STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, 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

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Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of Fayetteville 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 disclosed certain deficiencies that are detailed in the Audit Findings and Recommendations section of this report. The University's response is included following the unresolved finding.

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

April 19, 2006

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the accompanying financial statements of Fayetteville State University, a constituent institution of the 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 Fayetteville 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 Fayetteville State University Foundation, Inc., and Subsidiary, which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the Fayetteville State University Foundation, Inc., and Subsidiary were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 14 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 February 17, 2006, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Leslie W. Merritt, Jr.

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

February 17, 2006

FAYETTEVILLE STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

This section of the Fayetteville State University (the "University") annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2005, and includes comparative data for the year ended June 30, 2004. The discussion describes important trends and events that have impacted the fiscal health of the University and that may continue to exert influence in future years. This discussion has been prepared by University management along with the financial statements and related notes and should be read in conjunction with and is qualified in its entirety by the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the University's management.

Using the Annual Report

This annual report consists of a series of financial statements prepared in accordance with the Governmental Accounting Standards Board (GASB). The GASB establishes standards for external financial reporting for public colleges and universities and requires that financial statements be presented on a consolidated basis for the University as a whole, with resources classified for accounting and reporting purposes into four net assets categories. Previous financial reporting requirements focused on the accountability of individual funds groups rather than on the University as a whole. One of the most important questions asked is whether the University as a whole is better or worse off as a result of the year's activities. The key to understanding this question is the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets. These statements present financial information in a form similar to that used by corporations. They are prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. For the fiscal year ended June 30, 2005, the University implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. This Statement establishes and modifies disclosure requirements related to investment risks and deposit risks.

The Notes to the Financial Statements should be read in conjunction with the financial statements. The Notes to the Financial Statements provide information regarding the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on long-term liabilities, accounts receivable, accounts payable, revenues, and expenses, required information on pension plans, other post employment benefits, insurance against losses, and commitments and contingencies, and if necessary, a discussion of accounting changes, adjustments to prior periods, and events subsequent to the University's financial statement period. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used by private-sector companies. The University's supporting organization, the Fayetteville State University Foundation, Inc., and Subsidiary, (the "Foundation") is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. Therefore, the results of its operations are not blended with the University's financial statements, but are discretely presented, and are not included in this Management's Discussion and Analysis.

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2005. Its combined net assets increased $6.55 million from the previous year, which is an increase of 13.03 percent.

Summary of Net Assets

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

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

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

Condensed Summary of Net Assets (in millions)

	2005	2004	Increase/ (Decrease)	Percent Change
Assets:				
Current Assets	$ 11.82	$ 12.69	$ (0.87)	-6.86%
Noncurrent Assets:				
Capital	49.48	38.62	10.86	28.12%
Other	12.75	15.66	(2.91)	-18.58%
Total Assets	74.05	66.97	7.08	10.57%
Liabilities:				
Current Liabilities	5.16	4.87	0.29	5.95%
Noncurrent Liabilities	12.06	11.82	0.24	2.03%
Total Liabilities	17.22	16.69	0.53	3.18%
Net Assets:				
Invested in Capital Assets, Net of Related Debt	42.86	34.10	8.76	25.69%
Restricted:				
Nonexpendable	5.89	5.75	0.14	2.43%
Expendable	5.15	6.73	(1.58)	-23.48%
Unrestricted	2.93	3.70	(0.77)	-20.81%
Total Net Assets	$ 56.83	$ 50.28	$ 6.55	13.03%

Net Assets categories are defined in Note 1.L of the Notes to the Financial Statements.

As of June 30, 2005, total University assets were $74.05 million. The University's largest asset is its net investment in capital assets of $49.48 million, representing 66.82 percent of total assets at June 30, 2005. Current assets decreased by $.87 million primarily due to a decrease in cash and cash equivalents of $2.46 million and an increase in intergovernmental receivables of $1.66 million.

Noncurrent capital assets increased by $10.86 million primarily due to the increase in construction in progress relating to capital expenditures funded by proceeds from the sale of North Carolina general obligation bonds. Noncurrent other assets decreased by $2.91 million primarily due to a decrease in restricted cash and cash equivalents of $1.50 million and a decrease in the amount due from primary government of $1.42 million.

