



STATE OF NORTH CAROLINA

NORTH CAROLINA STATE UNIVERSITY

RALEIGH, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

NORTH CAROLINA STATE UNIVERSITY

RALEIGH, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

ERSKINE B. BOWLES, PRESIDENT

BOARD OF TRUSTEES

WENDELL MURPHY, CHAIRMAN

ADMINISTRATIVE OFFICERS

DR. JAMES L. OBLINGER, CHANCELLOR

CHARLES D. LEFFLER, VICE CHANCELLOR FOR FINANCE AND BUSINESS



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of North Carolina State University for the year ended June 30, 2006, 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

January 4, 2007

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
BASIC FINANCIAL STATEMENTS	
University Exhibits	
A-1 Statement of Net Assets	16
A-2 Statement of Revenues, Expenses, and Changes in Net Assets	18
A-3 Statement of Cash Flows	19
Component Unit Exhibits	
B-1 Statement of Financial Position	21
B-2 Statement of Activities	22
Notes to the Financial Statements	23
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	65
ORDERING INFORMATION	67



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
North Carolina State University
Raleigh, North Carolina

We have audited the accompanying financial statements of North Carolina 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, 2006, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the North Carolina 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 NC State Investment Fund, Inc., which represents 18.58%, 26.53%, and 5.41%, respectively, of the assets, net assets and revenues of the University; nor the financial statements of the North Carolina State University Foundation, Inc., and the NCSU Student Aid Association, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are 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 North Carolina State University Foundation, Inc., and the NCSU Student Aid Association, Inc., were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

June 30, 2006, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2006, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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



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

December 1, 2006

NORTH CAROLINA STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Management's Discussion and Analysis of the financial report provides an overview of the accompanying basic financial statements. It includes comparative financial analysis with discussion of significant changes from the prior year. The overview also includes information on currently known facts, decisions, or conditions affecting the financial affairs of the University.

Financial Highlights

NC State University's net assets increased by 8.9% to \$1.1 billion in fiscal year 2006. Net assets represent the University's equity, the assets less the liabilities. A major part of this net assets increase was the result of increases of \$84.9 million in capital assets, net of related debt. The University's endowment assets also increased by \$15.4 million, to a total of \$155.1 million.

Revenues increased by 5.5% to \$956.4 million in fiscal year 2006. Revenues represent amounts received or accrued that are either operating or nonoperating on the accompanying financial statements. A major part of the revenues increase was the result of increased tuition and fees (operating) and state appropriations (nonoperating). Tuition and fees increased by 8.1% to \$135.1 million. State appropriations increased by 9.1% to \$400.0 million.

Operating Expenses increased by 7.2% to \$956.9 million in fiscal year 2006. Operating expenses represent amounts paid or accrued for operating purposes. A major part of the expense increase was the result of increases in Operations and Maintenance of Plant, Instruction, Research, and Public Service expenses. These expenses increased as a result of increases in salaries and benefits, supplies and materials, and utilities costs.

Using the Financial Statements

The University's financial statements are used to evaluate financial position as of June 30th and the results of operations for the fiscal year then ended. The *Statement of Net Assets* provides information relative to the evaluation of financial position. The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information relative to the evaluation of the results of operations. Its ending net assets agree to the total net assets on the *Statement of Net Assets*.

The financial statements also include a *Statement of Cash Flows*. This statement is used to identify the University's sources and uses of cash. The ending cash on the *Statement of Cash Flows* agrees to the total cash reported to the *Statement of Net Assets*. Also, this statement reconciles the net operating loss reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* to the net cash used by operating activities.

In using the financial statements, the *Notes to the Financial Statements* accompanying the financial statements should be read in conjunction with the financial statements. The notes provide information regarding the significant accounting principles applied in the financial

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

statements, authority for and associated risk of deposits and investments, detailed information on long-term liabilities, detailed information on accounts receivable, accounts payable, revenues and expenses, required information on pension plans and other post employment benefits, insurance against losses, commitments and contingencies, and accounting changes. If necessary, the disclosures include a discussion of 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.

Comparative Condensed Financial Statement Information

Statement of Net Assets

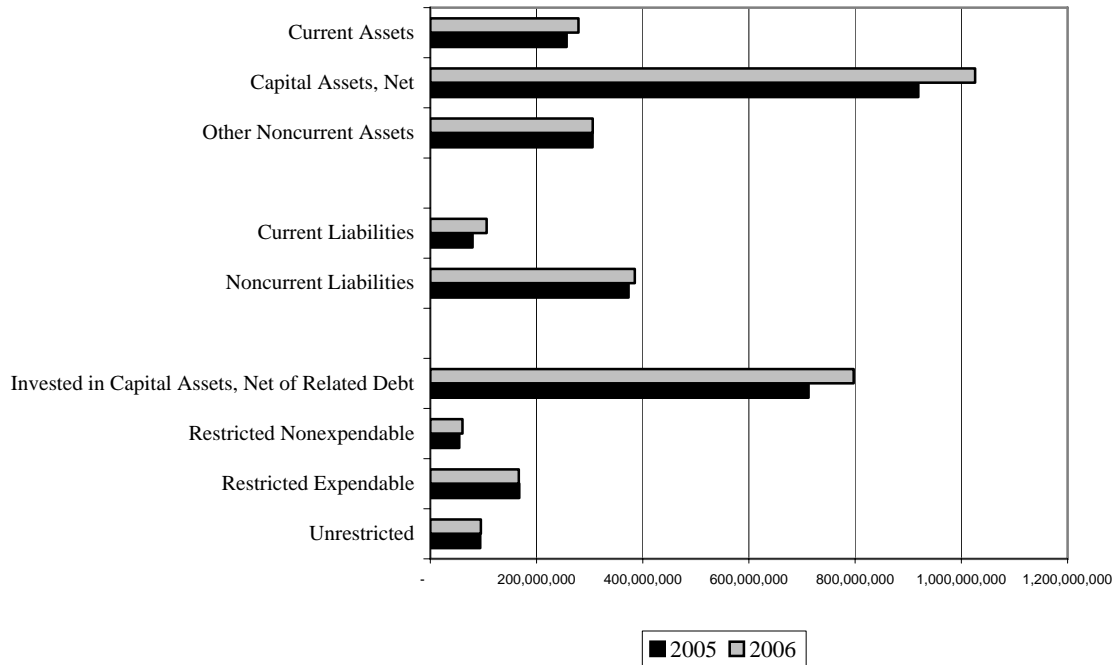
The *Statement of Net Assets* provides information regarding the University's assets, liabilities, and net assets as of June 30, 2006. Asset and liability balances are classified as either current or noncurrent. Assets classified as current are those that are available to pay for current liabilities or current year expenditures. Liabilities classified as current are those that are due and payable in the next fiscal year. The net asset balances are classified as either invested in capital assets, net of related debt, restricted or unrestricted. In addition, net assets classified as restricted are classified as either nonexpendable or expendable. Overall, the *Statement of Net Assets* provides information to evaluate the financial strength of the University and its ability to meet current and long-term obligations.

Following is a comparative analysis on the condensed balances reported in the *Statement of Net Assets* as of June 30, 2006, and 2005.

	2006	2005	Increase/ (Decrease)
Assets			
Current Assets	\$ 278,960,603	\$ 256,646,594	\$ 22,314,009
Capital Assets, Net	1,025,755,445	918,993,804	106,761,641
Other Noncurrent Assets	305,914,848	305,552,428	362,420
Total Assets	<u>1,610,630,896</u>	<u>1,481,192,826</u>	<u>129,438,070</u>
Liabilities			
Current Liabilities	106,087,466	79,595,009	26,492,457
Noncurrent Liabilities	385,046,545	373,333,728	11,712,817
Total Liabilities	<u>491,134,011</u>	<u>452,928,737</u>	<u>38,205,274</u>
Net Assets			
Invested in Capital Assets, Net of Related Debt	797,135,394	712,183,236	84,952,158
Restricted			
Nonexpendable	60,415,528	54,518,640	5,896,888
Expendable	166,734,710	167,621,179	(886,469)
Unrestricted	95,211,253	93,941,034	1,270,219
Total Net Assets	<u>\$ 1,119,496,885</u>	<u>\$ 1,028,264,089</u>	<u>\$ 91,232,796</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graph illustrates the assets, liabilities and net assets of the University as of June 30, 2006, as compared to June 30, 2005.



Assets totaled \$1.6 billion, an increase of \$129.4 million over the prior year. The increase in assets includes capital asset growth of \$106.8 million, an increase in other noncurrent assets of \$.4 million, and an increase in current assets of \$22.3 million.

The capital asset growth is due primarily to \$70.8 million in capital grants, including the State's higher education bond program. Another major factor is some \$18.3 million from capital appropriations. Bond and commercial paper financing provided available funds for the remaining capital growth.

Other noncurrent assets increased by just \$.4 million. Increases in endowment investments and other long-term investments of \$31.2 million were offset by decreases in noncurrent restricted cash of \$18.1 million and restricted due from primary government of \$13.1 million. The growth in long-term investment balances is the result of increased external participation in the NC State Investment Fund and realized and unrealized gains. The restricted due from primary government decreased because the receivable for state-wide bonds and certificates of participation dropped. Noncurrent restricted cash dropped because financing proceeds held in the prior year were used. Unexpended financing proceeds decreased from \$30.4 million to \$14.4 million in fiscal year 2006. Also, more cash was moved to current restricted cash to cover increased payables.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The net increase in current assets is caused by a \$14.1 million increase in cash and cash equivalents and an increase in restricted cash of \$11.9 million, as more was necessary to cover current liabilities and short-term debt. Receivables also rose by \$5.1 million. These increases are partially offset by decreases in other receivables, mainly in due from State of North Carolina component units (The Golden LEAF, Inc.).

