)
	<hr/>
Net Cash Used by Operating Activities	(27,287,763.86)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	27,087,456.39
Noncapital Grants	410,629.93
Noncapital Gifts	1,333,243.15
Additions to Endowments	240.00
William D. Ford Direct Lending Receipts	7,792,636.00
William D. Ford Direct Lending Disbursements	(7,792,636.00)
Related Activity Agency Receipts	5,043.07
Related Activity Agency Disbursements	(86,717.53)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	28,749,895.01

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	7,957,416.80
State Capital Appropriations	792,100.00
Capital Grants	7,506,589.94
Capital Gifts	6,000.00
Proceeds from Sale of Capital Assets	5,055.85
Acquisition and Construction of Capital Assets	(7,473,923.58)
Principal Paid on Capital Debt	(1,490,000.00)
Interest and Fees Paid on Capital Debt	(1,465,916.58)
Payment to Bond Escrow Agent	(7,846,274.30)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(2,008,951.87)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	2,904,017.74
Investment Income	697,692.42
Purchase of Investments and Related Fees	(2,814,261.29)
	<hr/>
Net Cash Provided by Investing Activities	787,448.87
	<hr/>
Net Increase in Cash and Cash Equivalents	240,628.15
Cash and Cash Equivalents - July 1, 2004	13,633,688.48
	<hr/>
Cash and Cash Equivalents - June 30, 2005	\$ 13,874,316.63

The University of North Carolina at Asheville
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2005

Exhibit A-3
Page 2

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

Operating Loss	\$ (33,220,283.55)
Adjustments to Reconcile Operating (Loss) to Net Cash Used by Operating Activities:	
Depreciation Expense	5,209,133.79
Allowances, Write-Offs, and Amortizations	8,186.25
Changes in Assets and Liabilities:	
Receivables (Net)	(67,361.74)
Inventories	(39,948.73)
Accounts Payable and Accrued Liabilities	80,598.78
Due to Primary Government	36.13
US Government grants refundable	41,181.10
Deferred Revenue	574,273.14
Compensated Absences	118,841.02
Deposits Payable	(27,646.80)
Note Principal Repayments	310,676.99
Notes Issued	(275,450.24)
Net Cash Used by Operating Activities	<u>\$ (27,287,763.86)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 9,986,481.60
Restricted Cash and Cash Equivalents	3,149,388.63
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>738,446.40</u>
Total Cash and Cash Equivalents - June 30, 2005	<u>\$ 13,874,316.63</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Change in Fair Value of Investments	\$ 1,124,222.86
Loss on Disposal of Capital Assets	101,568.27

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

The University of North Carolina at Asheville Foundation, Inc.
Statement of Financial Position
June 30, 2005

Exhibit B-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 1,842,661.25
Receivables:	
Accrued Interest and Dividend Receivable	4,923.00
Sales Tax Receivable	1,831.96
Student Loans Receivable, Net	6,319.85
UNCA Employee Loans Receivable, Net	7,910.68
Receivable from UNCA	37,500.00
Other Receivables	1,750.00
Promises to Give, Net	187,277.00

Total Current Assets	2,090,173.74
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Property and Equipment, Net	17,782.18
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Other Assets:

Investments	11,236,582.67
Promises to Give, Net	155,206.56
Land Held for Resale	18,000.00
Beneficial Interest in Perpetual Trust	152,011.71

Total Other Assets	11,561,800.94
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Total Assets	\$ 13,669,756.86
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LIABILITIES

Current Liabilities:

Accounts Payable	\$ 38,928.97
Annuities Payable	28,370.00

Total Current Liabilities	67,298.97
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Annuities Payable	302,568.38
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Total Liabilities	369,867.35
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NET ASSETS

Unrestricted	1,464,815.76
Temporarily Restricted	4,877,699.06
Permanently Restricted	6,957,373.69

Total Net Assets	13,299,888.51
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Total Liabilities and Net Assets	\$ 13,669,755.86
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See Note 1 in the Notes to the Financial Statements.

