



# STATE OF NORTH CAROLINA

**FINANCIAL STATEMENT AUDIT REPORT OF**

**APPALACHIAN STATE UNIVERSITY**

**BOONE, 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**

**APPALACHIAN STATE UNIVERSITY**

**BOONE, NORTH CAROLINA**

**FOR THE YEAR ENDED JUNE 30, 2005**

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**THE UNIVERSITY OF NORTH CAROLINA**

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STATE OF NORTH CAROLINA  
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**AUDITOR'S TRANSMITTAL**

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

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

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements and our consideration of the University's administration of federal programs in accordance with applicable laws, regulations, contracts and grants 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

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**INDEPENDENT AUDITOR'S REPORT**

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Board of Trustees  
Appalachian State University  
Boone, North Carolina

We have audited the accompanying financial statements of Appalachian State University, 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 units, 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 Appalachian State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Appalachian State University Foundation or the Appalachian Student Housing Corporation, which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the Appalachian State University Foundation and the Appalachian Student Housing Corporation 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 provide a reasonable basis for our opinions.

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

## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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As discussed in Note 15 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 October 14, 2005, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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



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

October 14, 2005

## APPALACHIAN STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

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### **Overview of the Financial Statement Information**

Appalachian State University is pleased to present its financial statements for fiscal year 2005. These statements are prepared in accordance with recent Governmental Accounting Standard's Board (GASB) Statement Numbers 34, 35, 39 and 40. GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, established a new reporting format for annual financial statements. GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*, applied the new reporting standards to public colleges and universities. Also, in accordance with GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*, Exhibits B-1 and B-2 discretely present the component units, Appalachian State University Foundation and the Appalachian Student Housing Corporation. GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, was implemented this year and those requirements are disclosed in Note 2B within the Notes to the Financial Statements.

### **Statement of Net Assets**

The Statement of Net Assets (condensed, comparative table presented within this discussion and analysis) presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. It provides readers with information on the assets available to continue operations, and the amounts owed to vendors, investors, and lending institutions. The change in net assets (assets minus liabilities) from year to year is an indicator of the financial condition of the institution. Restricted nonexpendable net assets consist of loan funds and endowment gifts with specific restrictions on spending the principal. Restricted expendable net assets consist of income from endowment funds, gifts and pledges with specific restrictions, unexpended bond proceeds and grants from third party agencies with expenditure restrictions.

Notable changes in the Statement of Net Assets include an increase of \$12,010,330.66 in Restricted Cash and Cash Equivalents. This was due primarily to \$9,575,862.31 of cash temporarily invested by the Appalachian State University Foundation with the University's pooled cash on deposit with the State Treasurer's Short Term Investment Fund. Most of the remainder of this increase is the net change between the two years' unspent bond proceeds. See related discussion in Capital Debt and Asset Administration. The \$6,303,117.05 increase in Restricted Due From Primary Government was due to an increased receivable as of June 30 of the University's share of the North Carolina General Obligation Bonds and also in the receivable for Repairs and Renovations appropriation. The increase in Nondepreciable Capital Assets is primarily due to the purchase of land on Daniel Boone Drive Extension for \$2,057,729.36 and \$5,082,000.00 for the purchase of land associated with the Quality Inn acquisition. The remainder of the change is mostly due to the net change (buildings placed in service as opposed to construction spending for buildings not yet placed into service) in Construction in Progress. Depreciable Capital Assets increased

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

mainly due to placing the \$36,401,912.00 Library and Information Commons in service and the purchase of the Quality Inn for \$3,588,520.00. The \$9,640,090.49 increase in Funds Held for Others resulted from \$9,575,862.31 of cash temporarily invested by the Appalachian State University Foundation with the University's pooled cash on deposit with the State Treasurer's Short Term Investment Fund. The \$22,245,859.85 increase in Long-Term Liabilities was predominantly due to the issuance of The General Revenue and Refunding Revenue Bonds, Series 2005, for \$50,915,000.00 and related defeasance of \$21,880,000.00 of 2000 Series Bonds (see related discussion in Capital Debt and Asset Administration).

In the Net Assets section, the increase in Invested in Capital Assets, Net of Related Debt is due to the asset explanations above. For further discussion, see the discussion in Capital Debt and Asset Administration. Restricted Expendable Net Assets increased mostly because of the \$9,575,862.31 of cash temporarily invested by the Appalachian State University Foundation with the University's pooled cash on deposit with the State Treasurer's Short Term Investment Pool. Finally, the decrease in Unrestricted Net Assets was principally due to funds spent for land and the Quality Inn purchase previously mentioned (discussed above in Capital Assets section and later in Capital Debt and Asset Administration). Overall, Appalachian had an increase of \$41,113,244.21 in total Net Assets.

### Condensed Statement of Net Assets

	Fiscal Year 2005	Fiscal Year 2004	\$ Change	% Change
<b>Assets</b>				
Current Assets	\$ 73,532,106.17	\$ 75,878,409.90	\$ (2,346,303.73)	(3.1)
Noncurrent Assets				
Restricted Cash and Cash Equivalents	30,830,799.48	18,820,468.82	12,010,330.66	63.8
Restricted Due From Primary Government	9,575,015.86	3,271,898.81	6,303,117.05	192.6
Capital Assets - Nondepreciable	61,376,796.79	49,869,400.40	11,507,396.39	23.1
Capital Assets - Depreciable, Net	254,724,041.55	207,613,996.34	47,110,045.21	22.7
Other	18,018,042.20	17,116,007.71	902,034.49	5.3
<b>Total Assets</b>	448,056,802.05	372,570,181.98	75,486,620.07	20.3
<b>Liabilities</b>				
Current Liabilities	27,843,108.58	25,345,789.80	2,497,318.78	9.9
Funds Held Others	10,153,173.80	513,083.31	9,640,090.49	1,878.9
Long-Term Liabilities	132,752,910.63	110,507,050.78	22,245,859.85	20.1
Other Noncurrent Liabilities	4,142,031.57	4,151,924.83	(9,893.26)	(0.2)
<b>Total Liabilities</b>	174,891,224.58	140,517,848.72	34,373,375.86	24.5
<b>Net Assets</b>				
Invested in Capital Assets, Net of Related Debt	214,480,938.28	175,063,649.18	39,417,289.10	22.5
Restricted				
Nonexpendable	6,677,543.45	6,699,651.56	(22,108.11)	(0.3)
Expendable	16,166,460.62	6,463,599.84	9,702,860.78	150.1
Unrestricted	35,840,635.12	43,825,432.68	(7,984,797.56)	(18.2)
<b>Total Net Assets</b>	<u>\$ 273,165,577.47</u>	<u>\$ 232,052,333.26</u>	<u>\$ 41,113,244.21</u>	17.7

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

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### **Statement of Revenues, Expenses, and Changes in Net Assets**

The Statement of Revenues, Expenses, and Changes in Net Assets (condensed, comparative table presented on the next page) depicts operating and nonoperating revenues and expenses. Note that State appropriations are considered nonoperating revenues.

