



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

THE UNIVERSITY OF NORTH CAROLINA AT WILMINGTON

WILMINGTON, 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 WILMINGTON
WILMINGTON, NORTH CAROLINA
FOR THE YEAR ENDED JUNE 30, 2005

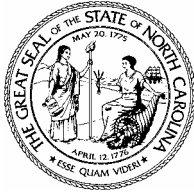
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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of The University of North Carolina at Wilmington 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 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.

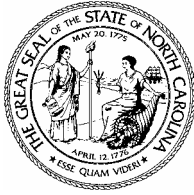
Leslie W. Merritt, Jr.

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

March 13, 2006

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Office of the State Auditor

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of The University of North Carolina at Wilmington, 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 Wilmington'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 Donald R. Watson Foundation, Inc., which represent less than one percent of the assets, net assets and revenues of the University; or the financial statements of The UNCW Corporation, Inc., which represent 100% of the University's discretely presented component unit. 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 Donald R. Watson Foundation, Inc., and The UNCW Corporation, 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 reports of other auditors provides a reasonable basis for our opinion.

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

The University of North Carolina at Wilmington 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.

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 January 13, 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

January 13, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Analysis

The University of North Carolina at Wilmington provides the following Management's Discussion and Analysis (MD&A) as an overview of the financial activities for the fiscal year ending June 30, 2005. The preceding transmittal letter and the following financial statements and notes to the financial statements comprise our complete set of financial information. The MD&A identifies significant transactions that have financial impact and highlights favorable and unfavorable trends. Comparative data for the previous year is presented to help better understand the financial information.

Using the Financial Statements

The University's financial report includes three basic comprehensive financial statements that depict the financial activity and fiscal condition of the University for the current year: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. These financial statements are prepared in accordance with Government Accounting Standards Board (GASB) principles. During 2002, the University adopted GASB Statement No. 35, *Basic Financial Statements - Management's Discussion and Analysis - for Public Colleges and Universities*, as amended by GASB Statements No. 37 and No. 38. These GASB statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis to focus on the University as a whole, with resources classified for accounting and reporting purposes in four net asset categories. Previous financial reporting requirements focused on the accountability of individual fund groups rather than on the University as a single unified entity. Our current statements present financial information in a form similar to that used by corporations. The accrual basis of accounting has been used to prepare the statements. This method of accounting requires that revenues and assets are recognized when the service is provided. Expenses and liabilities are recognized when others provide services, regardless of when cash is exchanged.

The Statement of Net Assets includes all University assets and liabilities. The University's net assets (the monetary difference between total assets and total liabilities) are one indicator of the University's financial viability. Over time, changes in net assets provide information on the improvement or erosion of the University's financial condition when considered with non-financial facts such as enrollment levels and the condition of facilities.

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the fiscal year. Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 classifies State appropriations and gifts as nonoperating revenues. With State appropriations and gifts being classified as nonoperating revenues, most public institutions will report an operating deficit. In the past, State appropriations and gifts were included as normal operating revenues, and contributed to operation expenditures, which generally resulted in a net positive number for operating income.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Another important factor to consider when evaluating the financial viability of the University is the ability to meet financial obligations as they mature. The Statement of Cash Flows presents information that allows the reader to evaluate the University's ability to meet its financial obligations on a current basis.

Financial Highlights

The State's continuing revenue shortfall caused the University to lose \$1.7 million in permanent and one-time funds. Of this the University endured permanent reductions of \$858,000, a \$373,000 one-time reduction to building reserve operations, and \$473,000 in one-time funds transferred to the Hurricane Relief account. The continuing reductions resulted in a decrease to the regular term instruction budget of \$300,000, including reductions to student computer labs, classroom technology, faculty professional development, and partnership teaching initiatives.

On a positive note, the University received \$2.0 million in recurring funds in support of the Marine Biotechnology program, \$876,700 in repair and renovation funding, and \$500,000 for planning and design of a facility for the University's School of Nursing.

Capital projects continued to move ahead. The University expended \$18.0 million in State bond referendum capital funds. This capital funding is part of the bonds that were approved in 2000. The University is earmarked to receive a total of \$109.2 million for capital projects under the statewide bond program. Funds received this year were used to complete construction on a new building for the Watson School of Education, the addition to Hoggard Hall (information technology), the renovation to Westside Hall (student health), and the completion of the Infrastructure Expansion Projects. Funds were also used to pay for initial design costs related to the Academic Classroom and General Classroom Buildings. The pace of construction on campus continues to grow.