The University's liabilities totaled $17.22 million at June 30, 2005. Noncurrent long-term liabilities of $8.78 million, consisting of $6.08 million bonds payable and $2.70 million compensated absences, are the largest liabilities. Other liabilities consist of contracts and retainage payables of $2.35 million, U.S. government grants refundable of $1.99 million, and funds held for others of $1.30 million.

The University recorded a slight increase in current liabilities of $.29 million. The change was due in large part to the increase in contracts payable associated with bond construction projects.

The University's current assets of $11.82 million covered the current liabilities of $5.16 million, as the current ratio was $2.29 in current assets to every $1.00 in current liabilities.

At June 30, 2005, the University had outstanding bonds of $6.62 million. Bonds payable is the University's largest liability at June 30, 2005, representing 38.42 percent of total University liabilities.

The $6.55 million overall increase in net assets was largely attributable to the increase in capital assets, net of related debt, of $8.76 million and a decrease in current assets restricted cash of $2.06 million.

Summary of Revenues, Expenses, and Changes in Net Assets

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

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

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

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

	2005	2004	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees, Net	$ 12.69	$ 10.15	$ 2.54	25.02%
Grants and Contracts	10.07	9.83	0.24	2.44%
Auxiliary Activities	4.91	4.51	0.40	8.87%
Other Educational Activities	0.15	0.06	0.09	150.00%
Total Operating Revenues	27.82	24.55	3.27	13.32%
Total Operating Expenses	80.13	71.64	8.49	11.85%
Operating Loss	(52.31)	(47.09)	(5.22)	11.09%
Nonoperating Revenues:				
State Appropriations	38.34	37.42	0.92	2.46%
Other Nonoperating Revenues	9.66	8.35	1.31	15.69%
Net Nonoperating Revenues	48.00	45.77	2.23	4.87%
Loss Before Other Revenues	(4.31)	(1.32)	(2.99)	226.52%
Capital Contributions	10.80	6.14	4.66	75.90%
Permanent Endowment Additions	0.06	0.14	(0.08)	-57.14%
Increase in Net Assets	6.55	4.96	1.59	32.06%
Net Assets:				
Beginning of Year (as Restated)	50.28	45.32	4.96	10.94%
End of Year	$ 56.83	$ 50.28	$ 6.55	13.03%

The Condensed Summary of Revenues, Expenses, and Changes in Net Assets reflects a positive year with an increase in net assets of $6.55 million at the end of the year.

Total operating loss for fiscal year 2005 was $52.31 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB, the University shows a significant operating loss.

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

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

Operating expenses, including depreciation of $2.19 million, totaled $80.13 million. Of this total, $36.50 million, or 45.55 percent, was used for instruction and student support; $9.56 million, or 11.93 percent, was used for institutional support; $9.90 million, or 12.35 percent, was used for operations and maintenance of plant; and $9.67 million, or 12.07 percent, was used for auxiliary enterprises.

The University's largest source of nonoperating revenue is the State of North Carolina appropriation. This is received in monthly payments, beginning in July of each year, since the State's fiscal year begins on July 1st. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year beginning July 1, 2004, and ending June 30, 2005, the appropriations from the State for the University were $38.34 million for operations. This appropriation was fully recorded by the University during the University's fiscal year ending June 30, 2005.

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

Capital Assets

With the successful passage of the higher education bond referendum in November 2000, the University received a $46.00 million allocation to enhance campus facilities. Major capital expenditures through the year ended June 30, 2005, include the Residence Hall ($6.12 million), Seabrook Renovation ($6.20 million), Lyons Renovation and Additions ($1.82 million), Cook Dining Conversion ($2.20 million), and Spaulding Renovation Conversion ($1.45 million). The bond referendum is discussed in detail in Note 13.B to the financial statements.

On April 14, 2005, the University extinguished long-term debt obligations by the issuance of new long-term debt instruments, the University of North Carolina System Pool Revenue Bonds Series 2005B, in the amount of $2.77 million. The refunding component of this bond issue was used to advance refund $2.53 million of the outstanding Fayetteville State University Dining System Facility Fee Revenue Bonds, Series 1997. As a result, the University reduced its debt service requirements by $.05 million over the next 18 years and obtained an economic gain of $.12 million. The bond defeasance is discussed in detail in Note 7.D to the financial statements.