Appalachian State experienced an increase in State Appropriations of \$4,451,973.00, for a 5.1% change. The University's share of hurricane reversion was \$264,956.00, which is netted against Appropriations of \$91,822,647.00 for reporting purposes. Other Nonoperating Revenues increased \$2,887,106.01, which included a \$1,672,618.00 premium on the sale of the General Revenue and Refunding Revenue Bonds, Series 2005. The bond sale is discussed further in the Capital Asset and Debt Administration section later. The \$17,571,741.00 increase in Capital Grants was an increase in utilization of the University's share of the North Carolina General Obligation Bonds for the UNC system capital projects. The increase in Capital Appropriations of \$1,251,200.00 was an increase in funding from the State's Repairs and Renovation program. Finally, Net Assets increased \$41,113,244.21 due to the excess of Revenues over Expenses.

In total, Operating Expenses grew by \$12,809,021.75. This represented a 6% increase. Salaries and Benefits increased from \$133,177,764.06 to \$141,113,599.43, for a rate of 6%. Supplies and Materials were \$27,382,495.87 this year as compared to \$25,761,158.83 for last year, for an increase of 6% also. Services decreased 6%, to \$22,130,267.84 as opposed to \$23,651,429.07 last year. Scholarships and Fellowships decreased from \$8,925,337.51 to \$8,812,920.13, for a 1% decline. Utilities incurred the biggest increase at 39%. Those expenditures rose from \$10,259,992.82 to \$14,265,592.23. This increase was mainly due to new structures placed into service and rising fuel prices. As alluded to in the Economic Outlook below, these expenditures could be a big concern in the upcoming year. Finally, Depreciation increased 9% from \$10,217,665.26 to \$11,097,493.80.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	Fiscal Year 2005	Fiscal Year 2004	\$ Change	% Change
<b>Operating Revenues</b>				
Tuition and Fees	\$ 54,990,282.18	\$ 51,445,372.92	\$ 3,544,909.26	6.9
Grants and Contracts	8,637,470.06	8,611,151.39	26,318.67	0.3
Sales and Services, net	54,672,037.50	52,535,318.40	2,136,719.10	4.1
Interest Earnings on Loans	8,687.09	27,973.16	(19,286.07)	(68.9)
Other Operating Revenues	930,427.78	1,022,961.40	(92,533.62)	(9.0)
<b>Total Operating Revenues</b>	119,238,904.61	113,642,777.27	5,596,127.34	4.9
<b>Operating Expenses</b>	224,802,369.30	211,993,347.55	12,809,021.75	6.0
<b>Operating Loss</b>	(105,563,464.69)	(98,350,570.28)	(7,212,894.41)	(7.3)
<b>Nonoperating Revenues</b>				
State Appropriations	91,557,691.00	87,105,718.00	4,451,973.00	5.1
Other Nonoperating Revenues	16,041,770.90	13,154,664.89	2,887,106.01	21.9
<b>Net Nonoperating Revenues</b>	107,599,461.90	100,260,382.89	7,339,079.01	7.3
<b>Income Before Other Revenues</b>	2,035,997.21	1,909,812.61	126,184.60	6.6
Capital Grants	37,428,206.00	19,856,465.00	17,571,741.00	88.5
Capital Appropriations	1,497,400.00	246,200.00	1,251,200.00	508.2
Capital Gifts, net	151,641.00	697,403.27	(545,762.27)	(78.3)
Additions to Endowments	1,705.74	1,705.74	(1,705.74)	(100.0)
<b>Total Other Revenues</b>	39,077,247.00	20,801,774.01	18,275,472.99	87.9
<b>Total Increase in Net Assets</b>	41,113,244.21	22,711,586.62	18,401,657.59	81.0
<b>Net Assets</b>				
Net Assets at Beginning of Year, as restated	232,052,333.26	209,318,974.77	22,733,358.49	10.9
<b>Net Assets at End of Year</b>	<u>\$ 273,165,577.47</u>	<u>\$ 232,030,561.39</u>	<u>\$ 41,135,016.08</u>	17.7

### Economic Outlook

The economic environment continues to show mixed signs of improvement. The University attained a growth in net assets of \$41,113,244.21 for the year compared to a \$22,711,586.62 increase last year. State appropriations were \$91,557,691.00 during fiscal year 2005, compared to \$87,105,718.00 in fiscal year 2004. The effects of the hurricanes in September 2005 could affect operations and financial performance.

### Capital Asset and Debt Administration

The University is involved in several construction, renovation, and property acquisition projects. 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 System. The funds authorized are to be used solely for capital facilities costs on the University of North Carolina campuses as specified in the legislation.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

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Appalachian State University will receive \$87,406,200.00 of this bond issue of which \$72,014,724.61 has been expended and accrued to date, for construction of new facilities, renovation of existing structures, and the purchase of additional buildings and land. Major projects related to the bond issue include the following:

- The Library and Information Commons, costing \$36,401,912.00, was placed into service this year. A 300 space parking deck and renovations to the former library building are also included in this project, which is expected to be completed in the year 2006.
- The Rankin Science Building comprehensive renovation and new annex, is expected to be completed in 2006, at an estimated cost \$17,438,174.00.
- The Turchin Visual Arts Center was placed into service this year, costing \$3,585,467.62. The acquisition cost was \$2,700,000.00 (which was not funded through the bond issue.) Renovation costs were funded through the bond issue except for \$2,160,000.00 which was funded from other sources.