Liabilities totaled \$491.1 million, an increase of \$38.2 million over the prior year. The increase in liabilities is attributable to an increase in noncurrent liabilities of \$11.7 million and an increase in current liabilities of \$26.5 million.

The most significant factor in the noncurrent liabilities increase is the \$16.9 million rise in funds held in trust for investment pool participants (various foundations). This increase was partially offset by a decrease in long-term liabilities, mainly in bonds payable. The current liability increase is caused by a \$14.0 million increase in commercial paper short-term debt, an \$8.0 million increase in accounts payable and accrued liabilities (primarily in retainage and later paid employee benefit liabilities), and smaller increases in other liability accounts.

Net assets totaled \$1.1 billion, an increase of \$91.2 million over the prior year. The higher net assets are attributable to increases of \$84.9 million in capital assets, net of related debt, \$5.0 million in restricted balances, and \$1.3 million in unrestricted balances.

The University's current assets are more than sufficient to cover current liabilities with a ratio of 2.6x, as compared to 3.2x in the prior year. The University's total assets excluding capital assets, net of depreciation, are more than sufficient to cover total liabilities with a ratio of 1.2x, as compared to 1.2x in the prior year. The University's total assets are significantly more than the University's liabilities with a ratio of 3.3x, as compared to 3.3x in the prior year. These financial ratios are indicators of NC State's financial strength and its ability to meet current and long-term obligations.

Statement of Revenues, Expenses, and Changes in Net Assets

The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information regarding the University's activities for the year ending June 30, 2006. The activity balances are classified as operating, nonoperating, or other. Activities classified as operating include all revenues of the University except those considered nonoperating or those associated with funds received to enhance capital assets or permanent endowments, and all expenses except those related to interest expense on financing activities, loss on disposal of capital assets, and investment expenses (shown as net against investment income). Activities classified as nonoperating include State appropriations, noncapital gifts and grants revenue, investment income (net of investment expenses), and gains or losses on disposal of capital assets. Activities classified as other include capital gifts or grants and additions to permanent endowments. Overall, the *Statement of Revenues, Expenses, and Changes in Net Assets* provides information to evaluate the University's management of operations and maintenance of financial strength.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Following is a comparative analysis on the condensed balances reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* for the fiscal years ended June 30, 2006, and 2005.

	<u>2006</u>	<u>2005</u>	<u>Increase/ (Decrease)</u>
Operating Activities:			
Operating Revenues	\$ 489,385,302	\$ 467,603,184	\$ 21,782,118
Operating Expenses	<u>956,888,382</u>	<u>892,259,241</u>	<u>64,629,141</u>
Net Operating Loss	(467,503,080)	<u>(424,656,057)</u>	(42,847,023)
Nonoperating Activities:			
Nonoperating Revenues	467,042,836	439,368,289	27,674,547
Nonoperating Expenses	<u>8,187,273</u>	<u>6,601,969</u>	<u>1,585,304</u>
Net Nonoperating Revenues	<u>458,855,563</u>	<u>432,766,320</u>	<u>26,089,243</u>
Other Activities:			
Capital Grants and Gifts	94,590,022	113,909,198	(19,319,176)
Additions to Permanent Endowments	<u>5,290,291</u>	<u>1,076,833</u>	<u>4,213,458</u>
Total Other Activity Increases	<u>99,880,313</u>	<u>114,986,031</u>	<u>(15,105,718)</u>
Increases in Net Assets	<u>\$ 91,232,796</u>	<u>\$ 123,096,294</u>	<u>\$ (31,863,498)</u>

The 2005 balances were restated to be consistent with the current year presentation by following the current year methodology on scholarship discounting and in moving Public Safety from Institutional Support to Operations and Maintenance of Plant.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating and Nonoperating Activities

The following illustrates the relationships of operating and nonoperating revenue sources and expense functions to total revenue/expenses for the fiscal year 2006 and 2005, and the consistency of relationships between the two years.

Operating and Nonoperating Revenues

Title	<u>% to Total 2006</u>	<u>% to Total 2005</u>
State Appropriations	42%	41%
Research Contracts and Grants	20%	21%
Student Tuition and Fees	14%	14%
Sales and Services	14%	14%
Noncapital Grants and Gifts	5%	5%
Federal Appropriations	2%	2%
Other	<u>3%</u>	<u>3%</u>
Total	<u>100%</u>	<u>100%</u>

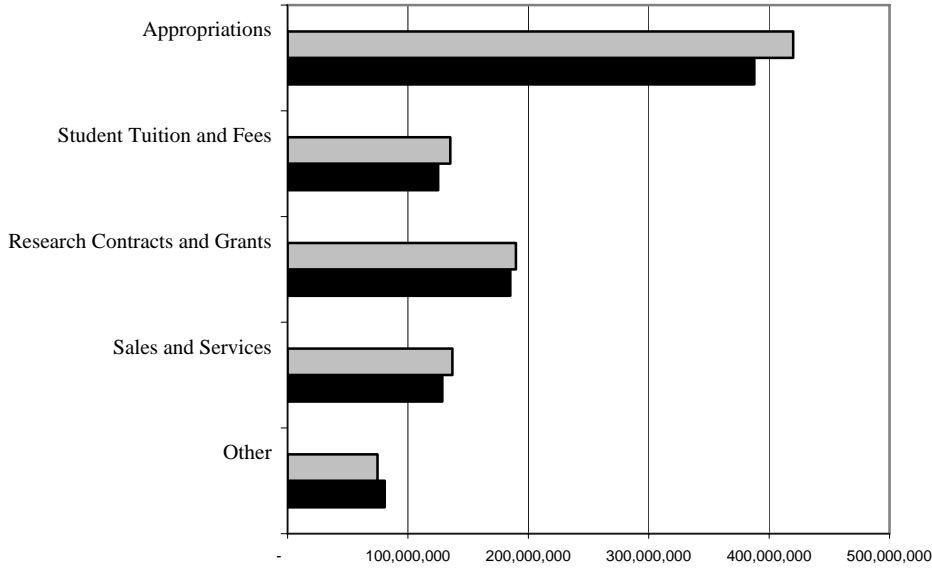
Operating and Nonoperating Expenses

Title	<u>% to Total 2006</u>	<u>% to Total 2005</u>
Instruction	28%	28%
Research	21%	21%
Public Service	11%	11%
Auxiliary Enterprises	11%	11%
Operations & Maintenance of Plant	8%	7%
Academic Support	7%	7%
Institutional Support	5%	5%
Depreciation	4%	4%
Student Financial Aid	2%	3%
Student Services	2%	2%
Other	<u>1%</u>	<u>1%</u>
Total	<u>100%</u>	<u>100%</u>

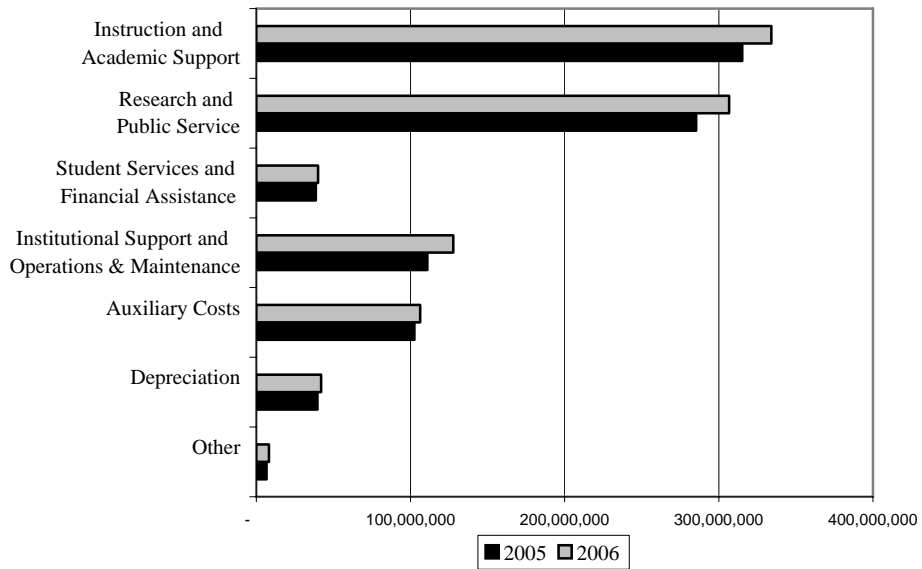
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graphs illustrate the University's operating and nonoperating revenues/expenses by source/function.