Factors Impacting Future Periods

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

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

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

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

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

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

Fayetteville State University
Statement of Net Assets
June 30, 2005 ***Exhibit A-1***

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	5,900,455.14
Restricted Cash and Cash Equivalents		1,533,024.87
Receivables, Net (Note 4)		3,606,042.97
Inventories		161,998.29
Notes Receivable (Note 4)		618,188.55
Total Current Assets		11,819,709.82
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		3,466,580.44
Restricted Due from Primary Government		2,341,755.59
Endowment Investments		4,697,936.53
Other Long-Term Investments		419,404.41
Notes Receivable, Net (Note 4)		1,833,764.30
Capital Assets - Nondepreciable (Note 5)		23,774,693.18
Capital Assets - Depreciable, Net (Note 5)		25,703,088.32
Total Noncurrent Assets		62,237,222.77
Total Assets		74,056,932.59
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 6)		3,533,478.50
Due to Primary Government		31,807.42
Deferred Revenue		639,844.77
Interest Payable		71,615.33
Long-Term Liabilities - Current Portion (Note 7)		886,317.33
Total Current Liabilities		5,163,063.35
Noncurrent Liabilities:		
Funds Held for Others		1,297,683.80
U. S. Government Grants Refundable		1,987,054.34
Long-Term Liabilities (Note 7)		8,775,035.56
Total Noncurrent Liabilities		12,059,773.70
Total Liabilities		17,222,837.05
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		42,860,781.50
Restricted for:		
Nonexpendable:		
Scholarships and Fellowships		3,671,081.75
Endowed Professorships		1,632,882.00
Loans		589,825.21
Expendable:		
Scholarships and Fellowships		1,430,229.79
Endowed Professorships		752,972.57
Departmental Uses		490,009.36
Capital Projects		1,282,218.22
Debt Service		1,192,155.98
Unrestricted		2,931,939.16
Total Net Assets	$	56,834,095.54

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

Fayetteville State University
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2005 ***Exhibit A-2***

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 8)	$	12,692,314.47
Federal Grants and Contracts		10,053,092.90
State and Local Grants and Contracts		11,858.76
Sales and Services, Net (Note 8)		4,912,266.01
Interest Earnings on Loans		3,580.77
Other Operating Revenues		144,764.19
Net Operating Revenues		27,817,877.10
EXPENSES		
Operating Expenses:		
Salaries and Benefits		45,396,745.54
Supplies and Materials		10,236,792.13
Services		14,048,431.06
Scholarships and Fellowships		6,221,348.86
Utilities		2,042,051.96
Depreciation		2,185,831.81
Total Operating Expenses		80,131,201.36
Operating Loss		(52,313,324.26)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		38,340,345.44
Noncapital Grants		8,822,301.27
Noncapital Gifts		558,103.01
Investment Income (Net of Investment Expense of $16,522.31)		599,248.49
Interest and Fees on Debt		(618,819.06)
Other Nonoperating Revenues		302,108.14
Net Nonoperating Revenues		48,003,287.29
Loss Before Other Revenues		(4,310,036.97)
Capital Appropriations		604,200.00
Capital Grants		10,201,114.17
Additions to Endowments		60,423.90
Increase in Net Assets		6,555,701.10
NET ASSETS		
Net Assets - July 1, 2004		50,278,394.44
Net Assets - June 30, 2005	$	56,834,095.54

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

Fayetteville State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2005 — *Exhibit A-3*