Other major capital projects (not funded through the University wide bond issue) to be completed in the near future includes:

- The Student Recreation Center is expected to be completed in 2006. The estimated cost for this project is \$28,000,000.00.
- The Student Union Solarium was placed in service November 2004, at a cost of \$2,943,284.05.
- Owens Field House (Athletic Facility at Kidd Brewer Stadium) is scheduled to be reconstructed along with stadium seating upgrades and improvements to Varsity Gymnasium. This project has an estimated cost of \$32,000,000.00.
- The Wellborn Dining Hall replacement is expected to be completed in 2008. The estimated cost for this project is \$28,000,000.00.
- In addition to the current renovations of White and Lovill residence halls, Appalachian is planning to start renovation of two residence halls in 2006 at approximately \$6,000,000.00 each. In 2007 the preliminary plans are to demolish the oldest residence hall and build an addition to, and renovate an adjacent residence hall for approximately \$18,000,000.00. The funding for these residence hall projects will require external financing of approximately \$30,000,000.00 over the next four years.

Appalachian issued \$50,915,000.00 of General Revenue and Refunding Revenue Bonds, Series 2005 at an average interest rate of 4.543322%. Of this amount, \$12,500,000.00 is for two of the Student Housing buildings mentioned above and \$16,000,000.00 for the Athletic Facilities mentioned above. The remainder was used to pay issue costs and to fund the escrow deposit required to pay future principal and interest requirements for the defeased ASU Housing and Student Center System Revenue Bonds-Series 2000 and the ASU Parking System Revenue Bonds-Series 2000. The defeased amounts were \$12,340,000.00 for the ASU Housing and Student Center System Revenue Bonds-Series 2000 and \$9,540,000.00 for

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)**

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the ASU Parking System Revenue Bonds-Series 2000. The refunding portion of the 2005 bonds had a net present value savings of \$834,633.12. The defeased bonds had a combined average interest rate of 5.607655%. The escrow deposit and liability for the defeased bonds are not included in the Statement of Net Assets.

Total annual debt service payments were \$9,366,219.55 in 2005 compared to \$8,989,814.15 last year.

***Appalachian State University***  
***Statement of Net Assets***  
***June 30, 2005***

***Exhibit A-1***

**ASSETS**

Current Assets:

Cash and Cash Equivalents	\$ 46,113,724.79
Restricted Cash and Cash Equivalents	15,527,152.73
Receivables, Net (Note 4)	5,974,353.18
Due from University Component Units	613,032.23
Inventories	4,559,454.40
Notes Receivable, Net (Note 4)	744,388.84

Total Current Assets	73,532,106.17
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Noncurrent Assets:

Restricted Cash and Cash Equivalents	30,830,799.48
Restricted Due from Primary Government	9,575,015.86
Endowment Investments	5,948,158.07
Other Long-Term Investments	8,743,827.77
Notes Receivable, Net (Note 4)	3,326,056.36
Capital Assets - Nondepreciable (Note 5)	61,376,796.79
Capital Assets - Depreciable, Net (Note 5)	254,724,041.55

Total Noncurrent Assets	374,524,695.88
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Total Assets	448,056,802.05
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**LIABILITIES**

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	14,124,321.86
Due to Primary Government	68,433.12
Deferred Revenue	6,178,110.26
Interest Payable	1,128,188.98
Long-Term Liabilities - Current Portion (Note 7)	6,344,054.36

Total Current Liabilities	27,843,108.58
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Noncurrent Liabilities:

Deposits Payable	239,993.84
Funds Held for Others	10,153,173.80
U. S. Government Grants Refundable	3,902,037.73
Long-Term Liabilities (Note 7)	132,752,910.63

Total Noncurrent Liabilities	147,048,116.00
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Total Liabilities	174,891,224.58
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*Appalachian State University*  
*Statement of Net Assets*  
*June 30, 2005*

*Exhibit A-1*  
*Page 2*

**NET ASSETS**

Invested in Capital Assets, Net of Related Debt	214,480,938.28
Restricted for:	
Nonexpendable:	
Research	20,000.00
Endowed Professorships	6,128,158.07
Loans	527,385.38
Other	2,000.00
Expendable:	
Scholarships and Fellowships	88,973.00
Research	8,963.29
Departmental Uses	976,552.55
Capital Projects	2,872,400.50
Debt Service	10,740,704.62
Other	1,478,866.66
Unrestricted	<u>35,840,635.12</u>
Total Net Assets	<u><u>\$ 273,165,577.47</u></u>

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

***Appalachian State University  
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)	\$ 54,990,282.18
Federal Grants and Contracts	6,761,215.56
State and Local Grants and Contracts	1,412,717.05
Nongovernmental Grants and Contracts	463,537.45
Sales and Services, Net (Note 9)	54,672,037.50
Interest Earnings on Loans	8,687.09
Other Operating Revenues	930,427.78

Total Operating Revenues	119,238,904.61
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**EXPENSES**

Operating Expenses:

Salaries and Benefits	141,113,599.43
Supplies and Materials	27,382,495.87
Services	22,130,267.84
Scholarships and Fellowships	8,812,920.13
Utilities	14,265,592.23
Depreciation	11,097,493.80

Total Operating Expenses	224,802,369.30
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Operating Loss	(105,563,464.69)
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**NONOPERATING REVENUES (EXPENSES)**

State Appropriations	91,557,691.00
Noncapital Grants	9,946,655.20
Noncapital Gifts	5,627,387.74
Investment Income	3,541,884.96
Interest and Fees on Capital Asset-Related Debt	(4,613,598.12)
Other Nonoperating Revenues	1,539,441.12

Net Nonoperating Revenues	107,599,461.90
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Income Before Other Revenues, Expenses, Gains, or Losses	2,035,997.21
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Capital Appropriations	1,497,400.00
Capital Grants	37,428,206.00
Capital Gifts	151,641.00

Increase in Net Assets	41,113,244.21
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**NET ASSETS**

Net Assets - July 1, 2004, as Restated (Note 16)	232,052,333.26
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Net Assets - June 30, 2005	\$ 273,165,577.47
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The accompanying notes to the financial statements are an integral part of this statement.