Operating and Nonoperating Revenues



Operating and Nonoperating Expenses



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total revenues (operating and nonoperating) increased \$49.5 million or 5.5% over the prior year. Appropriations (State and Federal Land Grant Institution), increased by \$32.3 million or 8.3% over the prior year as a result of increased enrollments and legislative salary increases. Student tuition and fees increased by \$10.1 million or 8.1% over the prior year because of enrollment growth and approved tuition and fee rate increases. Research contracts and grants increased by \$4.6 million or 2.5% over the prior year due to additional demand for services. Sales and services increased by \$8.4 million or 6.5% over the prior year. This increase resulted from auxiliary growth, primarily in Veterinary Hospital, housing, and food services revenues. Other revenues (including operating and nonoperating sources) had a net decrease of \$6.0 million or (7.4%) over the prior year, primarily as a result of a large gain on a real estate transaction in 2005 and a decrease in Golden LEAF noncapital grants in 2006.

Total expenses (operating and nonoperating) increased \$66.2 million or 7.4% over the prior year, primarily as a result of increases in salaries and benefits of \$42.7 million and supplies and materials of \$12.0 million. The salaries and benefits increase is due primarily to a 2.0% salary increase and the one week bonus leave granted by the legislature. The supplies increase is the result of increased spending on scientific equipment, computer hardware and software, agricultural and animal supplies, and furniture.

Other Activity

Other activity totaled \$99.9 million, down \$15.1 million from the prior year. This decrease is caused by a \$41.1 million drop in State bond proceeds and \$1.6 million drop in capital gifts. These decreases are offset by increases of \$6.7 million in Certificate of Participation (COPS) funding, \$2.8 million Golden LEAF and other capital grants, \$13.9 million in capital appropriations, and \$4.2 million in additions to endowments. The other activity total includes \$89.1 million in capital grants and appropriations (primarily in State bond proceeds), \$5.5 million in capital gifts and \$5.3 million in permanent endowments.

Statement of Cash Flows

The *Statement of Cash Flows* provides information about the University's cash activities for the year. The sources and uses of cash are classified as operating activities, noncapital financing activities, capital financing activities, and investing activities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Following is a comparative analysis on the condensed balances reported in the *Statement of Cash Flows* for the fiscal years ended June 30, 2006, and 2005.

	<u>2006</u>	<u>2005</u>	<u>Increase/ (Decrease)</u>
Operating Activities			
Sources	\$ 490,559,619	\$ 463,189,348	\$ 27,370,271
Uses	<u>908,745,554</u>	<u>853,173,948</u>	<u>55,571,606</u>
Cash Used by Operating Activities	<u>(418,185,935)</u>	<u>(389,984,600)</u>	<u>(28,201,335)</u>
Noncapital Financing Activities			
Sources	543,487,391	515,053,334	28,434,057
Uses	<u>76,679,873</u>	<u>72,636,196</u>	<u>4,043,677</u>
Cash Provided by Noncapital Financing Activities	<u>466,807,518</u>	<u>442,417,138</u>	<u>24,390,380</u>
Capital Financing Activities			
Sources	128,517,096	241,032,753	(112,515,657)
Uses	<u>161,624,501</u>	<u>255,289,620</u>	<u>(93,665,119)</u>
Cash Used by Capital Financing Activities	(33,107,405)	(14,256,867)	(18,850,538)
Investing Activities			
Sources	466,833,938	634,151,846	(167,317,908)
Uses	<u>474,522,614</u>	<u>659,103,511</u>	<u>(184,580,897)</u>
Cash Provided (Used) by Investing Activities	<u>(7,688,676)</u>	<u>(24,951,665)</u>	<u>17,262,989</u>
Net Increase (Decrease) in Cash	<u>\$ 7,825,502</u>	<u>\$ 13,224,006</u>	<u>\$ (5,398,504)</u>

Cash increased by \$7.8 million during fiscal year 2006, compared to an increase of \$13.2 million in the prior year. Major factors in the current year were the increases in customer receipts and unexpended capital appropriations.

The *Statement of Cash Flows* is divided into four types of activities that generate and use cash. The first section deals with cash flows from operating activities, and includes sources such as tuition and fees and contracts and grants. Major operating uses of cash include salaries and payments to vendors. Because appropriations, gifts, and some grants are not considered operating activities, generally the University has a net outflow of cash in operating activities. Fiscal years 2006 and 2005 both show cash used by operating activities.

Cash provided by noncapital financing activities includes sources such as appropriations, Federal Family Education Loan receipts, foundations' deposits for investment, and noncapital gifts and grants. Noncapital financing uses include Federal Family Education Loan disbursements and other payments.

Cash provided by capital financing activities includes sources such as proceeds from capital debt and capital appropriations, grants and gifts. Major capital financing uses include

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

purchases of capital assets and payment of principal and interest on capital debt. The cash flows from capital financing showed net cash used of \$33.1 million. Cash used exceeded cash provided, primarily because cash used for acquisition and construction of capital assets included financing proceeds received in the prior year.

Cash flows from investing activities include sources such as proceeds from investment transactions and dividend and interest income. The major investing use of cash is the purchase of investments. The cash flows from investing activities showed net cash used of \$7.7 million. Cash used exceeded cash provided because the purchases of investments (cash use) is included in investing activities, while the external participation in the Investment Fund (cash provided) is included in noncapital financing activities.

Capital Assets and Long-Term Debt Activities

Capital Assets

The University capitalizes assets that have a value or cost equal to or greater than \$5,000 at the date of acquisition and an expected useful life of more than one year. Repairs and renovations that do not extend the life of the building beyond the expected useful life at acquisition, nor increase the future service potential of the building are expensed and not capitalized.

Machinery and Equipment are depreciated over their estimated useful lives, generally 3 to 15 years beginning in the year of acquisition. Buildings and General Infrastructure are depreciated over their estimated useful lives, generally 10 to 50 years for buildings and 15 to 75 years for general infrastructure beginning in the year that the construction is completed or, if purchased after construction, when acquired. Land and Construction in Progress are nondepreciable capital assets. When a construction project is completed, the capital project costs are moved from the Construction in Progress account to either Buildings or General Infrastructure as appropriate.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

As shown in the following table, the University increased its net capital assets by \$106.8 million during fiscal year 2006.

	<u>2006</u>	<u>2005</u>	<u>Increase/ Decrease</u>
Land	\$ 23,330,450	\$ 22,951,966	\$ 378,484
Construction in Progress	97,809,121	170,116,963	(72,307,842)
Buildings	1,025,273,474	828,493,888	196,779,586
Machinery and Equipment	223,790,341	224,020,918	(230,577)
General Infrastructure	<u>104,423,851</u>	<u>96,923,003</u>	<u>7,500,848</u>
Total Capital Assets	1,474,627,237	1,342,506,738	132,120,499
Accumulated Depreciation	<u>448,871,792</u>	<u>423,512,934</u>	<u>25,358,858</u>
Net Capital Assets	<u>\$ 1,025,755,445</u>	<u>\$ 918,993,804</u>	<u>\$ 106,761,641</u>

In addition to costs incurred, the University had \$107.7 million in outstanding commitments for construction projects as of June 30, 2006.

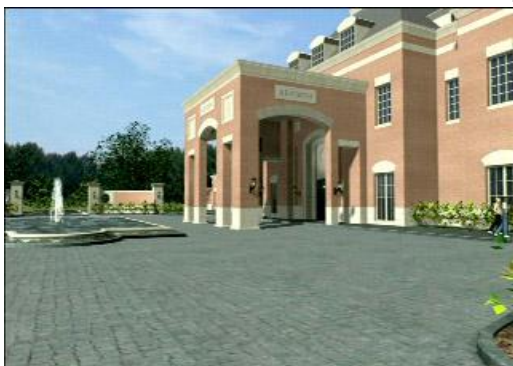
The major change in capital assets during the year was related to the improvement and modernization of Buildings and General Infrastructure. These improvements were provided primarily by funds from the State of North Carolina Higher Education Improvement Bond Referendum (State Bond Program), State capital appropriations, and University debt financing.

Following are some of the major construction projects completed or in progress as of June 30, 2006.

Construction of the College of Engineering Complex-Phase II was completed during fiscal year 2006. This state of the art building is located on Centennial Campus and will provide Computer Science and Electrical and Computer Engineering with laboratories, offices and classrooms.

Renovations to the David Clark Laboratory Building were completed during fiscal year 2006. This project entailed renovating approximately 41,800 gross square feet of existing interior space and adding an additional 16,000 gross square feet for the Zoology and Biological Sciences Programs.

Also finished was a complete modernization of the Schaub Food Science Building. This renovation entailed an overhaul of 96,300 gross square feet for mechanical, electrical and laboratory systems, classrooms and office spaces.



Construction of the new 59,000-square foot Dorothy and Roy Park Alumni Center on Centennial Campus continued throughout fiscal year 2006, and is expected to open its doors in mid fiscal year 2007.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

As the location for reunions, post-game receptions, parties and seminars, Chancellor James L. Oblinger described the Park Alumni Center as a home for alumni to celebrate important events in their own lives and in the life of NC State.

Current renovation projects on campus include the modernization of mechanical, electrical, laboratory systems and classrooms and office spaces in South Gardner Hall for the departments of Genetics, Microbiology, Plant Pathology and Entomology.

The addition of 40,000 gross square feet to Jordan Hall adds classrooms, lecture halls, distance-learning facilities and class labs for the College of Natural Resources and Physical and Mathematical Sciences.

The new E. Carroll Joyner Visitor Center and Advancement Services Building neared completion and was partially occupied by the advancement staff in fiscal year 2006, with an official opening in September 2006. Prospective students and their parents will begin their campus visits at the center and get a glimpse into what makes NC State one of the finest universities in America.