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	27,536,283.05
Payments to Employees and Fringe Benefits		(45,029,919.35)
Payments to Vendors and Suppliers		(26,230,587.57)
Payments for Scholarships and Fellowships		(6,221,348.86)
Loans Issued		(548,333.23)
Collection of Loans		657,853.19
Interest Earned on Loans		3,826.88
Other Receipts		33,838.45
Net Cash Used by Operating Activities		(49,798,387.44)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Appropriations		38,340,345.44
Noncapital Grants		8,822,301.27
Noncapital Gifts		558,103.01
Additions to Endowments		60,423.90
Federal Family Education Loan Receipts		15,612,077.00
Federal Family Education Loan Disbursements		(16,621,771.00)
Related Activity Agency Receipts		138,312.91
Net Cash Provided by Noncapital Financing Activities		46,909,792.53
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Proceeds from Capital Debt		2,770,000.00
State Capital Appropriations		604,200.00
Capital Grants		11,621,485.90
Proceeds from Sale of Capital Assets		313,358.14
Acquisition and Construction of Capital Assets		(13,013,776.75)
Principal Paid on Capital Debt		(3,065,000.00)
Interest and Fees Paid on Capital Debt		(601,095.61)
Net Cash Used by Capital Financing and Related Financing Activities		(1,370,828.32)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		833,074.18
Investment Income		297,641.25
Purchase of Investments and Related Fees		(834,161.48)
Net Cash Provided by Investing Activities		296,553.95
Net Decrease in Cash and Cash Equivalents		(3,962,869.28)
Cash and Cash Equivalents - July 1, 2004		14,862,929.73
Cash and Cash Equivalents - June 30, 2005	$	10,900,060.45

RECONCILIATION OF NET OPERATING EXPENSES TO NET CASH USED BY OPERATING ACTIVITIES

Operating Loss	$	(52,313,324.26)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		2,185,831.81
Allowances, Write-Offs, and Amortizations		66,706.08
Changes in Assets and Liabilities:		
Receivables (Net)		(639,715.07)
Inventories		50,675.96
Accounts Payable and Accrued Liabilities		(98,817.37)
Due to Primary Government		(40,410.07)
U. S. Government Grants Refundable		33,838.45
Deferred Revenue		297,305.55
Compensated Absences		550,001.52
Student Loans Issued		(548,333.23)
Student Loan Principal Repayments		657,853.19
Net Cash Used by Operating Activities	$	(49,798,387.44)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	5,900,455.14
Restricted Cash and Cash Equivalents		1,533,024.87
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		3,466,580.44
Total Cash and Cash Equivalents - June 30, 2005	$	10,900,060.45

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Change in Fair Value of Investments	$	294,312.06

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

Fayetteville State University Foundation, Inc., and Subsidiary
Statement of Financial Position
June 30, 2005

Exhibit B-1

ASSETS		
Current Assets:		
Cash in Bank	$	1,276,013
Restricted Cash - Housing Foundation		1,412,034
Accrued Interest Receivable		2,345
Accounts Receivable		67,675
Prepaid Expenses		14,382
Due from Fayetteville State University		24,122
Investments		2,062,130
Property, Plant, and Equipment, Net		13,504,616
Total Assets		18,363,317
LIABILITIES		
Current Liabilities:		
Accounts Payable		12,797
Current Maturities of Long-Term Debt		200,000
Security Deposits		33,000
Unearned Revenue		43,497
Long-Term Debt		14,465,000
Total Liabilities		14,754,294
NET ASSETS		
Unrestricted:		
Fayetteville State University Housing Foundation		(1,029,443)
Fayetteville State University Foundation		1,391,690
Permanently Restricted		3,246,776
Total Net Assets	$	3,609,023

See Note 1 in the Notes to the Financial Statements

Fayetteville State University Foundation, Inc., and Subsidiary
Statement of Activities
For the Fiscal Year Ended June 30, 2005 *Exhibit B-2*

CHANGES IN UNRESTRICTED NET ASSETS		
Revenues:		
Gifts and Donations	$	77,728
Interest and Dividend Income		23,651
Rental Income		1,559,004
Total Unrestricted Revenues		1,660,383
Net Assets Released from Restrictions		24,992
Total Unrestricted Revenues and Net Assets Released from Restrictions		1,685,375
Expenses:		
Program Services		1,971,478
Management and General		14,375
Fund Raising		6,066
Total Expenses		1,991,919
Decrease in Unrestricted Net Assets		(306,544)
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Revenues and Gains:		
Gifts and Donations		96,989
Interest and Dividend Income		75,200
Unrealized Gain on Investments		139,382
Total Permanently Restricted Revenues and Gains		311,571
Net Assets Released from Restrictions		(24,992)
Increase in Permanently Restricted Net Assets		286,579
Decrease in Net Assets		(19,965)
Net Assets at Beginning of Year		3,628,988
Net Assets at End of Year	$	3,609,023

See Note 1 in the Notes to the Financial Statements

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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. Fayetteville 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 unit is discretely presented in the University's financial statements. The discretely presented component unit's financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize its legal separateness.