***Appalachian State University***  
***Statement of Cash Flows***  
***For the Fiscal Year Ended June 30, 2005***

***Exhibit A-3***

**CASH FLOWS FROM OPERATING ACTIVITIES**

Received from Customers	\$ 117,538,934.42
Payments to Employees and Fringe Benefits	(139,137,996.47)
Payments to Vendors and Suppliers	(64,532,380.93)
Payments for Scholarships and Fellowships	(8,812,920.13)
Loans Issued	(708,463.00)
Collection of Loans	802,967.64
Interest Earned on Loans	7,651.68
Other Receipts	916,729.29
	<hr/>
Net Cash Used by Operating Activities	(93,925,477.50)

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

State Appropriations	91,557,691.00
Noncapital Grants	9,769,425.74
Noncapital Gifts	4,675,164.25
Related Activity Agency Receipts	10,595,373.04
Related Activity Agency Disbursements	(955,282.55)
Other Payments	(115,969.51)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	115,526,401.97

**CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES**

Proceeds from Capital Debt	52,587,618.00
State Capital Appropriations	1,497,400.00
Capital Grants	31,125,088.95
Capital Gifts	152,425.36
Proceeds from Sale of Capital Assets	2,111.97
Acquisition and Construction of Capital Assets	(68,448,050.79)
Principal Paid on Capital Debt and Leases	(4,752,621.43)
Interest and Fees Paid on Capital Debt and Leases	(4,662,707.69)
Payment to Bond Escrow Agent	(23,590,430.38)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(16,089,166.01)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Proceeds from Sales and Maturities of Investments	169,543.02
Investment Income	2,542,874.04
	<hr/>
Cash Provided by Investing Activities	2,712,417.06

Net Increase in Cash and Cash Equivalents	8,224,175.52
Cash and Cash Equivalents - July 1, 2004	84,247,501.48
	<hr/>
Cash and Cash Equivalents - June 30, 2005	\$ 92,471,677.00

***Appalachian State University***  
***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 USED BY OPERATING ACTIVITIES**

Operating Loss	\$ (105,563,464.69)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	11,097,493.80
Allowances, Write-Offs, and Amortizations	154,152.62
Nonoperating Other Income	952,223.49
Changes in Assets and Liabilities:	
Receivables (Net)	(1,182,614.46)
Inventories	(425,671.81)
Accounts Payable and Accrued Liabilities	652,350.05
Due to Primary Government	(8,578.88)
Deferred Revenue	392,773.82
Compensated Absences	51,255.12
Deposits Payable	(29,212.60)
Note Principle Repayments	692,279.04
Notes Issued	(708,463.00)
	<u>(708,463.00)</u>
Net Cash Used by Operating Activities	<u>\$ (93,925,477.50)</u>

**RECONCILIATION OF CASH AND CASH EQUIVALENTS**

Current Assets:	
Cash and Cash Equivalents	\$ 46,113,724.79
Restricted Cash and Cash Equivalents	15,527,152.73
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>30,830,799.48</u>
Total Cash and Cash Equivalents - June 30, 2005	<u>\$ 92,471,677.00</u>

**NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

Assets Acquired through a Gift	\$ 151,641.00
Change in Fair Value of Investments	580,116.54
Reinvested Distributions	375,801.68
Loss on Disposal of Capital Assets	206,167.40

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

***Appalachian State University Foundations***  
***Statement of Financial Position***  
***June 30, 2005***

***Exhibit B-1***

	<b>Appalachian State University Foundation</b>	<b>Appalachian Student Housing Corporation</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 610,763.00	\$ 2,549,893.00
Investments	54,207,829.00	
Real Estate Held for Resale	88,021.00	
Cash Surrender Value of Life Insurance	141,958.00	
Assets Held by Trustees		5,006,581.00
Receivables, Net	121,826.00	16,484.00
Trusts and promises to give, net	11,094,910.00	
Prepaid Expenses	25,751.00	63,924.00
Deferred Charges		371,132.00
In-Kind Gifts	9,347.00	
Property and Equipment, Net	1,909,125.00	21,217,729.00
	<u>68,209,530.00</u>	<u>29,225,743.00</u>
Total Assets	<u>68,209,530.00</u>	<u>29,225,743.00</u>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Expenses	15,720.00	388,338.00
Grants Payable to University	613,032.00	
Deferred Revenue	342,669.00	94,806.00
Interest Payable		48,162.00
Deposits Payable	3,462.00	
Split Interest Agreement Obligations	2,410,446.00	
Bonds Payable		26,110,000.00
	<u>3,385,329.00</u>	<u>26,641,306.00</u>
Total Liabilities	<u>3,385,329.00</u>	<u>26,641,306.00</u>
<b>NET ASSETS</b>		
Unrestricted	6,603,000.00	2,584,437.00
Temporarily Restricted	21,518,306.00	
Permanently Restricted	36,702,895.00	
	<u>64,824,201.00</u>	<u>2,584,437.00</u>
Total Net Assets	<u>\$ 64,824,201.00</u>	<u>\$ 2,584,437.00</u>

See Note 1 in the Notes to the Financial Statements

***Appalachian State University Foundations  
Statement of Activities  
For the Fiscal Year Ended June 30, 2005***

***Exhibit B-2***

	<b>Appalachian State University Foundation</b>	<b>Appalachian Student Housing Corporation</b>
<b>CHANGES IN UNRESTRICTED NET ASSETS</b>		
Revenues, Gains, and Other Support:		
Contributions	\$ 567,072.00	\$ 0.00
Investment Income	834,923.00	104,854.00
Rental and other auxiliary income	54,676.00	3,986,716.00
Net realized and unrealized gains on investments	60,678.00	
Other income	37,424.00	426,523.00
Subtotal	1,554,773.00	4,518,093.00
Net Assets Released from Restrictions:	4,841,069.00	
Total Revenues, Gains, and Other Support	6,395,842.00	4,518,093.00
Expenses and Losses:		
Program services:		
General University Support	3,536,808.00	
Student Financial Aid	1,494,747.00	
Alumni Affairs	108,568.00	
Other	539,213.00	
Total program services	5,679,336.00	
Supporting services:		
General and administrative	78,273.00	461,501.00
Fund raising	321,532.00	
Other		2,555,167.00
Total supporting services	399,805.00	3,016,668.00
Total Expenses	6,079,141.00	3,016,668.00
Transfers/reclassifications to other funds	(241,281.00)	
Increase in Unrestricted Net Assets	75,420.00	1,501,425.00
<b>CHANGES IN TEMPORARILY RESTRICTED NET ASSETS</b>		
Revenues, Gains, and Other Support:		
Contributions	7,102,955.00	
Investment Income	168,717.00	
Rental and other auxiliary income	66,615.00	
Net realized and unrealized gains on investments	1,675,338.00	
Other losses	(117,667.00)	
Subtotal	8,895,958.00	
Net Assets Released from Restrictions:	(4,841,069.00)	
Total Revenues, Gains, and Other Support	4,054,889.00	
Net increase in allowance for doubtful promises to give	43,458.00	
Net increase in change in split interest agreement obligation	(119,824.00)	
Transfers/reclassifications from other funds	466,008.00	
Increase in Temporarily Restricted Net Assets	4,444,531.00	