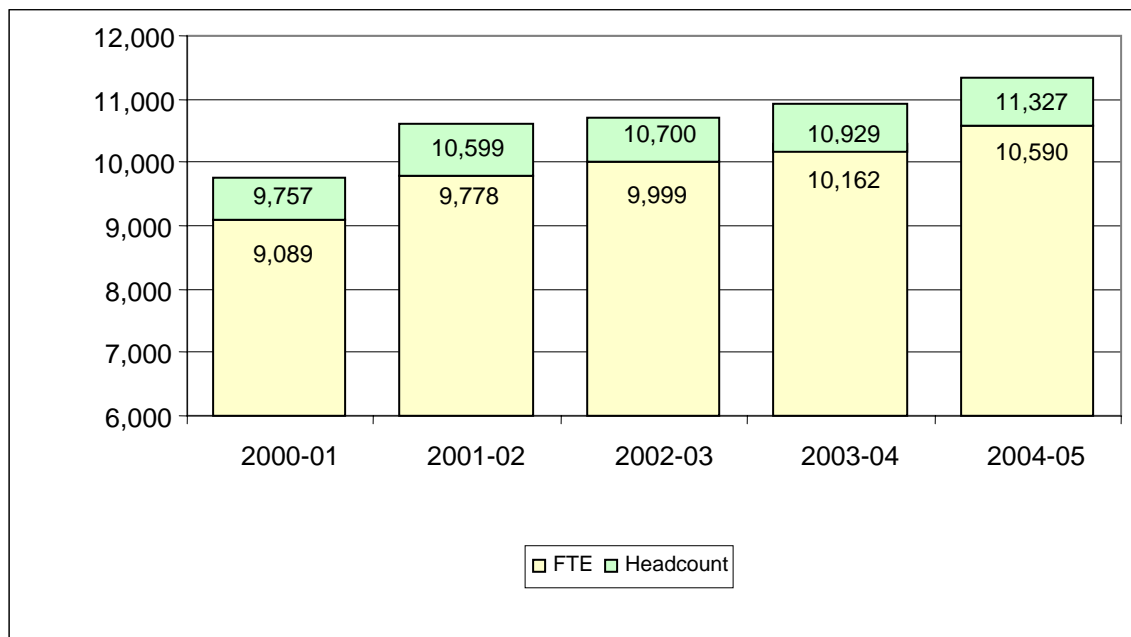
Bonds payable had a refunding of the Recreation Bonds and a series of the Dorm and Dining Hall bonds which were replaced by the issuance of Series 2005A general revenue bonds. This refunding will reduce future interest cost for the University.

The University's endowment received gifts of \$1.4 million last fiscal year. The total return for the same period was 13.6%. The endowment closed the year with a record market value of \$33.5 million.

The University is still experiencing strong enrollment growth as illustrated by the graph below, depicting enrollment growth over the last five years. In the fall of 2004, the headcount was 11,327 and the full time equivalence of 10,590.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Fall Enrollment



Statement of Net Assets

The Statement of Net Assets presents the assets (current and noncurrent), liabilities (current and noncurrent), and net assets (total assets minus total liabilities) of the University. This statement provides a fiscal snapshot of the University's financial position as of June 30, 2005. The data provides readers of this statement information on assets available to continue operations; pay amounts due vendors, investors, and lending institutions; and the net assets available for expenditure by the University.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statements of Net Assets June 30, as Indicated

	2005	2004	Change	% Change
Assets				
Current Assets	\$ 50,328,312	\$ 48,895,617	\$ 1,432,695	2.9%
Noncurrent Assets	274,170,033	240,139,966	34,030,067	14.2%
Total assets	<u>\$ 324,498,345</u>	<u>\$ 289,035,583</u>	<u>\$ 35,462,762</u>	12.3%
Liabilities				
Current Liabilities	\$ 17,512,647	\$ 15,271,175	\$ 2,241,472	14.7%
Noncurrent Liabilities	77,557,940	81,091,595	(3,533,655)	-4.4%
Total Liabilities	<u>\$ 95,070,587</u>	<u>\$ 96,362,770</u>	<u>\$ (1,292,183)</u>	-1.3%
*Net Assets				
Invested in Capital Assets	\$ 148,468,713	\$ 124,446,818	\$ 24,021,895	19.3%
Restricted Nonexpendable	26,948,561	22,845,233	4,103,328	18.0%
Restricted Expendable	27,652,187	23,017,848	4,634,339	20.1%
Unrestricted	26,358,297	22,362,914	3,995,383	17.9%
Total Net Assets	<u>\$ 229,427,758</u>	<u>\$ 192,672,813</u>	<u>\$ 36,754,945</u>	19.1%

* Net asset categories are defined in Note 1, Subsection L of the notes to the financial statements

On June 30, 2005, total University assets were \$324.5 million. The largest asset categories include the University's investment in capital assets (\$191.2 million), cash and cash equivalents (\$75.3 million), and the endowment investments (\$30.9 million).

University liabilities totaled \$95.1 million on June 30, 2005. Long-term debt of \$67.5 million, consisting of bonds payable, notes payable, and capitalized lease obligations, is the largest liability category. Total liabilities decreased \$1.3 million from June 30, 2004, primarily due to the payment of bond principal.

Statement of Revenues, Expenses, and Changes in Net Assets

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

Operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are used to acquire or produce the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided; i.e., State appropriations and investment income. Nonoperating expenses include interest expense, extraordinary items, and accounting changes/corrections, i.e., expenses not involved in the normal operations of the University.

Condensed Statements of Revenues, Expenses, and Changes in Net Assets For Year Ended June 30, as Indicated

	2005	2004	Change	% Change
Operating Revenue				
Tuition and Fees (Net)	\$ 53,331,801	\$ 46,666,124	\$ 6,665,677	14.3%
Sales and Service (Net)	23,268,560	21,091,762	2,176,798	10.3%
Grants and Contracts	24,109,262	20,907,343	3,201,919	15.3%
Other	2,455,530	2,446,672	8,858	0.4%
Total Operating Revenue	<u>103,165,153</u>	<u>91,111,901</u>	<u>12,053,252</u>	13.2%
Operating Expenses				
Salaries and Benefits	99,802,644	94,957,908	4,844,736	5.1%
Supplies and Materials	13,712,245	3,376,723	10,335,522	306.1%
Services	32,134,511	37,465,672	(5,331,161)	-14.2%
Scholarships	6,807,419	5,598,657	1,208,762	21.6%
Utilities	5,572,359	5,157,856	414,503	8.0%
Depreciation	5,817,035	5,315,764	501,271	9.4%
Total Operating Expense	<u>163,846,213</u>	<u>151,872,580</u>	<u>11,973,633</u>	7.9%
Operating Loss	<u>(60,681,060)</u>	<u>(60,760,679)</u>	<u>79,619</u>	-0.1%
Nonoperating Revenues				
State Appropriations	64,581,662	57,941,784	6,639,878	11.5%
Capital Gifts and Grants	26,005,129	18,431,104	7,574,025	41.1%
Noncapital Gifts and Grants	4,784,915	5,554,002	(769,087)	-13.8%
Other	2,064,299	3,546,539	(1,482,240)	-41.8%
Total Nonoperating Revenues	<u>97,436,005</u>	<u>85,473,429</u>	<u>11,962,576</u>	14.0%
Increase in Net Assets	<u>36,754,945</u>	<u>24,712,750</u>	<u>12,042,195</u>	48.7%
Net Assets - Beginning of year	<u>192,672,813</u>	<u>167,960,063</u>	<u>24,712,750</u>	14.7%
Net Assets - End of Year	<u>\$ 229,427,758</u>	<u>\$ 192,672,813</u>	<u>\$ 36,754,945</u>	19.1%