Discretely Presented Component Unit – The Fayetteville State University Foundation Inc., and Subsidiary ("Foundation") is a legally separate, tax-exempt, not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. The Fayetteville State University Housing Foundation, LLC is a wholly owned subsidiary of the Foundation. Its primary purpose is to build, maintain, and manage a student housing facility for students of Fayetteville State University.

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 40 directors. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the

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

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

During the year ended June 30, 2005, the Foundation distributed $19,150.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Fayetteville State University Foundation, Inc., and Subsidiary at (910) 672-1151.

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

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

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

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

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

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

E. **Investments** - This classification includes mutual funds and United States Government Securities held by the University. These investments are accounted for at fair value, as determined by quoted market prices. The net increase in the fair value of investments is recognized as a component of investment income.

F. **Receivables –** Receivables consist of tuition and fees 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 and merchandise for resale, are valued at the lower of cost or market value using the first-in, first-out method.

H. **Capital Assets –** Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

NOTE 2 - DEPOSITS AND INVESTMENTS

A. **Deposits –** Unless specifically exempt, the University is required by *North Carolina General Statute* 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2005, the University's deposit with the State Treasurer's Short-Term Investment Fund totaled $10,825,979.53. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.41 years as of June 30, 2005. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool which includes the State Treasurer's Short-Term Investment Fund are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.ncosc.net/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

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 follows the Cash Management Plan (Plan) approved by the North Carolina Office of State Controller. As provided by the Plan, all funds belonging to the University are deposited with the State Treasurer pursuant to G.S. 147-77 and G.S. 147-69.1. As provided by the Plan, imprest checking accounts are established with outside banks when considered effective in meeting management objectives. All imprest checking accounts are authorized by the University Treasurer and are limited to the minimum amount needed for sanctioned purposes.

As of June 30, 2005, the carrying amount of the University's deposits not with the State Treasurer was $62,381.42 and the bank balance was $67,492.21. The University's bank balance was covered by federal depository insurance and was not exposed to custodial credit risk.

B. **Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

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

Investments of the University's component unit, the Fayetteville State University Foundation Inc., and Subsidiary, 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.

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 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.

Non-Pooled Investments

	Fair Value	Investment Maturities (in Years): Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities:					
U.S. Treasuries	$ 419,404.41	$ 419,404.41	$ 0.00	$ 0.00	$ 0.00
Mutual Bond Funds	1,779,982.68			1,779,982.68	
		$ 419,404.41	$ 0.00	$ 1,779,982.68	$ 0.00
Other Securities:					
Other Mutual Funds	2,917,953.85				
Total Non-Pooled Investments	$ 5,117,340.94				

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The University does not have a formal policy that addresses credit risk. As of June 30, 2005, the University's investments were rated as follows:

	Fair Value	Unrated
Mutual Bond Funds	$ 1,779,982.68	$ 1,779,982.68

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 investments were not exposed to custodial credit 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.

Investment return of the University's endowment funds is predicated under classical trust doctrines. Unless the donor has stipulated otherwise, capital gains and losses are accounted for as part of the endowment principal and are not available for expenditure. The University's endowment spending policy governs the rate at which funds are released to the operating budget from the endowment. The University uses a disciplined spending rate with a long-term spending rule. The target rate for spending is set between 4% and 6% of the endowment's three-year average year end market value. In order to preserve the purchasing power of the endowment, the portfolio is invested with the expectation of generating a long-term rate of return at least equal to the payout plus the rate of inflation. At June 30, 2005, there was no net appreciation available to be spent.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2005, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 1,036,579.09	$ 455,593.55	$ 580,985.54
Accounts	515,466.22		515,466.22
Intergovernmental	2,171,144.43		2,171,144.43
Investment Earnings	30,820.90		30,820.90
Interest on Loans	60,060.67		60,060.67
Other	247,565.21		247,565.21
Total Current Receivables	$ 4,061,636.52	$ 455,593.55	$ 3,606,042.97
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	$ 608,999.93	$ 0.00	$ 608,999.93
Institutional Student Loan Programs	9,188.62		9,188.62
Total Notes Receivable - Current	$ 618,188.55	$ 0.00	$ 618,188.55
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 2,276,968.14	$ 443,203.84	$ 1,833,764.30