***Appalachian State University Foundations  
Statement of Activities  
For the Fiscal Year Ended June 30, 2005***

***Exhibit B-2  
Page 2***

	<b>Appalachian State University Foundation</b>	<b>Appalachian Student Housing Corporation</b>
<b>CHANGES IN PERMANENTLY RESTRICTED NET ASSETS</b>		
Revenues, Gains, and Other Support:		
Contributions	1,645,833.00	
Investment losses	(41,683.00)	
Net realized and unrealized gains on investments	151,443.00	
Total Revenues, Gains, and Other Support	1,755,593.00	
Net decrease in allowance for doubtful promises to give	(61,722.00)	
Transfers/reclassifications to other funds	(224,727.00)	
Increase in Permanently Restricted Net Assets	1,469,144.00	
<b>Increase in Net Assets</b>	5,989,095.00	1,501,425.00
Net Assets at Beginning of Year	58,835,106.00	1,083,012.00
<b>Net Assets at End of Year</b>	<b>\$ 64,824,201.00</b>	<b>\$ 2,584,437.00</b>

See Note 1 in the Notes to the Financial Statements

**APPALACHIAN STATE UNIVERSITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2005**

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**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. Appalachian State University 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 discretely presented in the University's financial statements. Discretely presented component units' financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

**Discretely Presented Component Units** - The Appalachian State University Foundation and the Appalachian Student Housing Corporation are legally separate not-for-profit corporations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Appalachian State University Foundation is a legally separate, tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 26 self-perpetuating members of which four members are administrative officers of the University. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

During the year ended June 30, 2005, the Foundation distributed \$5,679,336.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Vice Chancellor for University Advancement or the ASU Foundation President. The financial statements of the Corporation may be obtained from the Vice Chancellor for Student Development. The address is: Dougherty Administration Building, 438 Academy Street, Boone, NC 28608.

- 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

- E. Investments** - This classification includes equity investments, mutual funds, money market funds, and other asset holdings by the University. Except for 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 in the fair value of investments is recognized as a component of investment income.

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, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.

- G. Inventories** - Inventories, consisting of expendable supplies, are valued at cost 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 75 years for general infrastructure, 10 to 50 years for buildings, and 3 to 15 years for equipment.

The scientific, art, and historical collections are capitalized at cost or fair value at the date of donation. These collections are depreciated over the life of the collection using the straight-line method. The estimated useful lives for the collections are 10 years.

- 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, 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 deferred losses on refunds are amortized over the life of the new debt using the straight-line method. Issuance costs are expensed

- K. **Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

**L. Net Assets** - The University's net assets are classified as follows:

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

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

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

**O. Internal Sales Activities** - Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as central stores, copy centers, motor pool, postal services, steam plant, electric utility, and telecommunications. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

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departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

**NOTE 2 - DEPOSITS AND INVESTMENTS**

- A. Deposits** - Unless specifically exempt, the University is required by *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.

Deposits include cash and cash equivalents and certificates of deposit totaling \$92,471,677.00. The University's portion of the State Treasurer's Investment Pool was \$90,805,151.95. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name.

The carrying amount of the University's deposits not with the State Treasurer was \$1,610,726.80 and the bank balance was \$1,725,977.08. 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>\$ 1,487,583.10</u>
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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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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.

The financial statements and disclosures for the State Treasurer's Investment Pool are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to 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 previously discussed.

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

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

Investments of the University's component unit(s), the Foundation and Student Housing Corporation, 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:

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**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 percentage method. Under this method, each participating fund's investment balance is determined on the basis of percentages of original investment. 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.

### Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)	
		1 to 5	6 to 10
Debt Securities			
Mutual Bond Funds	\$ 4,004,856.10	\$ 2,396,074.91	\$ 1,608,781.19
Other Securities			
Other Mutual Funds	7,764,890.02		
Total Long-Term Investment Pool	\$ 11,769,746.12		

*Credit Risk:* The University's Endowment Board does not have a formal policy that addresses credit risk. As of June 30, 2005, the investments in the Long-Term Investment Pool were rated as follows:

	Fair Value	AA Aa
Mutual Bond Funds	\$ 4,004,856.10	X

Rating Agency: Standard & Poors

*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

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

Board does not have a formal policy for custodial credit risk. The University's investments in the Long-Term Investment Pool were not exposed to custodial credit risk.

**Concentration of Credit Risk:** The University Endowment Board places a 5% limit on the amount the Board may invest in any one issuer. The Long-Term Investment Pool was not exposed to concentration of credit risk.

**Foreign Currency Risk:** Foreign currency risk is defined by GASB Statement No. 40 as the risk that changes in exchange rates will adversely affect the fair value of an investment. The University Endowment Board does not have a formal policy for foreign currency risk. The Long-Term Investment Pool's exposure to foreign currency risk is as follows:

Investment	Fair Value (U.S. Dollars)
Vanguard Total International	
Stock Fund Index	<u>\$ 1,148,697.43</u>

**Non-Pooled Investments** - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2005, for the University's non-pooled investments. 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.

The investment policy for bond proceeds is established by the applicable bond covenants.

### Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in years)
		Less Than 1
Debt Securities		
Money Market Mutual Funds	\$ 2,842,493.35	<u>\$ 2,842,493.35</u>
Other Securities		
Closed-End Mutual Funds	22,235.43	
Domestic Stocks-Held by Counterparty	55,203.34	
Other	<u>2,307.60</u>	
Total Long-Term Investment Pool	<u>\$ 2,922,239.72</u>	

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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*Credit Risk:* The University does not have a formal policy that addresses credit risk. As of June 30, 2005, the University's non-pooled investments were rated as follows:

	Fair Value	AAAm Aaa
Money Market Mutual Funds	\$ 2,842,495.36	X

Rating Agency: Standard & Poors

*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 does not have a formal policy for custodial credit risk. The University's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty's Trust Dept or Agent not in University's Name
Closed-End Mutual Funds	\$ 22,235.43
Domestic Stocks	55,203.34
Total	\$ 77,438.77

*Concentration of Credit Risk:* The University places no limit on the amount that may be invested in any one issuer. The University's non-pooled investments are not exposed to concentration of credit risk.

*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 does not have a formal policy for foreign currency risk. The University's non-pooled investments were not exposed to foreign currency risk.

### 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which limits spending to 5% of an individual endowment account's net asset value at the end of the previous year. An earnings reserve must be held in each endowment account in an amount equal to 5% of the original contribution. Earnings in excess of the reserve amount as calculated at the end of each fiscal year are eligible for pay out. Realized and unrealized net capital losses that invade the original corpus amounts are recovered from accumulated income before any spending budgets are calculated. Subject to these limitations, the budgeted spending amount will be based on the net asset value of each individual endowment fund. At June 30, 2005, net appreciation of \$1,518,866.68 was available to be spent, of which \$352,468.98 was restricted to specific purposes.

### NOTE 4 - RECEIVABLES

Receivables at June 30, 2005, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
<b>Current Receivables:</b>			
Students	\$ 1,886,101.87	\$ 406,322.27	\$ 1,479,779.60
Accounts	3,505,234.12	74,545.87	3,430,688.25
Intergovernmental	988,325.76		988,325.76
Investment Earnings	5,365.40		5,365.40
Interest on Loans	67,056.54		67,056.54
Other	3,137.63		3,137.63
<b>Total Current Receivables</b>	<u>\$ 6,455,221.32</u>	<u>\$ 480,868.14</u>	<u>\$ 5,974,353.18</u>
<b>Notes Receivable:</b>			
<b>Notes Receivable - Current:</b>			
Federal Loan Programs	\$ 743,638.84	\$ 0.00	\$ 743,638.84
Institutional Student Loan Programs	960.12	210.12	750.00
<b>Total Notes Receivable - Current</b>	<u>\$ 744,598.96</u>	<u>\$ 210.12</u>	<u>\$ 744,388.84</u>
<b>Notes Receivable - Noncurrent:</b>			
Federal Loan Programs	<u>\$ 3,530,004.42</u>	<u>\$ 203,948.06</u>	<u>\$ 3,326,056.36</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

### 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	\$ 8,888,541.69	\$ 0.00	\$ 7,310,553.55	\$ 0.00	\$ 16,199,095.24
Construction in Progress	40,980,858.71	(51,767,665.25)	55,964,508.09		45,177,701.55
<b>Total Capital Assets, Nondepreciable</b>	<b>49,869,400.40</b>	<b>(51,767,665.25)</b>	<b>63,275,061.64</b>		<b>61,376,796.79</b>
Capital Assets, Depreciable:					
Buildings	263,939,353.54	51,469,949.28	3,588,520.00		318,997,822.82
Machinery and Equipment	34,704,704.77		2,335,033.11	1,248,042.14	35,791,695.74
Art, Literature, and Artifacts	1,585,477.38		133,650.00		1,719,127.38
General Infrastructure	39,695,371.69	297,715.97	457,854.81	71,044.63	40,379,897.84
<b>Total Capital Assets, Depreciable</b>	<b>339,924,907.38</b>	<b>51,767,665.25</b>	<b>6,515,057.92</b>	<b>1,319,086.77</b>	<b>396,888,543.78</b>
Less Accumulated Depreciation/Amortization for:					
Buildings	98,833,895.95		7,843,617.08		106,677,513.03
Machinery and Equipment	25,256,500.55		2,172,234.78	1,162,875.90	26,265,859.43
Art, Literature, and Artifacts	543,348.41		142,170.74		685,519.15
General Infrastructure	7,677,166.13		939,471.20	81,026.71	8,535,610.62
<b>Total Accumulated Depreciation</b>	<b>132,310,911.04</b>		<b>11,097,493.80</b>	<b>1,243,902.61</b>	<b>142,164,502.23</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>207,613,996.34</b>	<b>51,767,665.25</b>	<b>(4,582,435.88)</b>	<b>75,184.16</b>	<b>254,724,041.55</b>
<b>Capital Assets, Net</b>	<b>\$ 257,483,396.74</b>	<b>\$ 0.00</b>	<b>\$ 58,692,625.76</b>	<b>\$ 75,184.16</b>	<b>\$ 316,100,838.34</b>

### NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 5,945,016.00
Accrued Payroll	3,953,047.24
Contract Retainage	4,181,782.46
Intergovernmental Payables	44,476.16
<b>Total Accounts Payable and Accrued Liabilities</b>	<b>\$ 14,124,321.86</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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### 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	\$ 106,214,000.00	\$ 50,915,000.00	\$ 26,149,000.00	\$ 130,980,000.00	\$ 4,650,000.00
Deduct Deferred Charge on Refunding		(1,710,430.38)		(1,710,430.38)	
Total Bonds Payable	<u>106,214,000.00</u>	<u>49,204,569.62</u>	<u>26,149,000.00</u>	<u>129,269,569.62</u>	<u>4,650,000.00</u>
Notes Payable	2,620,678.72		483,621.43	2,137,057.29	487,396.23
Arbitrage Rebate Payable	25,783.51		275.73	25,507.78	25,507.78
Compensated Absences	<u>7,613,575.18</u>	<u>4,225,254.48</u>	<u>4,173,999.36</u>	<u>7,664,830.30</u>	<u>1,181,150.35</u>
<b>Total Long-Term Liabilities</b>	<u>\$ 116,474,037.41</u>	<u>\$ 53,429,824.10</u>	<u>\$ 30,806,896.52</u>	<u>\$ 139,096,964.99</u>	<u>\$ 6,344,054.36</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2005	Principal Outstanding 06/30/2005
<u>Housing and Student Center System</u>						
ASU Housing and Student Center System Revenue Bonds	D	3-3.625%	07/01/2004	\$ 3,654,000.00	\$ 3,654,000.00	\$ 0.00
	I	5.5-5.8%	07/01/2007	1,760,000.00	1,405,000.00	355,000.00
	J	5.5-5.8%	07/01/2007	1,722,000.00	1,367,000.00	355,000.00
ASU Housing and Student Center System Revenue Bonds.	2000	5.606974%	07/15/2025	13,225,000.00	13,225,000.00	
ASU Housing and Student Center System Revenue Bonds.	2001	5.228044%	07/15/2027	6,680,000.00	450,000.00	6,230,000.00
ASU Housing and Student Center System Revenue Refunding Bonds.	2002	4.304976%	07/15/2015	13,240,000.00	1,210,000.00	12,030,000.00
Total Housing and Student Center System				<u>40,281,000.00</u>	<u>21,311,000.00</u>	<u>18,970,000.00</u>
<u>Student Union System</u>						
ASU Student Fee Revenue Refunding Bonds Student Union Building	1998	4.872630%	05/15/2012	8,050,000.00	3,340,000.00	4,710,000.00
<u>Utility System</u>						
ASU Utility System Revenue Refunding Bonds	1998	5.2885%	05/15/2024	27,535,000.00	1,545,000.00	25,990,000.00
<u>The University of North Carolina System Pool Revenue Bonds</u>						
Stadium Debt Fee Loan	(A)	4.338475%	10/01/2005	875,000.00	730,000.00	145,000.00
Broyhill Inn	(B)	5.514747%	10/01/2015	1,590,000.00	310,000.00	1,280,000.00
Doughton Renovation	(C)	5.015619%	04/01/2027	4,940,000.00	270,000.00	4,670,000.00
Total The University of North Carolina System Pool Revenue Bonds				<u>7,405,000.00</u>	<u>1,310,000.00</u>	<u>6,095,000.00</u>
<u>Parking System</u>						
ASU Parking System Revenue Bonds	2000	5.608336%	07/15/2025	10,200,000.00	10,200,000.00	
<u>ASU General Revenue Bonds</u>						
ASU General Revenue Bonds-Student Recreation Center	2003A	4.483238%	05/01/2028	25,635,000.00	1,335,000.00	24,300,000.00
ASU General Revenue Bonds-Housing, Athletics, Parking	2005	4.543322%	07/15/2030	50,915,000.00		50,915,000.00
Total General Revenue Bonds				<u>76,550,000.00</u>	<u>1,335,000.00</u>	<u>75,215,000.00</u>
Total Bonds Payable (principal only)				<u>\$ 170,021,000.00</u>	<u>\$ 39,041,000.00</u>	130,980,000.00
Less: Unamortized Loss on Refunding						<u>1,710,430.38</u>
Total Bonds Payable						<u>\$ 129,269,569.62</u>

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

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

(C) The University of North Carolina System Pool Revenue Bonds, Series 2002A

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

**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	\$ 4,650,000.00	\$ 5,386,942.12	\$ 487,396.23	\$ 97,217.84
2007	5,090,000.00	5,819,221.26	401,507.38	74,888.92
2008	5,310,000.00	5,610,991.26	416,311.40	55,737.12
2009	5,280,000.00	5,408,868.76	431,842.28	35,858.46
2010	5,455,000.00	5,190,553.76	100,000.00	15,217.23
2011-2015	28,645,000.00	22,309,043.83	300,000.00	19,564.99
2016-2020	27,315,000.00	15,816,540.70		
2021-2025	30,985,000.00	8,544,192.55		
2026-2030	16,400,000.00	2,111,450.00		
2031-2035	1,850,000.00	45,750.00		
<b>Total Requirements</b>	<b>\$ 130,980,000.00</b>	<b>\$ 76,243,554.24</b>	<b>\$ 2,137,057.29</b>	<b>\$ 298,484.56</b>

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

**ASU Housing and Student Center System:** On April 20, 2005, the University defeased \$12,340,000.00 of outstanding ASU Housing and Student Center System Revenue Bonds, Series 2000 (original issue amount \$13,225,000.00). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2005, the outstanding balance of the defeased ASU Housing and Student Center System bonds was \$12,340,000.00.

**ASU Parking System:** On April 20, 2005, the University defeased \$9,540,000.00 of outstanding ASU Parking System Revenue Bonds, Series 2000 (original issue amount \$10,200,000.00). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2005, the outstanding balance of the defeased ASU Parking System bonds was \$9,540,000.00.

As a result of these two bond defeasances, the University reduced its debt service requirements by \$1,254,750.87 over the next 25 years and obtained an economic gain of \$834,633.12.

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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

Purpose	Financial Institution	Interest Rate/Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2005	Principal Outstanding 06/30/2005
Electric Utility	BB & T	5.16%	05/31/2006	\$ 1,000,000.00	\$ 900,000.00	\$ 100,000.00
Visual Arts Center	Bank One	4.91%	08/01/2008	2,700,000.00	1,462,942.71	1,237,057.29
HLES Dell Computers	BB & T	6.31%	01/19/2005	52,407.42	52,407.42	0.00
Electric Utility	RBC Centura	4.30%	03/15/2013	1,000,000.00	200,000.00	800,000.00
Total Notes Payable				<u>\$ 4,752,407.42</u>	<u>\$ 2,615,350.13</u>	<u>\$ 2,137,057.29</u>

### NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for equipment, office space, and parking facilities. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2005:

<u>Fiscal Year</u>	<u>Amount</u>
2006	\$ 708,204.62
2007	536,009.24
2008	386,057.24
2009	19,542.92
Total Minimum Lease Payments	<u>\$ 1,649,814.02</u>

Rental expense for all operating leases during the year was \$2,405,235.00.