The University of North Carolina at Asheville Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2005

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Investment Income	\$ 83,659.20	\$ 208,968.39	\$ 0.00	\$ 292,627.59
Realized and Unrealized Gains on Sale of Investments	214,825.79	470,658.52		685,484.31
Family Business Forum	75,050.00			75,050.00
Special Events:				
Dave Hart Golf Classic	27,435.00			27,435.00
Athletic Auction	26,115.00			26,115.00
Loss on Perpetual Trust			(4,903.38)	(4,903.38)
Other Income	24,993.40	26,093.93		51,087.33
	<u>452,078.39</u>	<u>705,720.84</u>	<u>(4,903.38)</u>	<u>1,152,895.85</u>
Total Revenues				
PUBLIC SUPPORT				
Contributions	<u>201,673.32</u>	<u>1,067,849.55</u>	<u>420,220.42</u>	<u>1,689,743.29</u>
Net Assets Released from Restriction	<u>968,872.96</u>	<u>(968,872.96)</u>		
Total Revenues, Gains, and Other Support	<u>1,622,624.67</u>	<u>804,697.43</u>	<u>415,317.04</u>	<u>2,842,639.14</u>
EXPENSES				
Program Services	1,133,245.18			1,133,245.18
Supporting Services:				
Management and General	56,302.42			56,302.42
Fund Raising	315,345.16			315,345.16
Total Expenses	<u>1,504,892.76</u>			<u>1,504,892.76</u>
Change in Net Assets	117,731.91	804,697.43	415,317.04	1,337,746.38
NET ASSETS				
Net Assets - Beginning of Year	<u>1,347,083.85</u>	<u>4,073,001.63</u>	<u>6,542,056.65</u>	<u>11,962,142.13</u>
Net Assets - End of Year	<u>\$ 1,464,815.76</u>	<u>\$ 4,877,699.06</u>	<u>\$ 6,957,373.69</u>	<u>\$ 13,299,888.51</u>

See Note 1 in the Notes to the Financial Statements

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THE UNIVERSITY OF NORTH CAROLINA AT ASHEVILLE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Asheville is a constituent institution of the 16-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 unit. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component unit is discretely presented in the University's financial statements. The discretely presented component unit's financial data is reported in a separate financial statement because of its use of different GAAP reporting models and to emphasize its legal separateness.

Discretely Presented Component Unit – The University of North Carolina at Asheville Foundation, Inc., (Foundation) is a legally separate, tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 25 to 36 elected directors. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the University, the 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University of North Carolina at Asheville Foundation, Inc., is a private not-for-profit organization that reports its financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2005, the Foundation distributed \$1,023,459.89 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University Controller's Office, 207 Phillips Hall, One University Heights, Asheville, NC 28804, or by calling 828-232-5109.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - This classification includes mutual funds and money market funds. Except for money market funds, investments are accounted for at fair value, as determined by quoted market prices. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

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 charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of expendable supplies, are valued using the last invoice cost. Merchandise for resale is valued using the moving weighted average cost.
- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 20 years for general infrastructure, 20 to 30 years for buildings, and 3 to 5 years for equipment.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University does not capitalize the general collections available for use in the Ramsey Library or in other campus locations. The University maintains these collections for public exhibition, education or research; protect, keep unencumbered, care for and preserve; and requires proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized. Some special items are capitalized as shown below.

The colonial forge artwork was capitalized at fair value at the date of donation. This piece of art is depreciated over its useful life using the straight-line method. The estimated useful life of the artwork is 10 years.

The Bonsai collection, the Laliberte tapestry, the Gifts from the Mountain collection, the Birds of America collection, the Speculation Papers, and the Kelly Harrison collection were capitalized at 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 and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums. The University amortizes bond premiums 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 1 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 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

O. Internal Sales Activities – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as central stores, printing services, and telecommunication 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 *North Carolina 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 G.S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2005, the University's deposit with the State Treasurer's Short-Term Investment Fund totaled \$13,846,208.67. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.41 years as of June 30, 2005. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) 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.ncosc.net/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The carrying amount of the University's deposits not with the State Treasurer was \$16,337.96 and the bank balance was \$86,513.28. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2005, the University's bank balance was not exposed to custodial credit risk.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Investments - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 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 discussed below.