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	Increases	Decreases	Balance June 30, 2005
Capital Assets, Nondepreciable:				
Land	$ 938,643.22	$ 24,600.00	$ 0.00	$ 963,243.22
Construction in Progress	10,045,249.17	12,766,200.79		22,811,449.96
Total Capital Assets, Nondepreciable	10,983,892.39	12,790,800.79		23,774,693.18
Capital Assets, Depreciable:				
Buildings	64,102,767.27	34,500.00	135,000.00	64,002,267.27
Machinery and Equipment	5,134,224.41	261,741.40	316,948.74	5,079,017.07
General Infrastructure	2,693,400.77			2,693,400.77
Total Capital Assets, Depreciable	71,930,392.45	296,241.40	451,948.74	71,774,685.11
Less Accumulated Depreciation for:				
Buildings	39,942,929.26	1,497,479.19	123,750.00	41,316,658.45
Machinery and Equipment	2,909,414.84	605,884.30	283,037.42	3,232,261.72
General Infrastructure	1,440,208.30	82,468.32		1,522,676.62
Total Accumulated Depreciation	44,292,552.40	2,185,831.81	406,787.42	46,071,596.79
Total Capital Assets, Depreciable, Net	27,637,840.05	(1,889,590.41)	45,161.32	25,703,088.32
Capital Assets, Net	$ 38,621,732.44	$ 10,901,210.38	$ 45,161.32	$ 49,477,781.50

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	$ 1,915,851.47
Accrued Payroll	697,170.50
Contract Retainage	920,366.99
Intergovernmental Payables	14.86
Other	74.68
Total Accounts Payable and Accrued Liabilities	$ 3,533,478.50

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	$ 6,912,000.00	$ 2,770,000.00	$ 3,065,000.00	$ 6,617,000.00	$ 542,000.00
Compensated Absences	2,494,351.37	3,003,626.92	2,453,625.40	3,044,352.89	344,317.33
Total Long-Term Liabilities	$ 9,406,351.37	$ 5,773,626.92	$ 5,518,625.40	$ 9,661,352.89	$ 886,317.33

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2005	Principal Outstanding June 30, 2005
Dormitory System						
Dormitory System Revenue Bond	A	3.0%-3.625%	10/01/2005	$ 920,000.00	$ 908,000.00	$ 12,000.00
Dormitory System Revenue Bond	B	8.0%-10.0%	10/01/2009	1,750,000.00	1,185,000.00	565,000.00
Total Dormitory System				2,670,000.00	2,093,000.00	577,000.00
Dining System						
Dining System Facility Fee Revenue Bond	1997	4.1%-5.7%	04/14/2005	3,040,000.00	3,040,000.00	
The University of North Carolina System Pool Revenue Bonds						
Refunding of U.S. Department of Education Notes Payable	2002B	3.5%-5.375%	04/01/2022	1,245,000.00	105,000.00	1,140,000.00
Stadium Renovation	2002B	3.5%-5.0%	04/01/2012	2,735,000.00	605,000.00	2,130,000.00
Dining	2005B	3.5%-4.5%	04/01/2023	2,770,000.00		2,770,000.00
Total The University of North Carolina System Pool Revenue Bonds				6,750,000.00	710,000.00	6,040,000.00
Total Bonds Payable (principal only)				$ 12,460,000.00	$ 5,843,000.00	$ 6,617,000.00

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

	Annual Requirements	
	Bonds Payable	
Fiscal Year	Principal	Interest
2006	$ 542,000.00	$ 294,428.06
2007	550,000.00	275,332.50
2008	570,000.00	251,517.50
2009	590,000.00	225,737.50
2010	625,000.00	197,887.50
2011-2015	1,690,000.00	649,103.76
2016-2020	1,255,000.00	357,993.78
2021-2023	795,000.00	68,300.00
Total Requirements	$ 6,617,000.00	$ 2,320,300.60

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

Dining System: On April 14, 2005, the University issued $2,770,000.00 in The University of North Carolina System Pool Revenue Bonds, Series 2005B with an average interest rate of 4.13%. The refunding component of this bond issue was used to advance refund $2,530,000.00 of outstanding Fayetteville State University Dining System Facility Fee Revenue Bonds, Series 1997, with a combined average interest rate of 5.54%. Net proceeds of $2,752,109.90 resulted from the bond sale. As a result, the University reduced its debt service requirements by $49,920.10 over the next 18 years and obtained an economic gain of $115,134.33.