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Student tuition and fees (\$53.3 million) and sales and services from auxiliary enterprises (\$23.3 million) account for 74% of the University's operating revenue. Per GASB Statement No. 35, State appropriations must be reported as nonoperating revenue even though this revenue source covers operating expenses. The University's financial statements will show an operating loss in future years because of this required change in reporting revenue sources.

The major operating expense categories include salary and benefit payments to faculty and staff (\$99.8 million) and payments to vendors and suppliers for goods and services (\$45.8 million).

Statement of Cash Flows

The Statement of Cash Flows provides information about cash receipts and cash payments during the year. The Statement of Cash Flows also helps users assess the University's:

- Ability to generate future net cash flows;
- Ability to meet its obligations as they come due, and;
- Need for external financing.

Condensed Statements of Cash Flows For Year Ended June 30, as Indicated

	2005	2004	Change	% Change
Cash Provided (Used) by:				
Operating Activities	\$ (56,034,615)	\$ (52,539,729)	\$ (3,494,886)	7%
Noncapital Financing Activities	69,966,654	62,272,937	7,693,717	12%
Capital Financing Activities	(16,361,115)	(14,824,840)	(1,536,275)	10%
Investing Activities	725,559	4,179,133	(3,453,574)	-83%
Net Change in Cash	<u>(1,703,517)</u>	<u>(912,499)</u>	<u>(791,018)</u>	87%
Cash, Beginning of Year	<u>77,044,852</u>	<u>77,957,351</u>	<u>(912,499)</u>	-1%
Cash, Ending of Year	<u>\$ 75,341,335</u>	<u>\$ 77,044,852</u>	<u>\$ (1,703,517)</u>	-2%

Major sources of funds included in operating activities are student tuition and fees (\$53.3 million), auxiliary enterprises (\$23.3 million), and grants and contracts (\$24.1 million).

Major uses of funds in operating activities are compensation to employees (\$99.8 million) and payments to suppliers for goods and services (\$45.8 million).

The largest inflow of cash in the non-capital financing activities is the State of North Carolina appropriation of \$64.6 million. The new accounting standards require the University to reflect this source of revenue as nonoperating even though the University's budget depends on these funds to continue the current level of operations. Other noncapital financing activity includes gifts received (\$2.9 million).

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Cash provided by capital financing activities during fiscal year 2005 includes proceeds for a bond issue of \$13.2 million. The bond was a refunding bond used to retire older, more expensive bonds. Cash used in capital financing activities during fiscal year 2005 was primarily for the acquisition of capital assets (\$29.8 million) and the repayment of debt (\$16.2 million).

Capital Asset and Debt Administration

Capital Assets

The University had \$191.2 million invested in capital assets at year end.

Capital Assets June 30, as Indicated (Net of Depreciation)

	2005	2004	Variance
Land	\$ 4,990,910	\$ 4,574,910	\$ 416,000
Art, Literature and Artifacts	1,099,628	1,010,132	89,496
Construction in Progress	25,800,182	29,270,157	(3,469,975)
Building	137,347,785	111,276,226	26,071,559
Machinery and Equipment	8,905,122	7,568,525	1,336,597
Infrastructure	13,080,608	11,093,817	1,986,791
Total Capital Assets	\$ 191,224,235	\$ 164,793,767	\$ 26,430,468

Capital project scheduled for completion in 2005-2006 is the student apartments. We are also constructing an addition to the Union and a new cultural arts building both scheduled for completion in 2006-2007.

More detailed information on the University's capital assets is presented in Note 5 to the financial statements.

Debt

The University has \$67.5 million in outstanding bonds, notes and capital leases on June 30, 2005, of which \$67.3 million is for outstanding bonds. New bond debt includes the issuance of bonds of \$12.6 million for the partial defeasance of bond Series J Dorm and Dining Hall and complete defeasance of the Recreation bonds. This refunding will result in a reduction of interest expense for the University due to the lower interest rates on the newly issued bonds. There have been no other significant changes in credit ratings or debt limitations that would affect future financing for the University.

More detailed information on the University's long-term obligations is presented in Note 7 to the financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Economic Forecast

Despite reductions to State appropriations support, management believes that the University is well positioned to continue its strong financial condition and level of excellence in service to students, the community, and other constituencies. The University's strong financial position should provide a high degree of flexibility in obtaining debt funds on competitive terms. This flexibility, along with the University's ongoing efforts toward revenue diversification and cost containment, will enable the University to provide the necessary resources to support a continued level of excellence well into the future.

A crucial element to the University's future will continue to be our relationship with the State of North Carolina and its ability to fund higher education. There is a direct relationship between the growth of State support and the University's ability to control increases in tuition rates. Decreased State support generally results in increased tuition levels.