The Daniels Hall Laboratory Building, Phase I renovation for Engineering undergraduate functions includes the modernization of mechanical, electrical, and HVAC systems, classroom and office spaces.

Also, current renovations are taking place in the D.H. Hill Library to reclaim approximately 20,000 gross square feet of former staff workspace for public areas including a Special Collections Research Center, a new reading room and an exhibit gallery. In addition, the Library's infrastructure is being upgraded with the new, technology rich Learning Commons area.



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

More information about the University's long-range capital plan is located at http://www.ncsu.edu/facilities/construction_info/index.htm

Long-term Debt Activities

The University incurs long-term debt to finance construction projects, to purchase equipment using lease arrangements and to provide for accumulated unused vacation benefits for employees. As shown in the following chart, the University decreased its long-term debt by \$3.4 million during fiscal year 2006.

	<u>2006</u>	<u>2005</u>	<u>Increase/ (Decrease)</u>
Bonds Payable	\$ 211,173,722	\$ 222,068,796	\$ (10,895,074)
Capital Leases Payable	273,821	99,263	174,558
Compensated Absences	<u>50,825,595</u>	<u>43,546,662</u>	<u>7,278,933</u>
Total Long-term Liabilities	<u>\$ 262,273,138</u>	<u>\$ 265,714,721</u>	<u>\$ (3,441,583)</u>

There were no major changes in long-term debt in 2006. Bond debt principal payments and early payment of \$2.9 million in parking bonds explain the \$10.9 million decrease in bonds payable. Normal debt payments increased by \$1.1 million because of the \$81.6 million bond issue in fiscal year 2005. The one week vacation bonus granted by the legislature was the primary cause of the \$7.3 million increase in compensated absences.

Economic Factors That Will Affect the Future

Throughout its history, NC State has been dedicated to excellence in scholarship, extension, and research. The State of North Carolina has continued to demonstrate strong support for higher education. State appropriations (including capital appropriations) to NC State increased 12.8% in fiscal year 2006 and 21.4% in fiscal year 2007. Fiscal year 2007 tuition and fee increases of \$325 and \$105, respectively, will continue the upward trend in tuition and fee revenues. NC State's student enrollment is up 980 students, 31,129 for Fall 2006 as compared to 30,149 for Fall 2005. NC State ranks 16th out of 17 among its peer universities for tuition and fees. This rating is indicative of NCSU's affordability and value as compared to its peer group.

New University of North Carolina system President Erskine Bowles has instituted several initiatives to assure the legislature, taxpayers and students that University resources are used efficiently and effectively. He has commissioned a blue-ribbon President's Advisory Committee on Efficiency & Effectiveness (PACE) to review information from all the UNC universities. The committee will provide findings and recommendations on savings and operational improvements throughout the UNC system. Also, based on a proposal by President Bowles, the UNC Board of Governors approved a 6.5 percent annual cap on in-State tuition increases for UNC campuses for the next four years. President Bowles stated that the University must meet its constitutional and moral responsibility to keep tuition low, but ensure funding is adequate to provide a high-quality education.

North Carolina State University
Statement of Net Assets
June 30, 2006

Exhibit A-1

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 140,345,412
Restricted Cash and Cash Equivalents	50,387,375
Restricted Short-Term Investments	1,575,822
Receivables, Net (Note 4)	39,544,086
Due from Primary Government	8,957,309
Due from State of North Carolina Component Units	32,820,576
Inventories	4,123,846
Notes Receivable, Net (Note 4)	1,206,177
	<hr/>
Total Current Assets	278,960,603
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	10,032,320
Restricted Due from Primary Government	3,952,242
Endowment Investments	155,116,373
Other Long-Term Investments	125,826,480
Notes Receivable, Net (Note 4)	10,987,433
Capital Assets - Nondepreciable (Note 5)	121,139,571
Capital Assets - Depreciable, Net (Note 5)	904,615,874
	<hr/>
Total Noncurrent Assets	1,331,670,293
	<hr/>
Total Assets	1,610,630,896

LIABILITIES

Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	48,556,848
Due to Primary Government	346,461
Unearned Revenue	28,119,364
Interest Payable	1,989,494
Short-Term Debt (Note 7)	16,000,000
Long-Term Liabilities - Current Portion (Note 8)	11,075,299
	<hr/>
Total Current Liabilities	106,087,466
Noncurrent Liabilities:	
Deposits Payable	54,928
Funds Held for Others	2,286,510
U. S. Government Grants Refundable	6,368,396
Funds Held in Trust for Pool Participants	125,138,872
Long-Term Liabilities (Note 8)	251,197,839
	<hr/>
Total Noncurrent Liabilities	385,046,545
	<hr/>
Total Liabilities	491,134,011

North Carolina State University
Statement of Net Assets
June 30, 2006

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	797,135,394
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	9,452,850
Endowed Professorships	30,259,539
Departmental Uses	13,874,403
Loans	5,876,757
Other	951,979
Expendable:	
Scholarships and Fellowships	23,148,962
Research	15,504,530
Endowed Professorships	52,838,171
Departmental Uses	19,682,983
Loans	1,561,818
Capital Projects	46,985,145
Debt Service	1,652,441
Other	5,360,660
Unrestricted	95,211,253
Total Net Assets	<u><u>\$ 1,119,496,885</u></u>

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

North Carolina State University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2006

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 10)	\$ 135,105,304
Federal Appropriations	20,065,027
Federal Grants and Contracts	107,497,258
State and Local Grants and Contracts	33,774,114
Nongovernmental Grants and Contracts	48,365,619
Sales and Services, Net (Note 10)	136,939,626
Interest Earnings on Loans	163,363
Other Operating Revenues, Net (Note 10)	7,474,991
	<hr/>
Total Operating Revenues	489,385,302

EXPENSES

Operating Expenses:	
Salaries and Benefits	596,722,831
Supplies and Materials	114,057,877
Services	149,827,292
Scholarships and Fellowships	22,131,353
Utilities	32,139,776
Depreciation	42,009,253
	<hr/>
Total Operating Expenses	956,888,382
	<hr/>
Operating Loss	(467,503,080)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	399,960,661
Noncapital Grants	1,811,375
Noncapital Gifts	42,695,745
Investment Income (Net of Investment Expense of \$817,174)	14,311,141
Interest and Fees on Debt	(8,187,273)
Other Nonoperating Revenues	8,263,914
	<hr/>
Net Nonoperating Revenues	458,855,563
	<hr/>
Loss Before Other Revenues, Expenses, Gains, or Losses	(8,647,517)
Capital Appropriations	18,309,100
Capital Grants	70,814,354
Capital Gifts	5,466,568
Additions to Endowments	5,290,291
	<hr/>
Increase in Net Assets	91,232,796

NET ASSETS

Net Assets - July 1, 2005	<hr/>
	1,028,264,089
Net Assets - June 30, 2006	<hr/>
	\$ 1,119,496,885

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

North Carolina State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 480,402,008
Payments to Employees and Fringe Benefits	(586,990,112)
Payments to Vendors and Suppliers	(296,874,449)
Payments for Scholarships and Fellowships	(22,131,353)
Loans Issued	(2,749,640)
Collection of Loans	2,506,371
Interest Earned on Loans	176,249
Other Receipts	7,474,991
	<hr/>
Net Cash Used by Operating Activities	(418,185,935)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	399,960,661
Noncapital Grants	9,463,624
Noncapital Gifts	43,693,632
Additions to Endowments	5,290,291
Federal Family Education Loan Receipts	76,001,712
Federal Family Education Loan Disbursements	(76,215,296)
External Participation in Investment Fund	9,077,471
Other Payments	(464,577)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	466,807,518

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	16,000,000
State Capital Appropriations	18,309,100
Capital Grants	83,212,732
Capital Gifts	3,976,948
Proceeds from Sale of Capital Assets	7,018,316
Acquisition and Construction of Capital Assets	(138,855,410)
Principal Paid on Capital Debt and Leases	(12,521,156)
Interest and Fees Paid on Capital Debt and Leases	(9,878,544)
Other Payments	(369,391)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(33,107,405)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	456,563,790
Investment Income	10,270,148
Purchase of Investments and Related Fees	(474,522,614)
	<hr/>
Net Cash Used by Investing Activities	(7,688,676)
	<hr/>
Net Increase in Cash and Cash Equivalents	7,825,502
Cash and Cash Equivalents - July 1, 2005	192,939,605
	<hr/>
Cash and Cash Equivalents - June 30, 2006	\$ 200,765,107

North Carolina State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3

Page 2

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

Operating Loss	\$ (467,503,080)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	42,009,253
Allowances, Write-Offs, and Amortizations	(284,692)
Changes in Assets and Liabilities:	
Receivables (Net)	(3,587,868)
Inventories	(232,452)
Accounts Payable and Accrued Liabilities	309,392
Unearned Revenue	3,837,387
Compensated Absences	7,278,933
Deposits Payable	(12,808)
	<hr/>
Net Cash Used by Operating Activities	<u><u>\$ (418,185,935)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 140,345,412
Restricted Cash and Cash Equivalents	50,387,375
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	10,032,320
	<hr/>
Total Cash and Cash Equivalents - June 30, 2006	<u><u>\$ 200,765,107</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 260,714
Assets Acquired through a Gift	2,059,890
Change in Fair Value of Investments	7,121,502
Loss on Disposal of Capital Assets	(1,763,131)