NOTE 8 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	
Operating Revenues:						
Student Tuition and Fees	$ 17,654,201.10	$ 0.00	$ 4,824,416.26	$ 137,470.37	$ 12,692,314.47	
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	$ 2,749,638.56	$ 0.00	$ 693,151.03	$ 0.00	$ 2,056,487.53	(A)
Dining	1,950,624.84		536,276.49		1,414,348.35	(B)
Bookstore	248,070.18		36,427.06		211,643.12	
Other	1,144,113.80	434,842.69	15,131.89		694,139.22	
Sales and Services of Education and Related Activities	535,647.79				535,647.79	
Total Sales and Services	$ 6,628,095.17	$ 434,842.69	$ 1,280,986.47	$ 0.00	$ 4,912,266.01	

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

NOTE 9 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	$ 24,324,018.12	$ 1,333,784.55	$ 1,201,048.99	$ 10,400.00	$ 0.00	$ 0.00	$ 26,869,251.66
Research	331,572.23	99,461.00	138,451.01	2,500.00			571,984.24
Public Service	2,208,234.15	186,327.21	1,498,466.03	34,638.08			3,927,665.47
Academic Support	4,305,610.12	2,037,663.42	1,476,542.01				7,819,815.55
Student Services	2,571,112.16	349,614.52	605,307.62				3,526,034.30
Institutional Support	5,512,116.29	1,018,042.83	3,027,696.98				9,557,856.10
Operations and Maintenance of Plant	3,087,184.71	4,364,671.81	1,020,373.22		1,425,065.32		9,897,295.06
Student Financial Aid	373,506.83	4,028.80	43,788.07	5,681,325.96			6,102,649.66
Auxiliary Enterprises	2,683,390.93	843,197.99	5,036,757.13	492,484.82	616,986.64		9,672,817.51
Depreciation						2,185,831.81	2,185,831.81
Total Operating Expenses	$ 45,396,745.54	$ 10,236,792.13	$ 14,048,431.06	$ 6,221,348.86	$ 2,042,051.96	$ 2,185,831.81	$ 80,131,201.36

NOTE 10 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 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 $37,298,341.26, of which $23,594,694.41 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $1,415,681.66 and $512,004.87, respectively. The University made 100%

of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were $512,004.87, $51,436.28, and $0.00, respectively.

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

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

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2005, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2005, the University had a total payroll of $37,298,341.26, of which $9,244,978.49 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were $554,698.71 and $632,356.53, respectively.

B. **Deferred Compensation and Supplemental Retirement Income Plans** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to $107,112.00 for the year ended June 30, 2005.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2005, were $29,919.78. The voluntary contributions by employees amounted to $154,739.00 for the year ended June 30, 2005.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to $535,822.43 for the year ended June 30, 2005.

NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees - The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2005, the University's total contribution to the Plan was $1,050,869.53. 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 $146,136.54. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 12 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to 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 University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, and "all risks" for all buildings and contents.

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

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

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

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

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

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

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

NOTE 13 - COMMITMENTS AND CONTINGENCIES

A. Commitments - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were $17,251,634.75 at June 30, 2005.

B. University Improvement General Obligation Bonds – The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of $2.5 billion of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA), establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The

University's remaining authorization of $24,866,072.83 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

NOTE 14 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

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

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

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the financial statements of Fayetteville 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 February 17, 2006. We did not audit the financial statements of the Fayetteville State University Foundation, Inc., and Subsidiary, which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the discretely presented component unit, is based on the report of the other auditor.

As discussed in Note 14 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Audit Findings and Recommendations section of this report.