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 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, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 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.

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.

G.S. 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 unit, The University of North Carolina at Asheville Foundation, Inc., are subject to and restricted by G.S. 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 pools to manage investments and distribute investment income. The University utilizes the following investment pool:

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the utilized method. Under this method, each participating fund's investment balance is determined on the basis of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

number of units purchased multiplied by the current unit market value. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

The following table presents the fair value of investments at June 30, 2005, for the Long-Term Investment Pool.

Long-Term Investment Pool

<u>Investment Type</u>	<u>Value</u>
Money Market Funds	\$ 71,586.52
Mutual Funds	5,365,158.80
Long-Term Investment Pool	<u>\$ 5,436,745.32</u>

Interest Rate Risk: Interest rate risk is defined by GASB Statement No. 40 as the risk a government may face should interest rate variances affect the fair value of investments. The University's Endowment Board does not have a formal investment policy that addresses interest rate risk, however the investments in the Long-Term Investment Pool were not subject to interest rate risk.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University Endowment Board does not have a formal policy for custodial credit risk, however the investments in the Long-Term Investment Pool were not subject to custodial credit risk.

Concentration of Credit Risk and Foreign Currency Risk: Foreign currency risk is defined by GASB Statement No. 40 as the risk that changes in exchange rates will adversely affect the fair value of an investment. The University Endowment Board does not have a formal policy for foreign currency risk; however the investments of the Long-Term Investment Pool are not subject to foreign currency risk. The University Endowment Board's formal investment policy targets 60% domestic equity, 15% international, and 25% fixed income investments.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which limits spending to 4% of the endowment principal's three-year trailing market value. Under this policy, the spending level is agreed upon prior to the beginning of the University's fiscal year and maintained at that level unless altered by Board action. To the extent that the total return for the current year exceeds the payout, the excess is added to appreciation of principal. If current year earnings do not meet the payout requirements, the University uses accumulated appreciation in expendable net asset endowment balances to make up the difference. At June 30, 2005, net appreciation of \$2,143,140.40 was available to be spent, of which \$1,903,728.57 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2005, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 503,360.27	\$ 10,071.48	\$ 493,288.79
Accounts	441,809.50		441,809.50
Intergovernmental	152,579.20		152,579.20
Interest on Loans	37,129.34		37,129.34
Other	24,230.16		24,230.16
Total Current Receivables	<u>\$ 1,159,108.47</u>	<u>\$ 10,071.48</u>	<u>\$ 1,149,036.99</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	<u>\$ 353,946.34</u>	<u>\$ 42,739.05</u>	<u>\$ 311,207.29</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 868,508.46</u>	<u>\$ 104,891.53</u>	<u>\$ 763,616.93</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, 2005, is presented as follows:

	Balance July 1, 2004	Adjustments	Increases	Decreases	Balance June 30, 2005
Capital Assets, Nondepreciable:					
Land	\$ 2,515,703.97	\$ 0.00	\$ 0.00	\$ 0.00	\$ 2,515,703.97
Art, Literature, and Artifacts	501,702.70				501,702.70
Construction in Progress	21,461,394.08	(17,587,883.54)	6,864,853.49		10,738,364.03
Total Capital Assets, Nondepreciable	24,478,800.75	(17,587,883.54)	6,864,853.49	0.00	13,755,770.70
Capital Assets, Depreciable:					
Buildings	92,901,964.65	17,550,323.54		411,672.52	110,040,615.67
Machinery and Equipment	4,150,435.55	37,560.00	907,307.82	582,003.95	4,513,299.42
Art, Literature, and Artifacts	35,000.00				35,000.00
General Infrastructure	21,212,130.20			198,400.00	21,013,730.20
Total Capital Assets, Depreciable	118,299,530.40	17,587,883.54	907,307.82	1,192,076.47	135,602,645.29
Less Accumulated Depreciation/Amortization for:					
Buildings	34,404,847.98		3,618,021.09	310,104.25	37,712,764.82
Machinery and Equipment	3,658,077.27		392,615.09	582,003.95	3,468,688.41
Art, Literature, and Artifacts	24,500.00		3,500.00		28,000.00
General Infrastructure	9,185,023.55		1,194,997.61	198,400.00	10,181,621.16
Total Accumulated Depreciation	47,272,448.80	0.00	5,209,133.79	1,090,508.20	51,391,074.39
Total Capital Assets, Depreciable, Net	71,027,081.60	17,587,883.54	(4,301,825.97)	101,568.27	84,211,570.90
Capital Assets, Net	\$ 95,505,882.35	\$ 0.00	\$ 2,563,027.52	\$ 101,568.27	\$ 97,967,341.60