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

North Carolina State University Foundations
Statement of Financial Position
June 30, 2006

Exhibit B-1

	North Carolina State University Foundation, Inc.	NCSU Student Aid Association, Inc.
ASSETS		
Cash and Cash Equivalents	\$ 1,058,570	\$ 23,613,071
Investments	12,696,874	22,447,347
Investments with University Investment Pool	59,064,009	
Cash Surrender Value of Life Insurance	105,307	182,035
Real Estate Held for Resale	126,500	8,083,329
Receivables, Net		283,306
Pledges Receivable/Promises	5,389,717	44,685,060
Prepaid Expenses		64,671
Swap Contracts		1,819,797
Notes/Loans Receivable, Net		66,350
Property and Equipment, Net	251,866	69,089,086
	<hr/>	<hr/>
Total Assets	78,692,843	170,334,052
LIABILITIES		
Accounts Payable and Accrued Expenses	476,902	6,323,600
Deferred Revenue		2,228,049
Interest Payable		352,839
Deposits Payable		90,800
Funds Held for Others	395,125	
Split Interest Agreement Obligations	4,364,234	
Notes Payable		6,748,305
Bonds Payable		83,515,000
	<hr/>	<hr/>
Total Liabilities	5,236,261	99,258,593
NET ASSETS		
Unrestricted	11,967,160	17,471,475
Temporarily Restricted	27,072,231	29,925,475
Permanently Restricted	34,417,191	23,678,509
	<hr/>	<hr/>
Total Net Assets	\$ 73,456,582	\$ 71,075,459

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

North Carolina State University Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2006

Exhibit B-2

	North Carolina State University Foundation, Inc.	NCSU Student Aid Association, Inc.
CHANGES IN UNRESTRICTED NET ASSETS		
Revenues and Gains:		
Contributions	\$ 601,821	\$ 8,383,852
Donated Services and Noncash Contributions	190,500	1,926,394
Alumni Membership and Sales	1,060,174	296,220
Student Housing Rents		2,405,646
Income on Long-Term Investments	417,765	
Other Investment Income		1,129,531
Net Unrealized and Realized Gains on Long-Term Investments	995,191	252,914
Unrealized Gain on Swap Contracts		1,722,735
Other	960,960	1,255,645
Total Unrestricted Revenues and Gains	4,226,411	17,372,937
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	7,939,681	
Satisfaction of Equipment Acquisition Restrictions		7,539,840
Total Unrestricted Revenues, Gains, and Other Support	12,166,092	24,912,777
Expenses and Losses:		
University Support	9,292,477	7,222,110
University Facilities Support		7,539,840
Alumni Activities	799,166	
Student Housing		3,139,482
Management and General	282,922	462,346
Fund Raising	537,311	2,270,246
Total Expenses	10,911,876	20,634,024
Increase in Unrestricted Net Assets	1,254,216	4,278,753
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
Contributions	5,760,972	12,422,960
Donated Services and Noncash Contributions	126,500	127,199
Alumni Membership and Sales	27,888	
Income on Long-Term Investments	567,226	
Other Investment Income		432,179
Net Unrealized and Realized Gains on Long-Term Investments	2,744,464	
Unrealized Gain on Swap Contracts		1,879,315
Other	113	4,527,807
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	(7,939,681)	
Satisfaction of Equipment Acquisition Restrictions		(7,539,840)
Increase in Temporarily Restricted Net Assets	1,287,482	11,849,620
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Contributions	1,208,260	639,965
Donated Services and Noncash Contributions		279,950
Income on Long-Term Investments	182,246	
Other Investment Expense		(556,735)
Net Unrealized and Realized Gains on Long-Term Investments	120,064	555,036
Change in Value of Split Interest Agreements	(419,255)	
Other		79,562
Increase in Permanently Restricted Net Assets	1,091,315	997,778
Increase in Net Assets	3,633,013	17,126,151
Net Assets at Beginning of Year	69,823,569	53,949,308
Net Assets at End of Year	<u>\$ 73,456,582</u>	<u>\$ 71,075,459</u>

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

NORTH CAROLINA STATE UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. North Carolina 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 either blended or discretely presented in the University's financial statements. The blended component units, although legally separate, are, in substance, part of the University's operations and therefore, are reported as if they were part of the University. 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.

Blended Component Units - Although legally separate, the NC State Investment Fund, Inc., (Investment Fund) and the NC State University Partnership Corporation (Corporation), component units of the University, are reported as if they were part of the University.

The Investment Fund is governed by a Members Board consisting of six ex officio directors and five elected representatives. The Investment Fund's purpose is to support the University by operating an investment fund for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The Investment Fund is a governmental external investment pool. Because the majority of the Members Board of the Investment Fund consist of University administrators and Board Members

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and the Investment Fund's primary purpose is to benefit North Carolina State University, its financial statements have been blended with those of the University.

The Corporation is governed by a Board of Directors appointed by the Chancellor of the University. The Corporation's purpose is to support and benefit the University with the aims of creating new knowledge and improving the lives of the people of North Carolina. In addition, the Corporation formed NC State University Conference Center, LLC (LLC) on January 25, 2002, to develop, own, and operate a hotel, conference center, and public golf course on the Centennial Campus as outlined in the Campus Master Plan. Because the Corporation's Board is appointed by the Chancellor and its sole purpose is to support and benefit the University, both the Corporation and the LLC are considered part of the University for financial reporting purposes.

Separate financial statements for the Investment Fund may be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149. Financial information relative to the Corporation and the LLC may be obtained from the President of the Board of Directors, Campus Box 7003, Raleigh, NC 27695, or by calling (919) 515-2117. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

Discretely Presented Component Units – The North Carolina State University Foundation, Inc. (Foundation) and NCSU Student Aid Association, Inc. (Athletic Club) 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 Foundation and Athletic Club are legally separate, tax-exempt component units of the University. These entities act primarily as fund-raising organizations to supplement the resources that are available to the University in support of its programs. Separate Boards of Directors govern these entities independent of the University's Board of Trustees. Although the University does not control the timing or amount of receipts from these entities, the majority of resources, or income thereon, that these entities hold and invest are restricted to the activities of the University by the donors. Because these restricted resources held by these entities can only be used by, or for the benefit of the University, these entities are considered component units of the University and are reported in separate financial statements because of the difference in their reporting model, as described below.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

During the year ended June 30, 2006, the Foundation distributed \$9,372,010 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149.

During the year ended June 30, 2006, the Athletic Club distributed \$6,885,315 to the University for both restricted and unrestricted purposes. Complete financial statements for the Athletic Club can be obtained from the NCSU Student Aid Association, PO Box 37100 Raleigh, NC 27627, or by calling (919) 865-1500.

- 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, for proprietary activities, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - This classification includes long-term fixed income investments, equity investments, foreign equity mutual funds, money market funds, limited partnerships, real estate investment trusts, real estate, alternative investments such as private equity, and other asset holdings by the University. Private equities include venture capital partnerships, buyouts, and international funds. Except for money market funds, private equity, real estate not held by a governmental external investment pool, and other asset holdings, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated. Private equity funds consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are valued utilizing the most current information provided by the general partner.

- F. Receivables** – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.

- G. Inventories** – Inventories, consisting of expendable supplies and merchandise for resale, are valued at the lower of cost or market value using the first-in, first-out method. Exceptions are the bookstore, which uses the retail method, and physical plant, which uses the moving weighted average 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 15 to 75 years for general infrastructure, 10 to 50 years for buildings, and 3 to 15 years for equipment.

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

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.
- J. Funds Held in Trust for Pool Participants** – Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Bonds payable are reported net of unamortized premium or discount. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. Losses on refundings and issuance costs on bonds payable are not material to the accompanying financial statements and are expensed in the year incurred.

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

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

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.

- M. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

- N. 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 operating 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.
- O. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

- P. 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, University Graphics, the Copy Center, the Creamery, Telecommunications, Physical Plant, and Motor Pool. In addition, the University has other miscellaneous sales and service units that operate 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, 2006, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$199,942,725 which represents the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University's equity position in the State Treasurer's Short-Term Investment Fund. 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 1.18 years as of June 30, 2006. 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.

Cash on hand at June 30, 2006, was \$443,862. The carrying amount of the University's deposits not with the State Treasurer was \$378,520 and the bank balance was \$597,082. 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, 2006, \$226,238 of the University's bank balance was 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 Investment Fund, a University component unit, 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 are subject to the following risks.

Interest Rate Risk: Interest rate risk is the risk the University may face should interest rate variances affect the fair value of investments. The University does not have a formal policy that addresses interest rate risk.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University does not have a formal policy that addresses credit risk.

Custodial Credit Risk: 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.

Foreign Currency Risk: Foreign currency risk is 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Following is a discussion of the various pooled and non-pooled investment risks.

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Pool ownership is measured using the unit value method. Under this method, each participating fund's investment balance is determined on a market value basis. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board. This pool also participates in the Investment Fund.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the Long-Term Investment Pool.