The University will continue to execute its long-range plan to modernize and expand teaching and research facilities to address the issues of growth and the continuing effects of technology on teaching and research methodologies.

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

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

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

Contacting the University's financial management

This financial report is designed to provide our students, citizens, investors and creditors with a general overview of the University's finances and demonstrate accountability of all funds received. Questions or additional financial information may be obtained by contacting University Financial Services at 910-962-3144.

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

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 37,341,544.10
Restricted Cash and Cash Equivalents	7,084,658.38
Receivables, Net (Note 4)	4,579,974.98
Inventories	312,536.86
Notes Receivable, Net (Note 4)	1,009,597.80

Total Current Assets	50,328,312.12
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Noncurrent Assets:

Restricted Cash and Cash Equivalents	30,915,133.04
Receivables, Net (Note 4)	389,018.43
Restricted Due from Primary Government	9,829,313.46
Endowment Investments	30,871,977.23
Other Long-Term Investments	7,053,940.33
Notes Receivable, Net (Note 4)	3,886,415.37
Capital Assets - Nondepreciable (Note 5)	31,890,719.35
Capital Assets - Depreciable, Net (Note 5)	159,333,515.33

Total Noncurrent Assets	274,170,032.54
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Total Assets	324,498,344.66
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	8,756,105.89
Due to Primary Government	22,571.74
Deferred Revenue	4,585,696.61
Long-Term Liabilities - Current Portion (Note 7)	4,148,272.76

Total Current Liabilities	17,512,647.00
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Noncurrent Liabilities:

Funds Held for Others	3,935,072.98
U. S. Government Grants Refundable	4,445,028.70
Long-Term Liabilities (Note 7)	69,177,838.38

Total Noncurrent Liabilities	77,557,940.06
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Total Liabilities	95,070,587.06
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University of North Carolina at Wilmington
Statement of Net Assets
June 30, 2005

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	148,468,712.58
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	13,711,175.60
Research	978,230.12
Endowed Professorships	5,771,388.29
Departmental Uses	5,393,582.14
Loans	1,094,184.50
Expendable:	
Scholarships and Fellowships	3,089,596.46
Research	2,105,333.35
Endowed Professorships	331,670.52
Departmental Uses	6,400,263.78
Loans	231,839.59
Capital Projects	9,371,027.90
Debt Service	6,122,455.45
Unrestricted	<u>26,358,297.32</u>
Total Net Assets	<u><u>\$ 229,427,757.60</u></u>

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

***University of North Carolina at Wilmington
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)	\$ 53,331,801.06
Federal Grants and Contracts	20,166,335.81
State and Local Grants and Contracts	2,409,695.49
Nongovernmental Grants and Contracts	1,533,231.02
Sales and Services, Net (Note 9)	23,268,560.34
Other Operating Revenues	2,455,529.32
Total Operating Revenues	<u>103,165,153.04</u>

EXPENSES

Operating Expenses:

Salaries and Benefits	99,802,644.57
Supplies and Materials	13,712,244.91
Services	32,134,510.76
Scholarships and Fellowships	6,807,418.77
Utilities	5,572,358.67
Depreciation	5,817,036.02
Total Operating Expenses	<u>163,846,213.70</u>

Operating Loss	<u>(60,681,060.66)</u>
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	64,581,662.30
Noncapital Grants	524,828.57
Noncapital Gifts, Net (Note 9)	2,809,651.42
Investment Income (Net of Investment Expense of \$60,330)	5,398,895.93
Interest and Fees on Capital Asset-Related Debt	(2,914,350.35)
Other Nonoperating Expenses	(420,246.81)
Net Nonoperating Revenues	<u>69,980,441.06</u>

Income Before Other Revenues	9,299,380.40
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Capital Appropriations	1,376,700.00
Capital Grants	24,203,117.00
Capital Gifts	425,312.00
Additions to Endowments	1,450,434.86
Increase in Net Assets	<u>36,754,944.26</u>

NET ASSETS

Net Assets - July 1, 2004	<u>192,672,813.34</u>
Net Assets - June 30, 2005	<u>\$ 229,427,757.60</u>

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

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

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 97,339,245.53
Payments to Employees and Fringe Benefits	(100,034,679.76)
Payments to Vendors and Suppliers	(48,944,963.47)
Payments for Scholarships and Fellowships	(6,807,418.77)
Loans Issued	(1,148,557.00)
Collection of Loans	1,111,132.00
Interest Earned on Loans	12,525.01
Other Receipts	2,438,101.59
	<hr/>
Net Cash Used by Operating Activities	(56,034,614.87)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	64,581,662.30
Noncapital Grants	533,335.15
Noncapital Gifts	2,959,192.30
Additions to Permanent and Term Endowments	1,450,434.86
Related Activity Agency Receipts	442,029.94
	<hr/>
Cash Provided by Noncapital Financing Activities	69,966,654.55

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	13,167,752.37
State Capital Appropriations	1,376,700.00
Capital Grants	18,961,257.46
Capital Gifts	9,312.00
Acquisition and Construction of Capital Assets	(29,812,366.20)
Principal Paid on Capital Debt and Leases	(4,843,274.63)
Interest and Fees Paid on Capital Debt and Leases	(3,154,536.16)
Payment to Bond Escrow Agent	(12,080,000.00)
Other Receipts	14,039.70
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(16,361,115.46)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	25,731,334.13
Investment Income	3,783,518.30
Purchase of Investments and Related Fees	(28,789,293.34)
	<hr/>
Net Cash Provided by Investing Activities	725,559.09