Findings

1. Inadequate Controls over Cash Receipts and Deposits
2. Employees have Access Rights Inconsistent with Job Duties
3. Deficiencies in Internal Control Procedures over Cash Disbursements

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above are 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*.

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

This report is intended solely for the information and use of the Audit Committee, the Board of 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

February 17, 2006

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AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control. Finding numbers one and two were also reported in the prior year.

1. INADEQUATE CONTROLS OVER CASH RECEIPTS AND DEPOSITS

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

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

This finding was resolved during the audit period. The University strengthened internal controls over cash receipts and deposits so that no one individual controls all key aspects of a transaction or event and to include review and approval procedures over voided receipts.

2. EMPLOYEES HAVE ACCESS RIGHTS INCONSISTENT WITH JOB DUTIES

As previously reported, the University did not have adequate procedures in place to assure that employees only had information systems access rights necessary to perform their jobs. Employees had access rights inconsistent with the responsibilities of their jobs that would allow them to perform functions incompatible with their assigned duties. Adequate access controls over information systems are necessary to prevent unauthorized or inappropriate transactions.

The University did a detail research on all of the users of the Financial Reporting System and their access rights. On July 1, 2005, the University replaced their accounting system with SunGard SCT's Banner Finance.

University's Response: The University became aware of this issue in April 2005. Once this concern was brought to our attention, the University took immediate corrective action. All employee access rights were reviewed and any inconsistent rights were removed prior to the completion of the financial audit for the year ended June 30, 2004. In addition to these corrective actions, an independent consultant was hired to verify these corrective actions. This verification was provided to the University on September 1, 2005. As noted by the State Auditors, the University implemented a new accounting system on July 1, 2005. During this implementation process, system access rights were thoroughly reviewed prior to implementation and are in full compliance.

3. DEFICIENCIES IN INTERNAL CONTROL PROCEDURES OVER CASH DISBURSEMENTS

We noted deficiencies in internal control procedures over cash disbursements as follows:

- Purchase orders are not used correctly by the University. A sample of 50 payments for services was selected for testing. Results are as follows:
  - Seven purchase orders were created after services were provided and an invoice was submitted to the University for payment;
  - One purchase order was never created;
  - One invoice was matched with the wrong purchase order;
  - Policies and procedures governing contracted personal services are inadequate and inconsistently applied by the University. University staff are unclear on the documents required for payment for contracted services, in particular, the usage of Personal Service Agreements and Independent Contractor Determination Questionnaires. In addition, purchase orders for contracted services are not being used in accordance with the University's policies and procedures.
- Duplicate payments are occurring to University vendors. We noted four instances where vendors were paid twice for the same goods or services provided, which resulted in overpayments of $95,925.15. Credit memos were subsequently issued for three of the four instances noted.
- The University is writing travel advance checks for anticipated travel months sooner than what is commonly considered good business practice. Checks written for athletic travel are kept in an employee's drawer until picked up. We also noted an instance where a University employee was paid $9,255.00 in advance for meals and lodging expenses associated with two planned trips. The University wrote a check to the employee on December 17, 2004, even though the trips were planned for February 3, 2005, and February 27, 2005. On December 17, 2004, the University also wrote a check in the amount of $4,741.80 directly to a hotel for the lodging associated with one of the trips.

Sound internal controls require management to apply policies and procedures that ensure all transactions are processed with controls designed to prevent misappropriation of assets and errors that result in overpayments.

Recommendation: We recommend that the University strengthen internal controls over cash disbursements to include approved purchase orders prior to obtaining services, documentation that services have been performed prior to making payment, the creation and implementation of policies and procedures governing contracted personal services, and policies and procedures to eliminate duplicate payments and premature travel advances to University employees.

University's Response: Based on the Office of the State Controller's guidelines for internal control and cash disbursements, the University revised its policies and procedures for cash disbursements, contracted personal services, and travel. The University will conduct training to ensure staff is aware of the revised policies and procedures. Management oversight and internal verfication will be increased to ensure purchase orders are obtained prior to services and verfication of services performed is obtained prior to payment.

The University discovered the four overpayments during its review of management reports. Once these overpayments were discovered, the University immediately requested refunds from the vendors. The University has received credit memos and refunds totaling $95,635.15 or 99.7% of the overpayment amount.

ORDERING INFORMATION

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

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