Long-Term Investment Pool (Excludes Amounts Reported in the Investment Fund)

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
U.S. Treasuries	\$ 951,697	\$ 0	\$ 176,422	\$ 274,936	\$ 500,339
U.S. Agencies	654,471	34,430		117,664	502,377
Mortgage Pass Throughs	866,371				866,371
Collateralized Mortgage Obligations	774,998				774,998
State and Local Government	198,302		90,200	47,357	60,745
Asset-Backed Securities	29,262				29,262
Mutual Bond Funds	9,594,705			9,594,705	
Money Market Funds	225,076	225,076			
Domestic Corporate Bonds	1,152,538	20,012	534,990	411,435	186,101
Foreign Corporate Bonds	123,213	15,014	66,406	27,843	13,950
	<u>14,570,633</u>	<u>\$ 294,532</u>	<u>\$ 868,018</u>	<u>\$ 10,473,940</u>	<u>\$ 2,934,143</u>
Other Securities					
Pooled Investments	358,551				
Venture Capital	6,709,491				
Total Long-Term Investment Pool	<u>\$ 21,638,675</u>				

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2006, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB Ba	B	Unrated
Debt Securities Subject to Credit Risk Disclosures:								
U.S. Agencies	\$ 445,573	\$ 445,573	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Mortgage Pass Throughs	820,311	820,311						
Collateralized Mortgage Obligations	774,998	751,437	23,561					
State and Local Government	198,302	179,694	18,608					
Asset-backed Securities	29,262	29,262						
Mutual Bond Funds	9,594,705	4,494,307	4,854,276			246,122		
Money Market Funds	225,076	45,274		130,023				49,779
Domestic Corporate Bonds	1,152,538	21,241	23,457	320,668	495,744	226,247	65,181	
Foreign Corporate Bonds	123,213		26,162	37,541	47,240	12,270		
	<u>13,363,978</u>	<u>\$ 6,787,099</u>	<u>\$ 4,946,064</u>	<u>\$ 488,232</u>	<u>\$ 542,984</u>	<u>\$ 484,639</u>	<u>\$ 65,181</u>	<u>\$ 49,779</u>
Debt Securities Exempt From Credit Risk Disclosure:								
U.S. Treasuries	951,697							
U.S. Agencies	208,898							
Mortgage Pass Throughs	46,060							
Total Long-Term Investment Pool - Debt Securities	<u>\$ 14,570,633</u>							

Investment Fund - The Investment Fund began operations in April 1999 and is classified as a non-rated 2a7-like governmental external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The Investment Fund is utilized as one of the investment managers for the Long-Term Investment Pool and for the North Carolina State University Foundation, Inc., a discretely presented component unit in the accompanying financial statements, (the Investment Fund's internal participants). Other affiliated organizations not included in the University's reporting entity represent the pool's external participants. Fund ownership of the pool is measured using the dollar-day method. Under this method, each participating fund's investment balance is determined based on an assigned weighted value for the time the funds are on deposit. The external portion of the pool is presented in the accompanying financial statements as "Funds Held in Trust for Pool Participants."

The Investment Fund is not subject to any formal oversight other than that provided by the Investment Fund Members Board or its Board of Directors. The Members Board is responsible for adopting investment objectives and policies and for monitoring policy implementation and investment performance. The Members Board has chosen not to make individual security selection decisions. The Board of Directors has the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

responsibility to oversee the allocation of the Investment Fund's portfolio among the asset classes, investment vehicles, and investment managers.

State Street Bank & Trust Company is the custodian for the Investment Fund and provides the University with quarterly statements defining income and fair value information, which is then allocated among the pool's participants. There are no involuntary participants in the pool. The University has not provided or obtained any legally binding guarantees during the period to support the value for the pool's investments. The annual financial report for the Investment Fund may be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the Investment Fund.

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
Mutual Bond Funds	\$ 55,000,249	\$ 19,250,087	\$ 7,700,035	\$ 25,850,117	\$ 2,200,010
Money Market Funds	4,409,766	4,409,766			
	59,410,015	\$ 23,659,853	\$ 7,700,035	\$ 25,850,117	\$ 2,200,010
Other Securities					
Other Mutual Funds	49,463,013				
Real Estate Investment Trust	11,418,096				
Limited Partnerships	55,970,500				
Domestic Stocks	113,181,843				
Foreign Stocks	7,986,304				
Total Investment Pool	\$ 297,429,771				

At June 30, 2006, investments in the Investment Fund had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB Ba	CCC Caa	Unrated
Debt Securities Subject to Credit Risk Disclosure:								
Mutual Bond Funds	\$ 55,000,249	\$ 43,450,198	\$ 4,400,020	\$ 2,750,012	\$ 2,750,012	\$ 1,100,005	\$ 550,002	\$ 0
Money Market Mutual Funds	4,409,766			4,409,766				
Total Investment Fund - Debt Securities	\$ 59,410,015	\$ 43,450,198	\$ 4,400,020	\$ 7,159,778	\$ 2,750,012	\$ 1,100,005	\$ 550,002	\$ 0

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Foreign Currency Risk: At June 30, 2006, the Investment Fund's exposure to foreign currency risk is as follows:

Investment	Currency	Fair Value (U.S. Dollars)
Global Macro Limited Partnership (Vega)	EUR	\$ 229,079
Global Macro Limited Partnership (Vega)	YEN	534,517
International Long Short Equity Limited Partnership (PIMCO)	EUR	79,580
International Long Short Equity Limited Partnership (PIMCO)	YEN	132,335
International Long Short Equity Limited Partnership (PIMCO)	KRW-(South Korean)	89,146
Total		\$ 1,064,657

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
Money Market Funds	\$ 1,877,274	\$ 1,877,274	\$ 0	\$ 0	\$ 0
Other Securities					
Investments in Real Estate	19,106,035				
Domestic Stocks	927,550				
Venture Capital	533,500				
Collections & Mineral Rights	69,879				
Total Non-Pooled Investments	\$ 22,514,238				

At June 30, 2006, investments in Non-Pooled Investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	Unrated
Debt Securities Subject to Credit Risk Disclosure:			
Money Market Funds	\$ 1,877,274	\$ 1,877,274	\$ 0

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments – The following table presents the fair value of the total investments at June 30, 2006:

Investment Type	Fair Value
Debt Securities	
U.S. Treasuries	\$ 951,697
U.S. Agencies	654,471
Mortgage Pass Throughs	866,371
Collateralized Mortgage Obligations	774,998
State and Local Government	198,302
Asset-Backed Securities	29,262
Mutual Bond Funds	64,594,954
Money Market Funds	6,512,116
Domestic Corporate Bonds	1,152,538
Foreign Corporate Bonds	123,213
Other Securities	
Other Mutual Funds	49,463,013
Investments in Real Estate	19,106,035
Real Estate Investment Trust	11,418,096
Limited Partnerships	55,970,500
Pooled Investments	358,551
Domestic Stocks	114,109,393
Foreign Stocks	7,986,304
Venture Capital	7,242,991
Collections and Mineral Rights	69,879
Total Investments	\$ 341,582,684

Total investments include \$59,064,009 held in the “Investment Fund” for the North Carolina State University Foundation, Inc. This amount is excluded from the University proper financial statements and included in the accompanying component unit financial statements.

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University’s endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University pooled endowment funds are determined by applying 4% (the Board approved spending rate) to the average market value of the Long-Term Investment Pool (for a 20 quarter period), divided by the number of investment units in the pool to determine the “average spending amount” per unit of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

investment. The individual endowment fund payout or spending budget is then determined by applying the “average spending amount” to the number of investment units held by the individual endowment fund. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference. At June 30, 2006, net appreciation of \$107,488,700 was available to be spent, of which \$92,430,302 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 3,159,027	\$ 1,512,263	\$ 1,646,764
Accounts	20,385,970	1,899,820	18,486,150
Intergovernmental	17,540,283		17,540,283
Interest on Loans	345,731	308,111	37,620
Other	1,833,269		1,833,269
Total Current Receivables	\$ 43,264,280	\$ 3,720,194	\$ 39,544,086
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 1,032,380	\$ 21,977	\$ 1,010,403
Institutional Student Loan Programs	201,042	5,268	195,774
Total Notes Receivable - Current	\$ 1,233,422	\$ 27,245	\$ 1,206,177
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 11,340,709	\$ 740,138	\$ 10,600,571
Institutional Student Loan Programs	553,026	166,164	386,862
Total Notes Receivable - Noncurrent	\$ 11,893,735	\$ 906,302	\$ 10,987,433

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2006, is presented as follows:

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Capital Assets, Nondepreciable:				
Land	\$ 22,951,966	\$ 578,187	\$ 199,703	\$ 23,330,450
Construction in Progress	170,116,963	65,439,611	137,747,453	97,809,121
Total Capital Assets, Nondepreciable	193,068,929	66,017,798	137,947,156	121,139,571
Capital Assets, Depreciable:				
Buildings	828,493,888	197,723,142	943,556	1,025,273,474
Machinery and Equipment	224,020,918	14,030,961	14,261,538	223,790,341
General Infrastructure	96,923,003	7,500,848		104,423,851
Total Capital Assets, Depreciable	1,149,437,809	219,254,951	15,205,094	1,353,487,666
Less Accumulated Depreciation/Amortization for:				
Buildings	253,904,713	20,295,929	741,984	273,458,658
Machinery and Equipment	149,764,814	19,226,306	15,908,411	153,082,709
General Infrastructure	19,843,407	2,487,018		22,330,425
Total Accumulated Depreciation	423,512,934	42,009,253	16,650,395	448,871,792
Total Capital Assets, Depreciable, Net	725,924,875	177,245,698	(1,445,301)	904,615,874
Capital Assets, Net	\$ 918,993,804	\$ 243,263,496	\$ 136,501,855	\$ 1,025,755,445