Net Decrease in Cash and Cash Equivalents	(1,703,516.69)
Cash and Cash Equivalents - July 1, 2004	77,044,852.21
	<hr/>
Cash and Cash Equivalents - June 30, 2005	\$ 75,341,335.52

University of North Carolina at Wilmington
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	\$	(60,681,060.66)
Adjustments to Reconcile Operating Loss to Net Cash Provided by Operating Activities:		
Depreciation Expense		5,817,036.02
Allowances, Write-Offs, and Amortizations		135,810.16
Changes in Assets and Liabilities:		
Receivables, (Net)		(964,621.79)
Inventories		99,275.95
Accounts Payable and Accrued Liabilities		83,076.80
Due to Primary Government		(11,382.49)
Deferred Revenue		(239,366.86)
Compensated Absences		(235,957.00)
Note Principle Repayments		1,111,132.00
Notes Issued		(1,148,557.00)
Net Cash Used by Operating Activities	\$	<u>(56,034,614.87)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	\$	37,341,544.10
Restricted Cash and Cash Equivalents		7,084,658.38
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		<u>30,915,133.04</u>
Total Cash and Cash Equivalents - June 30, 2005	\$	<u>75,341,335.52</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$	416,000.00
Change in Fair Value of Investments		2,921,335.29
Loss on Disposal of Capital Assets		(428,753.39)

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

UNCW Corporation, Inc.
Statement of Net Assets
June 30, 2005

Exhibit B-1

ASSETS

Investments	\$ 27,051,592.00
Capital Assets - Construction in Progress	1,765,561.00
Debt Issuance Cost	<u>567,010.00</u>
Total Assets	<u>29,384,163.00</u>

LIABILITIES

Liabilities - Construction - Payable from Restricted Investments	37,537.00
Certificates of Participation Payable	<u>29,340,913.00</u>
Total Liabilities	<u>29,378,450.00</u>

NET ASSETS

Restricted Net Assets - Expendable	<u>5,713.00</u>
Total Net Assets	<u>\$ 5,713.00</u>

See Note 1 in the Notes to the Financial Statements

UNCW Corporation, Inc.
Statement of Revenues, Expenses, and
Changes in Net Assets

For the Period Ending March 10, 2005, Through June 30, 2005

Exhibit B-2

NONOPERATING REVENUES

Revenue from Investment, Net of \$91,645 Offset to Construction

Period Interest Expense

\$ 5,713.00

Change in Net Assets

5,713.00

Net Assets:

Beginning

Ending

\$ 5,713.00

See Note 1 in the Notes to the Financial Statements

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THE UNIVERSITY OF NORTH CAROLINA AT WILMINGTON
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 Wilmington 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 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 were part of the University. The discretely presented component unit's financial data is reported in separate financial statements to emphasize its legal separateness.

Blended Component Unit - Although legally separate, the Donald R. Watson Foundation, Inc. (Foundation), is a component unit of the University and is reported as if it were part of the University.

The Foundation is governed by a five-member board of which three are appointed by the Board of Trustees of the University of North Carolina at Wilmington. The Foundation's purpose is to aid, support and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because the elected directors of the Foundation are appointed by the members of The University of North Carolina at Wilmington Board of Trustees and the Foundation's sole purpose is to operate exclusively to solicit and receive contributions and to distribute income and principal

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and to carry out the purposes of selected organizations including the University, its financial statements have been blended with those of the University.

Separate financial statements for the Foundation may be obtained from the Financial Service's Office, 601 South College Road, or by calling 910-962-3244. 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 UNCW Corporation, Inc. (Corporation), is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. The Corporation was organized as a nonprofit corporation on November 14, 2002, to enhance the University of North Carolina at Wilmington's educational mission, including, without limitation, overseeing and assisting with the acquisition and financing of capital assets for the University.

Separate financial statements for the Corporation may be obtained from the University Financial Services Office, 601 South College Road, Wilmington, NC 28403 or by calling (910) 962-3144.

- 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 undeposited receipts, petty cash, cash on deposit with private bank accounts, savings 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 long-term fixed income investments, repurchase agreements, equity investments, mutual funds, money market funds, certificates of deposit, limited partnerships, real estate, and other asset holdings by the University. Except for money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

F. Receivables - Receivables consist of tuition and fees charged 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

G. Inventories - Inventories, consisting of expendable supplies, are valued at cost using the lower of cost or market value using the first-in, first-out method. Merchandise for resale is valued using the retail inventory 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 50 years for general infrastructure, 30 years for buildings, and 3 to 10 years for equipment.

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

I. Restricted Assets - Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

J. Noncurrent Long-Term Liabilities - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, and compensated absences that will not be paid within the next fiscal year.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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 yearend 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 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, garage and lease operations, postal services and telecommunications. In addition, the University has other miscellaneous sales and service unit that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service unit 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 unit 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 \$73,932,945.00. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, including certificates of deposit, was \$1,504,454.00 and the bank balance was \$1,599,399.16. 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 exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	<u>\$ 1,399,399.16</u>
--------------------------------	------------------------

- 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 and funds received for services rendered by health care professionals 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 and the Foundation 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 unitized method. Under this method, each participating fund's investment balance is determined on the basis of the number of units purchased multiplied times 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 by type and investments subject to interest rate risk at June 30, 2005, for the Long-Term Investment Pool. 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)		
		Less Than 1	1 to 5	6 to 10
Debt Securities:				
U.S. Treasuries	\$ 1,245,352.34	\$ 1,100,000.00	\$ 103,821.00	\$ 41,531.34
Repurchase Agreements	671,930.00		671,930.00	
Mutual Bond Funds	233,699.77		233,699.77	
Domestic Corporate Bonds	10,638.40		10,638.40	
Total Debt Securities	2,161,620.51	<u>\$ 1,100,000.00</u>	<u>\$ 1,020,089.17</u>	<u>\$ 41,531.34</u>
Other Securities:				
Certificates of Deposit	117,308.93			
Money Market Funds	2,776,195.48			
UNC Investment Fund	18,909,604.59			
Other Mutual Funds	12,632,509.13			
Investments in Real Estate	765.53			
Domestic Stocks	1,270,941.46			
Other (Life Insurance)	17,929.67			
Total Long-Term Investment Pool	<u>\$ 37,886,875.30</u>			

Certificates of deposit reported as investments are also a component of the deposit totals reported in the deposits section of this note.