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2005, were as follows:

	Amount
Accounts Payable	\$ 1,840,069.59
Accrued Payroll	505,943.74
Contract Retainage	299,816.58
Sales Tax Payable	7,186.91
Total Accounts Payable and Accrued Liabilities	\$ 2,653,016.82

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2005, is presented as follows:

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Current Portion
Bonds Payable	\$ 28,775,000.00	\$ 7,575,000.00	\$ 8,880,000.00	\$ 27,470,000.00	\$ 1,485,000.00
Add/Deduct Premium/Discount	663,338.07		28,840.79	634,497.28	
Total Bonds Payable	29,438,338.07	7,575,000.00	8,908,840.79	28,104,497.28	1,485,000.00
Compensated Absences	2,030,792.00	1,537,436.00	1,418,594.98	2,149,633.02	179,494.35
Total Long-Term Liabilities	\$ 31,469,130.07	\$ 9,112,436.00	\$ 10,327,435.77	\$ 30,254,130.30	\$ 1,664,494.35

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 June 30, 2005	Principal Outstanding June 30, 2005
Dormitory and Dining System						
UNCA Issued Revenue Bonds	C	4.75 - 5.0	06/01/2007	\$ 7,600,000.00	\$ 7,150,000.00	\$ 450,000.00
UNCA Issued Revenue Bonds	D	4.3 - 4.9	06/01/2007	3,695,000.00	3,190,000.00	505,000.00
UNCA System Pool Revenue Bonds	(A)	Variable	10/01/2008	2,580,000.00	1,455,000.00	1,125,000.00
UNCA Issued Revenue Bonds	2002	2.5 - 5.0	06/01/2027	18,900,000.00	1,550,000.00	17,350,000.00
UNCA System Pool Revenue Bonds	(B)	3.0 - 5.25	01/01/2023	7,575,000.00		7,575,000.00
Total Dormitory and Dining System				40,350,000.00	13,345,000.00	27,005,000.00
Parking System						
UNCA System Pool Revenue Bonds	(C)	5.0 - 5.5	10/01/2010	705,000.00	240,000.00	465,000.00
Total Bonds Payable (principal only)				\$ 41,055,000.00	\$ 13,585,000.00	27,470,000.00
Plus: Unamortized Premium						634,497.28
Total Bonds Payable						\$ 28,104,497.28

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

(B) The University of North Carolina System Pool Revenue Bonds, Series 2005

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University of North Carolina System Variable Rate Demand Pool Revenue Bonds, Series 1998A: In 1998, the Board of Governors of the University of North Carolina issued variable rate demand bonds in a system-wide financing arrangement for the benefit of its constituent universities. Through this system-wide financing, the University issued debt in the amount of \$2,580,000 with a final maturity date of October 1, 2008. These bonds are subject to mandatory sinking fund redemption that began on October 1, 1999. The University's proceeds from this issuance were used for a 200-car parking deck. While bearing interest at a weekly rate, these bonds are subject to purchase on demand with seven days' notice and delivery to the bond paying agent, The Bank of New York. Upon notice from the bond paying agent, the remarketing agent, Salomon Smith Barney, Inc. (now part of Citigroup Global Markets, Inc.) has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and NationsBank, N.A. (now part of Bank of America, N.A.), a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a standby fee equal to .20% of the available commitment, payable semiannually in advance, beginning on November 3, 1998, and on each May 1 and November 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (LIBOR plus one percent (1%)). LIBOR is the average of rates per annum for deposits to major money center banks in the London interbank market. Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2005, there were no Liquidity Provider Bonds held by the Liquidity Facility.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 60 equal monthly installments, beginning the first business day that is at least 180 days following such expiration date or

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

termination date along with accrued interest at the Liquidity Provider Rate.