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2006, were as follows:

	Amount
Accounts Payable	\$ 32,877,355
Accrued Payroll	6,338,123
Contract Retainage	6,302,228
Other	3,039,142
Total Accounts Payable and Accrued Liabilities	\$ 48,556,848

NOTE 7 - SHORT-TERM DEBT – COMMERCIAL PAPER PROGRAM

The University has available Commercial Paper Program financing for short-term credit up to \$100,000,000 to finance capital construction projects. The University's available funds are pledged to the Commercial Paper Program financing with the anticipation of converting to general revenue bond financing in the future. As of June 30, 2006, \$16,000,000 in Tax-Exempt Commercial Paper was outstanding.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Short-term debt activity for the year ended June 30, 2006, was as follows:

	Balance July 1, 2005	Draws	Repayments	Balance June 30, 2006
Commercial Paper Program	\$ 2,000,000	\$ 16,000,000	\$ 2,000,000	\$ 16,000,000

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2006, is presented as follows:

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Current Portion
Bonds Payable	\$ 213,795,000	\$ 0	\$ 10,435,000	\$ 203,360,000	\$ 8,625,000
Add/Deduct Premium/Discount	8,273,796		460,074	7,813,722	
Total Bonds Payable	222,068,796		10,895,074	211,173,722	8,625,000
Capital Leases Payable	99,263	260,714	86,156	273,821	110,493
Compensated Absences	43,546,662	35,356,608	28,077,675	50,825,595	2,339,806
Total Long-Term Liabilities	\$ 265,714,721	\$ 35,617,322	\$ 39,058,905	\$ 262,273,138	\$ 11,075,299

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2006	Principal Outstanding June 30, 2006
STUDENT HOUSING SYSTEM						
Dormitory Complex	(1) G	3%	09/01/2006	\$ 3,225,000	\$ 3,085,000	\$ 140,000
Refund Housing System Series H, J, & K	(1) N	5-5.8%	09/01/2009	4,110,000	3,090,000	1,020,000
Residence Hall Improvement Project	(1) (A)	3.25-5%	10/01/2010	15,770,000	8,175,000	7,595,000
Housing System Project	(1) (B)	5-5.5%	10/01/2010	3,020,000	1,315,000	1,705,000
Total Student Housing System				<u>26,125,000</u>	<u>15,665,000</u>	<u>10,460,000</u>
DINING HALL SYSTEM						
Dining Hall System Refunding Bonds	(2) 1996	4-5.3%	02/01/2012	2,345,000	1,045,000	1,300,000
STUDENT HEALTH SYSTEM						
Student Health Facility Project	(3) (A)	3.25-5.25%	10/01/2013	5,615,000	2,165,000	3,450,000
ATHLETIC SYSTEM						
Entertainment and Sports Arena Project	(4) (A)	3.25-5.25%	10/01/2018	6,325,000	1,605,000	4,720,000
CENTENNIAL CAMPUS SYSTEM						
Centennial Campus Projects	(5) 1997A	6.55-7.04%	12/15/2010	7,765,000	4,425,000	3,340,000
Centennial Campus Projects	(5) 1999A	4.574%*swap	12/15/2019	13,500,000	1,100,000	12,400,000
Total Centennial Campus System				<u>21,265,000</u>	<u>5,525,000</u>	<u>15,740,000</u>
STUDENT CENTER SYSTEM						
University Student Center	(6) 1996	4.5-5.1%	11/01/2009	2,210,000	1,245,000	965,000
CENTRAL STORES						
Central Stores Expansion Project	(7) (B)	5-5.75%	10/01/2020	3,370,000	550,000	2,820,000
GENERAL REVENUE						
Refund Housing System Series L & M	(8) 2002B	2-5%	10/01/2014	8,800,000	1,965,000	6,835,000
Centennial Campus Projects	(8) 2002C	2.75-6.45%	10/01/2013	7,160,000	1,920,000	5,240,000
Housing System Projects / Doak Field Project	(8) 2003A	2-5%	10/01/2018	26,735,000	135,000	26,600,000
Housing System Projects / Doak Field Project	(8) 2003B	3.54%*swap	10/01/2027	45,660,000	595,000	45,065,000
Various Construction Projects	(8) 2005A	3-5%	10/01/2025	81,615,000	1,450,000	80,165,000
Total General Revenue				<u>169,970,000</u>	<u>6,065,000</u>	<u>163,905,000</u>
Total Bonds Payable (principal only)				<u>\$ 237,225,000</u>	<u>\$ 33,865,000</u>	203,360,000
Less: Unamortized Discount						90,266
Plus: Unamortized Premium						<u>7,903,988</u>
Total Bonds Payable						<u>\$ 211,173,722</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

* For variable rate debt, interest rates in effect at June 30, 2006, are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

Designated student fees and revenue streams related to the systems financed above have been pledged for the payment of these bonds. In addition, fund reservations required by the Bond Indentures have been established and recorded as restricted net assets. The following revenues as summarized in Note 10 have been pledged or are security for the bonds.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- | | |
|--|--------------------------------|
| (1) Residential Life Revenues (Housing | (5) Centennial Campus Revenues |
| (2) Dining Revenues | (6) Student Center Revenues |
| (3) Student Health Revenues | (7) Central Stores Revenues |
| (4) Athletic Revenues | (8) Available Funds |

Available funds, as defined in the General Indenture dated October 1, 2001, are any funds of NC State in each fiscal year remaining after satisfying debt obligations excluding (1) State appropriations, (2) tuition payments, (3) funds restricted by gift, grant, or payee, (4) revenues from special facilities, and (5) funds restricted by law. Available funds are not pledged to the trustee, but rather are the source from which principal and interest on the bonds will be paid.

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

With regards to the following demand bonds, the issuer has entered into take-out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

The North Carolina State University at Raleigh Variable Rate Revenue Bonds (Centennial Campus Projects), Series 1999A: On September 22, 1999, the University issued tax-exempt variable rate revenue demand bonds in the amount of \$13,500,000 that have a final maturity date of December 15, 2019. The bonds are subject to mandatory sinking fund redemption that began on December 1, 2000. The University’s proceeds of this issuance were used to (i) discharge a portion of a loan from Wachovia Bank, N.A., the proceeds from which were used for the construction and equipping of a building known as the Partners II Building located on the Centennial Campus of NC State, (ii) paying the cost of relocating utility easements on the Centennial Campus of NC State, and (iii) paying the costs incurred in connection with the issuance of the 1999A bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, Lehman Brothers, Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Wachovia Bank, N.A., a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.11% of the available commitment, payable quarterly in arrears, beginning on October 1, 1999, and on each January 1, April 1, July 1, and October 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2006, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility has been extended and is scheduled to expire on September 15, 2006, unless otherwise extended based on the terms of the Agreement. Subsequent to June 30, 2006, the expiration date was extended to September 15, 2008.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 20 quarterly installments, beginning the first business day that is at least 180 days following such expiration date or termination date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of \$12,400,000 of demand bonds was “put” and not resold, the University would be required to pay \$3,156,098 a year for five years under this agreement assuming an 8.75% interest rate.

This bond also has an interest rate swap agreement for \$8,600,000 of the outstanding amount. During the year, net payments under the agreement were \$146,107. More information on the swap agreement is available in this note under “Interest Rate Swaps.”

The North Carolina State University at Raleigh General Revenue Bonds, Series 2003B: On June 20, 2003, the University issued tax-exempt variable rate revenue demand bonds in the amount of \$45,660,000 that have a final maturity date of October 1, 2027. The bonds are subject to mandatory sinking fund redemption that began on October 1, 2004. The University’s proceeds of this issuance were used to pay a portion of the costs of certain improvements on the campus of the University, to

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

refund certain debt previously incurred for that purpose, and to pay the costs incurred in connection with the issuance of the 2003B bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, UBS Financial Services Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Bayerische Landesbank, a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.13% of the available commitment, payable quarterly in arrears, beginning on July 1, 2003, and on each October 1, January 1, April 1, and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2006, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility expiration date has been extended and is scheduled to expire on November 30, 2015, unless otherwise extended based on the terms of the Agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 20 quarterly installments, beginning the first business day of January, April, July, or October, whichever first occurs on or following the Purchase Date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of \$45,065,000 of demand bonds was "put" and not resold, the University would be required to pay \$11,224,588 a year for five years under this agreement assuming an 8.75% interest rate.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

This bond also has an interest rate swap agreement for \$24,655,000 of the outstanding amount. During the year, net payments under the agreement were \$139,520. More information on the swap agreement is available below.

Interest Rate Swaps:

Objective: In order to protect against the potential of rising interest rates, the University entered into two separate pay-fixed, receive-variable interest rate swaps at a cost anticipated to be less than what the University would have paid to issue fixed-rate debt.