In addition to the interest rate risk disclosed above, the Long-Term Investment Pool portfolio includes investments with fair values highly sensitive to interest rate changes.

Credit Risk: The University's Endowment Board has an asset allocation of 30% for fixed income investments. This helps to limit the amount of credit risk in the endowment. Additionally, all fixed income investments are reviewed for credit risk. As of June 30, 2005, the investments in the Long-Term Investment Pool were rated as follows:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB Ba
Mutual Bond Funds	\$ 233,699.77	\$ 118,018.38	\$ 32,250.57	\$ 47,908.45	\$ 35,288.67	\$ 233.70
Domestic Corporate Bonds	10,638.40			10,638.40		

Rating Agency: Standard and Poor

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. The University's investments in the Long-Term Investment Pool were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty
US Treasuries	\$ 1,245,352.34
Repurchase Agreements	671,930.00
Domestic Corporate Bonds	10,638.40
Domestic Stocks	1,270,941.46
Total	<u>\$ 3,198,862.20</u>

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's investment policy permits it to invest up to 15.3% in various foreign currencies. The Long-Term Investment Pool's current position is 13.9%. The Long-Term Investment Pool's exposure to foreign currency risk is as follows:

Investment	Currency	Fair Value (U.S. Dollars)
Vanguard Developed Markets Index Fund	Various	\$ 1,227,802.68
Vanguard Emerging Markets Index Fund	Various	653,959.08
Total		<u>\$ 1,881,761.76</u>

Non-Pooled Investments - The University has investments in domestic stocks with a fair value of \$39,042.16 subject to interest rate risk at June 30, 2005. 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 does not have a formal investment policy that addresses interest rate risk.

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). When administering its power to spend net appreciation, the Board of Trustees is required to consider the University's long and short term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation that is spent is required to be spent for the purposes for which the endowment was established. The Board of Trustees chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the policy established by the Board, 4.5% of the average market value of endowment investments at the end of the previous three years has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending policy exceeds the investment income. At June 30, 2005, net appreciation of \$9,659,059.00 was available to be spent, of which \$7,341,345.00 was restricted to specific purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2005, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 498,759.52	\$ 49,873.42	\$ 448,886.10
Accounts	1,561,088.87		1,561,088.87
Intergovernmental	2,211,566.36		2,211,566.36
Pledges	44,435.24		44,435.24
Interest on Loans	253,730.76		253,730.76
Other	62,489.41	2,221.76	60,267.65
Total Current Receivables	<u>\$ 4,632,070.16</u>	<u>\$ 52,095.18</u>	<u>\$ 4,579,974.98</u>
Noncurrent Receivables:			
Pledges	\$ 3,513.63	\$ 175.68	\$ 3,337.95
Deferred Charges	385,680.48		385,680.48
Total Noncurrent Receivables	<u>\$ 389,194.11</u>	<u>\$ 175.68</u>	<u>\$ 389,018.43</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 1,004,088.03	\$ 100,333.22	\$ 903,754.81
Institutional Student Loan Programs	102,033.19		102,033.19
Other	3,809.80		3,809.80
Total Notes Receivable - Current	<u>\$ 1,109,931.02</u>	<u>\$ 100,333.22</u>	<u>\$ 1,009,597.80</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 4,278,216.48	\$ 427,821.65	\$ 3,850,394.83
Institutional Student Loan Programs	36,020.54		36,020.54
Total Notes Receivable - Noncurrent	<u>\$ 4,314,237.02</u>	<u>\$ 427,821.65</u>	<u>\$ 3,886,415.37</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	\$ 4,574,910.23	\$ 0.00	\$ 416,000.00	\$ 0.00	\$ 4,990,910.23
Art, Literature, and Artifacts	1,010,131.80		89,495.78		1,099,627.58
Construction in Progress	29,270,156.61	(31,951,936.93)	28,636,961.86	155,000.00	25,800,181.54
Total Capital Assets, Nondepreciable	34,855,198.64	(31,951,936.93)	29,142,457.64	155,000.00	31,890,719.35
Capital Assets, Depreciable:					
Buildings	159,946,744.10	29,611,756.60			189,558,500.60
Machinery and Equipment	22,115,851.81		3,702,838.50	1,412,687.22	24,406,003.09
General Infrastructure	18,253,783.16	2,340,180.43			20,593,963.59
Total Capital Assets, Depreciable	200,316,379.07	31,951,937.03	3,702,838.50	1,412,687.22	234,558,467.28
Less Accumulated Depreciation/Amortization for:					
Buildings	48,670,518.43		3,540,196.67		52,210,715.10
Machinery and Equipment	14,547,326.28		1,923,449.93	969,895.10	15,500,881.11
General Infrastructure	7,159,966.32		353,389.42		7,513,355.74
Total Accumulated Depreciation	70,377,811.03		5,817,036.02	969,895.10	75,224,951.95
Total Capital Assets, Depreciable, Net	129,938,568.04		(2,114,197.52)	442,792.12	159,333,515.33
Capital Assets, Net	\$ 164,793,766.68	\$ 0.00	\$ 27,028,260.12	\$ 597,792.12	\$ 191,224,234.68