Amounts due under this Standby Bond Purchase Agreement are allocated by the Trustee directly to and paid by the constituent universities participating in the system-wide bond issuance.

- D. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2005, are as follows:

<u>Fiscal Year</u>	Annual Requirements	
	Bonds Payable	
	Principal	Interest
2006	\$ 1,485,000.00	\$ 1,603,616.00
2007	1,515,000.00	1,564,196.00
2008	1,560,000.00	1,137,231.00
2009	1,630,000.00	1,077,014.00
2010	1,485,000.00	1,016,364.00
2011-2015	7,045,000.00	4,108,219.00
2016-2020	6,515,000.00	2,430,332.00
2021-2025	4,720,000.00	1,019,846.00
2026-2030	1,515,000.00	114,500.00
Total Requirements	\$ 27,470,000.00	\$ 14,071,318.00

Interest on the variable rate 1998A revenue bonds is calculated at 2.366% at June 30, 2005.

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

Dormitory and Dining System: On April 1, 2005, the University defeased \$5,860,000 of outstanding UNCA Issued Revenue Bonds, Series C (original issue amount \$7,600,000) and \$1,530,000 of outstanding UNCA Issued Revenue Bonds, Series D (original issue amount \$3,695,000). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. As a result, for the Series C bonds, the University reduced its debt service requirements by \$185,831.39 over the next 19 years and obtained an economic gain of \$130,792.03; for the Series D bonds the University reduced its debt service requirements by \$27,836.01 and obtained an economic gain of \$19,750.79. At June 30, 2005, the outstanding balance of the defeased Revenue bonds was \$7,390,000.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - LEASE OBLIGATIONS

The University entered into operating leases for digital printers/copiers and mailroom equipment. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2005:

<u>Fiscal Year</u>	<u>Amount</u>
2006	\$ 132,110.60
2007	38,358.28
2008	11,238.44
Total Minimum Lease Payments	<u>\$ 181,707.32</u>

Rental expense for all operating leases during the year was \$501,418.09.

NOTE 9 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Less Allowance for Uncollectibles</u>	<u>Net Revenues</u>	<u>Revenues Pledged as Security for Debt</u>
Operating Revenues:						
Student Tuition and Fees	\$ 16,167,507.27	\$ 0.00	\$ 1,733,467.51	\$ 20,631.01	\$ 14,413,408.75	\$ 675,537.15 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 3,700,037.23	\$ 0.00	\$ 418,818.98	\$ 661.80	\$ 3,280,556.45	\$ 3,276,426.45 (A)
Dining	2,963,156.59		346,333.01	361.48	2,616,462.10	2,616,462.10 (A)
Student Union and Cultural Services	24,341.13				24,341.13	
Health, Physical Education, and Recreation Services	180,282.44				180,282.44	
Bookstore	1,982,755.28			18.48	1,982,736.80	
Parking	374,001.23		32,595.17		341,406.06	247,291.82 (B)
Athletic	455,823.44				455,823.44	
Other	616,756.15	369,059.52			247,696.63	
Sales and Services of Education and Related Activities	754,944.10	410,253.74			344,690.36	
Total Sales and Services	<u>\$ 11,052,097.59</u>	<u>\$ 779,313.26</u>	<u>\$ 797,747.16</u>	<u>\$ 1,041.76</u>	<u>\$ 9,473,995.41</u>	<u>\$ 6,140,180.37</u>

Revenue Bonds Secured by Pledged Revenues:

(A) Dormitory and Dining Hall System Revenue Bonds

(B) Parking System Revenue Bonds

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 16,867,522.57	\$ 1,257,632.22	\$ 1,074,561.52	\$ 0.00	\$ 0.00	\$ 0.00	\$ 19,199,716.31
Research	349,479.09	104,458.42	101,907.19				555,844.70
Public Service	3,076,124.41	747,075.81	1,648,224.94		82,565.47		5,553,990.63
Academic Support	2,423,918.41	955,396.25	170,458.99				3,549,773.65
Student Services	2,134,297.99	168,795.45	810,778.03				3,113,871.47
Institutional Support	4,413,470.25	372,212.66	1,160,365.06		25.36		5,946,073.33
Operations and Maintenance of Plant	3,558,582.03	1,734,090.76	300,982.77		1,060,944.61		6,654,600.17
Student Financial Aid	24,670.30		3,532.44	2,060,046.01			2,088,248.75
Auxiliary Enterprises	3,706,091.84	3,509,789.13	4,192,242.57		799,701.19		12,207,824.73
Depreciation						5,209,133.79	5,209,133.79
Total Operating Expenses	<u>\$ 36,554,156.89</u>	<u>\$ 8,849,450.70</u>	<u>\$ 9,463,053.51</u>	<u>\$ 2,060,046.01</u>	<u>\$ 1,943,236.63</u>	<u>\$ 5,209,133.79</u>	<u>\$ 64,079,077.53</u>

NOTE 11 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2005, these rates were set at 2.17% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2005, the University had a total payroll of \$29,887,673.04, of which \$14,784,708.00 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$887,082.48 and \$320,828.16, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were \$320,828.16, \$29,825.44, and \$0.00, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.state.nc.us/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2005, 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, 2005, the University had a total payroll of \$29,887,673.04, of which \$11,846,065.35 was covered under the Optional Retirement Program. Total employee and employer contributions for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

pension benefits for the year were \$710,763.92 and \$810,270.87, 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 \$131,142.96 for the year ended June 30, 2005.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2005, were \$19,237.50. The voluntary contributions by employees amounted to \$252,053.00 for the year ended June 30, 2005.

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 \$316,453.92 for the year ended June 30, 2005.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2005, the University's total contribution to the Plan was \$852,184.75. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Long-Term Disability -** The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .445% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the year ended June 30, 2005, the University's total contribution to the DIPNC was \$118,506.94. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

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

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

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

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

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

A. Commitments - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$8,505,390.48 and on other purchases were \$1,883,658.22 at June 30, 2005.

B. Pending Litigation and Claims – The NC School Boards Association, et. al. filed a civil action against various State officials in their official capacity. The complaint sought a judicial determination as to whether the State Constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. In part, this civil action includes a determination of whether monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations are “civil penalties” which the State Constitution requires to be paid to the school fund in the county where they are collected. On July 1, 2005, the NC Supreme Court held in favor of the school boards. The matter has been remanded back to the trial court for disposition in accordance with the Superior Court’s decision. Determination of the amount due from the University is pending. At issue are approximately \$886,985 in parking fines since January 1995 to June 30, 2005, and \$100,000 annually.

The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

C. University Improvement General Obligation Bonds – The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of \$2.5 billion of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA), establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization of \$28,078,697.00 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

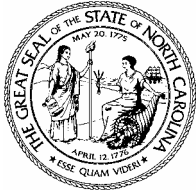
NOTE 15 - RELATED PARTIES

Foundations - There are two separately incorporated nonprofit foundations associated with the University. These foundations are the Center for Craft, Creativity and Design, Inc., and the North Carolina Arboretum Society, Inc.

The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these foundations. These organizations provided no support to the University for the year ended June 30, 2005.

NOTE 16 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2005, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*. This Statement establishes and modifies disclosure requirements related to investment risks: credit risk, interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.



STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
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
The University of North Carolina at Asheville
Asheville, North Carolina

We have audited the financial statements of The University of North Carolina at Asheville, a constituent institution of the 16-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, 2005, which collectively comprise the University's basic financial statements and have issued our report thereon dated March 22, 2006. We did not audit the financial statements of The University of North Carolina at Asheville Foundation Inc., which represent 100% of the University's discretely presented component units. These financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the report of the other auditors.

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to the discretely presented component unit.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

would not necessarily disclose all matters in the internal control 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 Governors, the Board of Trustees, management 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

March 22, 2006

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports 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

Telephone: 919/807-7500

Facsimile: 919/807-7647