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

### 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	
<b>Operating Revenues:</b>						
<b>Student Tuition and Fees</b>	\$ 58,822,903.54	\$ 0.00	\$ 3,786,581.84	\$ 46,039.52	\$ 54,990,282.18	
<b>Sales and Services:</b>						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 15,264,965.31	\$ 645,823.11	\$ 1,218,925.83	\$ 8,427.66	\$ 13,391,788.71	(A)
Dining	14,008,002.38	1,245,070.86	753,814.16	12,639.27	11,996,478.09	(B)
Student Union Services	154,969.40	32,615.30		8,812.39	113,541.71	(C)
Health, Physical Education, and Recreation Services	1,420,311.69	98,362.90	201,831.54	1,058.32	1,119,058.93	(D)
Bookstore	7,099,843.20	289,331.92	164,250.58	3,621.23	6,642,639.47	
Parking	2,157,798.60	18,049.00		(1,839.83)	2,141,589.43	
Camp Programs	2,362,114.48	193,512.12			2,168,602.36	
Steam Utility System	7,255,323.49	7,255,323.49				(E)
Athletic	1,986,201.56	125,526.70	384,576.84	7,790.81	1,468,307.21	
Other	8,513,373.49	2,614,246.62	591,106.68	2,794.33	5,305,225.86	
Sales and Services of Education and Related Activities	1,433,144.40	730,472.40	133,481.62		569,190.38	
Independent Operations	14,097,840.02	4,327,564.16		14,660.51	9,755,615.35	
<b>Total Sales and Services</b>	<u>\$ 75,753,888.02</u>	<u>\$ 17,575,898.58</u>	<u>\$ 3,447,987.25</u>	<u>\$ 57,964.69</u>	<u>\$ 54,672,037.50</u>	

Revenue Bonds Secured by Pledged Revenues:

- (A) Housing and Student Center System
- (B) UNC Pooled Revenue Bonds-  
    Broyhill Inn and Conference Center
- (C) ASU Student Fee Revenue Refunding Bonds  
    Student Union
- (D) ASU Housing and Student Center System Bonds  
    Bookstore
- (E) ASU Utility System Bonds

### 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	\$ 68,836,846.44	\$ 2,153,946.03	\$ 3,259,803.07	\$ 67,972.25	\$ 0.00	\$ 0.00	\$ 74,318,567.79
Research	458,758.60	162,838.02	432,177.86	11,708.75			1,065,483.23
Public Service	4,617,193.53	132,818.47	1,258,302.16	1,287,148.12	11,449.64		7,306,911.92
Academic Support	17,762,215.87	4,949,407.61	4,477,394.11	263,472.95	766.92		27,453,257.46
Student Services	4,779,764.62	142,315.92	775,824.89	88,331.00			5,786,236.43
Institutional Support	11,607,093.31	1,040,025.86	2,558,196.93		794.16		15,206,110.26
Operations and Maintenance of Plant	9,770,673.32	551,368.12	3,547,137.49		7,652,125.14		21,521,304.07
Student Financial Aid	37,770.93	210.57	23,001.28	5,959,299.22			6,020,282.00
Auxiliary Enterprises	22,335,073.53	8,801,521.34	4,889,581.77	1,134,987.84	6,600,456.37		43,761,620.85
Independent Operations	908,209.28	9,448,043.93	908,848.28				11,265,101.49
Depreciation						11,097,493.80	11,097,493.80
<b>Total Operating Expenses</b>	<u>\$ 141,113,599.43</u>	<u>\$ 27,382,495.87</u>	<u>\$ 22,130,267.84</u>	<u>\$ 8,812,920.13</u>	<u>\$ 14,265,592.23</u>	<u>\$ 11,097,493.80</u>	<u>\$ 224,802,369.30</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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### NOTE 11 - PENSION PLANS

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

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

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

For the year ended June 30, 2005, the University had a total payroll of \$119,164,504.93, of which \$57,809,911.60 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$3,468,594.70 and \$1,254,475.08, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were \$1,254,475.08, \$123,396.29, and \$0.00, respectively.

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

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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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 \$119,164,504.93, of which \$44,356,430.17 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$2,661,385.81 and \$3,033,979.82, 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 (CONCLUDED)

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the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$130,483.65 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 \$38,166.24. The voluntary contributions by employees amounted to \$723,608.85 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 \$1,529,571.23 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 postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2005, the University's total contribution to the Plan was

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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\$3,269,322.94. 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 \$454,640.22. 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 coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible. The

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, flood, and “all risks” for buildings and contents.

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

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

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. Health care coverage is provided to participants in international educational programs through the Preferred Health Plan for the University of North Carolina System for participants engaged in international educational activities. All exchange students and visitors are required to have medical insurance in effect for themselves and any accompanying spouse and dependents. The maximum coverage for sickness or injury is \$100,000 for the participants and dependents with no medical deductible per injury or sickness.

The University also purchased health care and life insurance for participants in the University camp programs with coverages of \$5,000 for accidental death and dismemberment and \$500 for sickness medical expense benefit. These plans are funded by individual contributions and the coverages were effected and placed by the North Carolina Department of Insurance through the State’s agent of record.

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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and compensation in accordance with the North Carolina Workers' Compensation Act. The University is self-insured for workers' compensation.

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

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

### NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$28,838,099.12 and on other purchases were \$2,792,902.99 at June 30, 2005.
- B. Pending Litigation and Claims** - The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.
- C. University Improvement General Obligation Bonds** - The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of \$2.5 billion of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for 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

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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(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 \$13,319,958.00 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

### NOTE 15 - 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.

### NOTE 16 - NET ASSET RESTATEMENTS

As of July 1, 2004, net assets as previously reported was restated as follows:

	<u>Amount</u>
July 1, 2004 Net Assets as Previously Reported	\$ 232,030,561.39
Restatements:	
Correction to Accounts Receivable	1,093.34
Correction to Sales Tax Payable	(789.47)
Correction to Accounts Payable	518.00
Correction to Sponsorships Receivable	<u>20,950.00</u>
July 1, 2004 Net Assets as Restated	<u><u>\$ 232,052,333.26</u></u>

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STATE OF NORTH CAROLINA  
Office of the State Auditor

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State Auditor

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

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Board of Trustees  
Appalachian State University  
Boone, North Carolina

We have audited the financial statements of Appalachian State University, 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 units, 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 October 14, 2005. We did not audit the financial statements of Appalachian State University Foundation and Appalachian Student Housing Corporation which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for Appalachian State University Foundation and Appalachian Student Housing Corporation, is based on the reports of the other auditors.

As discussed in Note 15 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

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

**Internal Control Over Financial Reporting**

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

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

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

Compliance and Other Matters

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

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

*Leslie W. Merritt, Jr.*

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

October 14, 2005

## DISTRIBUTION OF AUDIT REPORT

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

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President, The University of North Carolina  
Chancellor, Appalachian State University  
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Mr. James D. Johnson

Director, Fiscal Research Division

January 17, 2006

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