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 7,026,880.97
Interest Payable	1,245,579.13
Accrued Payroll	479,062.09
Other	4,583.70
Total Accounts Payable and Accrued Liabilities	\$ 8,756,105.89

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	\$ 70,065,000.00	\$ 12,630,000.00	\$ (16,040,000.00)	\$ 66,655,000.00	\$ 3,840,000.00
Add/Deduct Premium/Discount	868,105.18	537,752.37	(57,051.75)	1,348,805.80	
Deduct Deferred Charge on Refunding		(723,881.58)	48,258.77	(675,622.81)	
Total Bonds Payable	70,933,105.18	12,443,870.79	(16,048,792.98)	67,328,182.99	3,840,000.00
Notes Payable	124,473.67		(45,263.16)	79,210.51	45,263.16
Capital Leases Payable	180,873.51		(105,336.91)	75,536.60	75,536.60
Other Payables	106,933.37		(26,733.33)	80,200.04	
Compensated Absences	5,998,938.00	622,854.00	(858,811.00)	5,762,981.00	187,473.00
Total Long-Term Liabilities	\$ 77,344,323.73	\$ 13,066,724.79	\$ (17,084,937.38)	\$ 73,326,111.14	\$ 4,148,272.76

Additional information regarding capital lease obligations is included in Note 8

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
Dorm and Dining Hall						
Construction Dorm	B	7.5-8.0	01/31/2009	\$ 1,400,000.00	\$ 985,000.00	\$ 415,000.00
Construction Honors Dorm	J	4.7-5.4	01/31/2018	6,440,000.00	5,890,000.00	550,000.00
Total DDH Bonds				7,840,000.00	6,875,000.00	965,000.00
Physical Education						
Construct Trask Coliseum	B	5.1-5.5	01/31/2010	1,140,000.00	680,000.00	460,000.00
Union Revenue System						
Union Refund 1990	1997	4.8-5.0	01/31/2011	4,300,000.00	1,780,000.00	2,520,000.00
Recreation Revenue						
Construct Recreation Facility	1998	4.5-4.75	04/30/2005	10,300,000.00	10,300,000.00	
General Revenue						
Construct Dorm	2002A	3.0-5.0	01/31/2023	11,500,000.00	790,000.00	10,710,000.00
Westside Hall, Parking, Apartments	2002B	4.0-5.0	04/30/2022	6,735,000.00	625,000.00	6,110,000.00
Union Construction	2003A	2.5-5.25	01/31/2028	30,000,000.00	780,000.00	29,220,000.00
Refund DDH Series I	2003B	2.0-5.0	04/30/2009	5,100,000.00	1,060,000.00	4,040,000.00
Refund DDH J & Recreation	2005A	4.0-5.2	04/30/2019	12,630,000.00		12,630,000.00
Total General Revenue Bonds				65,965,000.00	3,255,000.00	62,710,000.00
Total Bonds Payable (principal only)				89,545,000.00	22,890,000.00	66,655,000.00
Plus: Unamortized Bond Premium						673,182.99
Total Bonds Payable				\$ 89,545,000.00	\$ 22,890,000.00	\$ 67,328,182.99

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Annual Requirements			
	Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2006	\$ 3,840,000.00	\$ 2,989,540.01	\$ 45,263.16	\$ 3,254.99
2007	4,050,000.00	2,880,910.01	33,947.35	887.72
2008	3,935,000.00	2,740,307.51		
2009	3,970,000.00	2,605,332.52		
2010	3,120,000.00	2,429,332.51		
2011-2015	14,910,000.00	10,227,743.78		
2016-2020	15,800,000.00	6,404,668.75		
2021-2025	11,250,000.00	2,804,612.51		
2026-2030	5,780,000.00	545,287.52		
Total Requirements	<u>\$ 66,655,000.00</u>	<u>\$ 33,627,735.12</u>	<u>\$ 79,210.51</u>	<u>\$ 4,142.71</u>

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

On April 14, 2005, the University issued \$12,630,000.00 in General Revenue Bond Series 2005A with an average interest rate of 4.6%. The refunding component of this bond issue was used to advance refund (defease) \$12,395,000 of outstanding Dormitory and Dining Hall Series J and the Recreation Revenue Bonds 1998, with a combined average interest rate of 4.9%. Net proceeds of \$13,118,881.58 resulted from the bond sale and were used to purchase Government Securities. The purchased 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 \$240,622.50 over the next 14 years and obtained an economic gain of \$320,224.56. At June 30, 2005, the outstanding balance of the defeased Dormitory and Dining Hall Series J and the Recreation Facility bonds was \$550,000 and \$0, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

E. Notes Payable - The University was indebted for notes payable for the purposes shown in the following table:

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2005	Principal Outstanding June 30, 2005
Parking Lot Construction	BB&T	5.23	02/01/2007	<u>\$ 430,000.00</u>	<u>\$ 350,789.49</u>	<u>\$ 79,210.51</u>

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to athletic field lighting equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2005:

<u>Fiscal Year</u>	<u>Amount</u>
2006	\$ 77,996.95
Total Minimum Lease Payments	<u>77,996.95</u>
Amount Representing Interest (8.72% Rate of Interest)	<u>2,460.35</u>
Present Value of Future Lease Payments	<u>\$ 75,536.60</u>

Machinery and equipment acquired under capital lease amounted to \$125,260.00 at June 30, 2005.

B. Operating Lease Obligations - The University entered into operating leases for office space. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2005:

<u>Fiscal Year</u>	<u>Amount</u>
2006	\$ 333,478.85
2007	<u>100,101.73</u>
Total Minimum Lease Payments	<u>\$ 433,580.58</u>

Rental expense for all operating leases during the year was \$501,406.00.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	<u>\$ 56,552,135.67</u>	<u>\$ 0.00</u>	<u>\$ 3,219,728.82</u>	<u>\$ 605.79</u>	<u>\$ 53,331,801.06</u>	<u>\$ 0.00</u>
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 9,310,754.90	\$ 0.00	\$ 684,323.82	\$ 5,584.46	\$ 8,620,846.62	\$ 8,620,846.62 (A)
Dining	8,254,407.41		519,548.23	5,272.56	7,729,586.62	7,729,586.62 (A)
Parking	1,537,787.70			328.24	1,537,459.46	
Health, Physical Education, and Recreation Services	1,105,669.14		348,808.32	3,752.03	753,108.79	753,108.79 (B)
Other	7,788,775.81	4,575,256.33	672,239.84	8,774.60	2,532,505.04	
Sales and Services of Education and Related Activities	<u>2,095,053.81</u>				<u>2,095,053.81</u>	
Total Sales and Services	<u>\$ 30,092,448.77</u>	<u>\$ 4,575,256.33</u>	<u>\$ 2,224,920.21</u>	<u>\$ 23,711.89</u>	<u>\$ 23,268,560.34</u>	<u>\$ 17,103,542.03</u>
Nonoperating - Noncapital Gifts	<u>\$ 2,812,048.86</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 2,397.44</u>	<u>\$ 2,809,651.42</u>	<u>\$ 0.00</u>

Revenue Bonds Secured by Pledged Revenues:

(A) Dormitory and Dining System

(B) Physical Education Facilities

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	\$ 50,814,158.27	\$ 987,150.65	\$ 6,181,394.40	\$ 137,209.73	\$ 0.00	\$ 0.00	\$ 58,119,913.05
Public Service	1,638,495.20	93,660.21	843,600.13	49,629.00	3,016.42		2,628,400.96
Organized Research	7,884,912.48	1,163,987.45	4,815,265.04	62,985.04	18,904.64		13,946,054.65
Libraries	1,866,001.09	72,844.39	2,459,321.62				4,398,167.10
Academic Support	4,669,933.97	250,851.31	1,825,049.18				6,745,834.46
Student Services	4,197,578.49	257,725.59	1,707,427.88				6,162,731.96
Institutional Support	11,551,463.52	214,169.50	3,077,089.95				14,842,722.97
Physical Plant	9,009,144.30	10,669,943.59	1,758,864.52	2,250.50	4,223,227.59		25,663,430.50
Auxiliary Enterprises	8,170,957.25	1,865.84	9,466,498.04		1,327,210.02		18,966,531.15
Financial Aid		46.38		6,555,344.50			6,555,390.88
Depreciation						5,817,036.02	5,817,036.02
Total Operating Expenses	<u>\$ 99,802,644.57</u>	<u>\$ 13,712,244.91</u>	<u>\$ 32,134,510.76</u>	<u>\$ 6,807,418.77</u>	<u>\$ 5,572,358.67</u>	<u>\$ 5,817,036.02</u>	<u>\$ 163,846,213.70</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 unit 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 \$84,948,252.00, of which \$41,215,133.00 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$2,472,908.00 and \$894,368.00, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were \$894,368.00, \$87,111.88, and \$0, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$84,948,252.00, of which \$31,941,881.00 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$1,916,516.00 and \$2,184,824.00, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$284,313.00 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 \$51,066.00. The voluntary contributions by employees amounted to \$529,967.00 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 \$1,344,867.00 for the year ended June 30, 2005.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide post employment 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$2,340,617.00. 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 \$325,549.00. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible except for theft losses that carry a \$1,000 per occurrence deductible.

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

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

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

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 unit 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$58,434,266.00 and on other purchases were \$3,956,760.00 at June 30, 2005.
- B. 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 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 \$52,624,762.00 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.
- C. Other Contingent Receivables** - The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied or, in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting principles generally accepted in the United States of America, these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year end is as follows:

Purpose	Amount
Endowment Pledges	\$ 110,892.00

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 15 - FOUNDATIONS

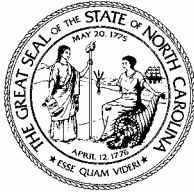
There are three separately incorporated nonprofit foundations associated with the University. These foundations are The Foundation of the University of North Carolina at Wilmington, Inc., The University of North Carolina at Wilmington Alumni Association, Inc., and The University of North Carolina at Wilmington Student Aid Association, Inc.

These organizations serve as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundations, except for support from each organization to the University. This support approximated \$1,035,793.00 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.

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

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

We have audited the financial statements of The University of North Carolina at Wilmington, 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 January 13, 2006. We did not audit the financial statements of The Donald R. Watson Foundation, Inc., which represent less than one percent, respectively, of the assets, net assets, and revenues of the University; or the financial statements of The UNCW Corporation, Inc., which represent 100% of the University's discretely presented component unit. 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 Donald R. Watson Foundation, Inc. and The UNCW Corporation, Inc., is based on the report of the other auditors.

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 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 Donald R. Watson Foundation, Inc., and the discretely presented component unit, The UNCW Corporation, Inc., were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to that entity or the discretely presented component unit.

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GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control 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., CPA, CFP
State Auditor

January 13, 2006

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Director, Fiscal Research Division

March 13, 2006

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