Terms fair values, and credit risk: The University's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated bonds payable category. The terms, fair values, and credit ratings of the outstanding swaps as of June 30, 2006, were as follows:

Associated Bond Issue	Notional Amounts	Effective Date	Fixed Rate Paid	Variable Rate Received	Fair Values	Swap Termination Date
Centennial Campus 1999A	\$ 8,600,000	10/1/1999	4.574%	67% of LIBOR ¹	\$ (442,000)	12/1/2019
General Revenue 2003B	<u>24,655,000</u>	6/20/2003	3.54%	BMA ¹	<u>2,045,000</u>	10/1/2027
Total	<u>\$ 33,255,000</u>				<u>\$ 1,603,000</u>	

¹ Variable rate received is the BMA from June 20, 2003, to July 1, 2006; thereafter, the variable rate received will be 75% of LIBOR. BMA is the Bond Market Association Municipal Swap Index.

Because rates have changed since the effective dates of the swaps, the 1999A swap has a negative fair value as of June 30, 2006. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the market values as of June 30, 2006.

As of June 30, 2006, the University was exposed to credit risk on the swap with a positive fair value. The State's maximum possible loss is equivalent to the positive fair value of the swap. The swap agreements require termination should the University's or the counterparty's credit rating fall below either Baa2 as issued by Moody's Investors Services (Moody's) or BBB as issued by Standards & Poor's (S&P) or Fitch Ratings. Also, under the terms of the swap agreements, should one party

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

become insolvent or otherwise default on its obligations, provisions permit the nondefaulting party to accelerate and terminate all outstanding transactions. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A3 as determined by Moody's or A- as determined by S&P, the swap will be collateralized by the counterparty with cash, US government or agency securities. If the counterparty is required to collateralize, then the collateral will be posted with a third party custodian or secured party. The two agreements entered into by the University, are held with separate counterparties. All the counterparties are rated A1 or better.

Basis risk: The University is exposed to basis risk on the swaps when the variable payment received is based on an index other than BMA. Should the relationship between LIBOR and BMA move to convergence, the expected cost savings may not be realized. As of June 30, 2006, the BMA rate was 3.97%, whereas 67% of LIBOR was 3.574%.

Termination risk: The University or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. If any of the swaps are terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the University would be liable to the counterparty for that amount.

Future Swaps: The University has also entered into an interest rate swap agreement for \$50,000,000 to be effective September 1, 2008, on a General Revenue Bond Issue planned for 2008.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

D. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2006, are as follows:

<u>Fiscal Year</u>	Annual Requirements		
	Revenue Bonds Payable		
	Principal	Interest	Interest Rate Swaps, Net
2007	\$ 8,625,000	\$ 9,051,664	\$ (23,998)
2008	8,875,000	8,659,891	(27,999)
2009	9,095,000	8,254,585	(33,000)
2010	9,340,000	7,828,529	(38,002)
2011	8,930,000	7,408,964	(43,003)
2012-2016	50,580,000	29,998,482	(306,033)
2017-2021	49,105,000	18,003,048	(479,071)
2022-2026	48,430,000	7,479,855	(407,812)
2027-2031	10,380,000	412,257	(22,790)
Total Requirements	\$ 203,360,000	\$ 97,097,275	\$ (1,381,708)

Interest on the variable rate 1999A bonds is calculated at 3.90% and the 2003B revenue bonds is calculated at 3.9%, the rates in effect at June 30, 2006 for each series.

The variable rate is changed weekly every Wednesday by the Remarketing agent with a maximum rate of 12%. In addition, the University has entered into interest rate swaps to synthetically fix a portion of the 1999A and 2003B bonds. Net amounts reported are based on rates as of June 30, 2006. As rates vary, the net swap payments will vary. See note 8C for more information on the demand bonds and the interest rate swaps.

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

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

In fiscal year 2004 the University defeased \$935,000 of outstanding University of North Carolina System Pool Revenue Bonds, Series 1998B (original issue amount \$1,695,000). An irrevocable trust was established with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement for Net Assets. At June 30, 2006, the outstanding balance of the defeased University of North Carolina System Pool Revenue Bonds, Series 1998B bonds was \$490,000.

In fiscal year 2005 the University defeased \$7,090,000 of outstanding North Carolina State University at Raleigh Revenue Bonds (Centennial

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Campus Projects), Series 1997B (original issue amount \$7,090,000). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2006, the outstanding balance of the defeased North Carolina State University at Raleigh Revenue Bonds (Centennial Campus Projects), Series 1997B bonds was \$7,090,000.

NOTE 9 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2006:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 121,678
2008	108,431
2009	<u>61,874</u>
Total Minimum Lease Payments	291,983
Amount Representing Interest (3.74 - 8.74% Rate of Interest)	<u>18,162</u>
Present Value of Future Lease Payments	<u><u>\$ 273,821</u></u>

Machinery and equipment acquired under capital lease amounted to \$605,002 at June 30, 2006.

- B. Operating Lease Obligations** - The University entered into operating leases for equipment and property rental. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2006:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 4,204,402
2008	2,296,954
2009	1,737,679
2010	999,224
2011	<u>140,019</u>
Total Minimum Lease Payments	<u><u>\$ 9,378,278</u></u>

Rental expense for all operating leases during the year was \$2,684,012.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	\$ 162,059,700	\$ 0	\$ 26,616,476	\$ 337,920	\$ 135,105,304	\$ 13,369,756 (D,E,F)
Other Operating Revenues	\$ 12,049,195	\$ 4,857,539	\$ 0	\$ (283,335)	\$ 7,474,991	\$ 6,108,836 (A,B,C,D,F)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 30,441,786	\$ 363,365	\$ 4,303,507	\$ 101,538	\$ 25,673,376	\$ 30,441,786 (B)
Dining	19,808,853	2,358,033	1,311,943	55,324	16,083,553	19,808,853 (C)
Bookstore	15,240,486	626,565			14,613,921	
Athletic	30,478,883	324,547		4	30,154,332	30,478,883 (D)
Parking	5,536,251	792,711		36,839	4,706,701	
Student Center	656,427	183,074		(499)	473,852	656,426 (E)
Student Health	3,664,514	251,218	564,836	40,709	2,807,751	3,664,515 (F)
Other	15,535,284	10,639,578	1,176,021	25,824	3,693,861	477,095 (G)
Sales and Services of Education and Related Activities	65,149,972	26,447,325		(29,632)	38,732,279	
Total Sales and Services	<u>\$ 186,512,456</u>	<u>\$ 41,986,416</u>	<u>\$ 7,356,307</u>	<u>\$ 230,107</u>	<u>\$ 136,939,626</u>	<u>\$ 85,527,558</u>

(A) Centennial Campus System
(B) Student Housing System
(C) Dining System
(D) Athletics System

(E) Student Center System
(F) Student Health System
(G) Other

NOTE 11 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 223,533,779	\$ 20,766,380	\$ 23,321,897	\$ 0	\$ 0	\$ 0	\$ 267,622,056
Research	137,000,175	22,512,503	38,253,145		554,338		198,320,161
Public Service	76,903,264	10,111,333	21,150,648		230,913		108,396,158
Academic Support	37,541,932	14,329,525	14,551,659		7,981		66,431,097
Student Services	10,445,062	1,457,951	4,118,842		39		16,021,894
Institutional Support	41,491,601	4,041,521	5,535,390		1,187		51,069,699
Operations and Maintenance of Plant	28,372,167	13,955,746	8,011,247		26,405,120		76,744,280
Student Financial Aid	589,685	155,547	1,152,545	22,131,353			24,029,130
Auxiliary Enterprises	40,845,166	26,727,371	33,731,919		4,940,198		106,244,654
Depreciation						42,009,253	42,009,253
Total Operating Expenses	<u>\$ 596,722,831</u>	<u>\$ 114,057,877</u>	<u>\$ 149,827,292</u>	<u>\$ 22,131,353</u>	<u>\$ 32,139,776</u>	<u>\$ 42,009,253</u>	<u>\$ 956,888,382</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - PENSION PLANS

- A. **Retirement Plans** - Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at 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, 2006, these rates were set at 2.34% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2006, the University had a total payroll of \$520,230,082, of which \$260,182,189 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$15,610,931 and \$6,088,263, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were \$6,088,263, \$5,342,109, and \$528,928, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2006, 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, 2006, the University had a total payroll of \$520,230,082, of which \$160,482,558 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$9,628,953 and \$10,977,007, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University. The voluntary contributions by employees amounted to \$1,807,906 for the year ended June 30, 2006.

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, 2006, were \$115,969. The voluntary contributions by employees amounted to \$3,457,987 for the year ended June 30, 2006.

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 \$9,683,679 for the year ended June 30, 2006.

- C. Federal Employment Retirement** – The Federal Retirement System is a multiple-employer retirement system and is composed of three retirement programs: the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1987, the Federal Employees Retirement System for Participants (FERS) employed after January 1, 1987, and the Civil Service Retirement Offset System for reemployed CSRS employees.

North Carolina Cooperative Extension employees with federal appointments prior to January 1, 1987, participate in the Civil Service Retirement System. Currently, 172 employees participate in CSRS. Participating employees are required by federal statute to contribute 7% of salary and the University 7% of salary to CSRS. In addition, the employees may contribute up to 10% of salary to the Thrift Savings Plan (a defined contribution plan managed by the Federal Retirement Thrift Investment Board). Total employee and employer contributions for CSRS for the year ended June 30, 2006, was \$918,115 and \$947,227 respectively. Employees covered under CSRS contributed \$68,100 to the Thrift Savings Plan.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Under Federal Employees Retirement System (FERS), employees are required to contribute 0.8% of salary and the University 11.2%. Currently, 11 employees participate in FERS. The University is also required to contribute 1% of participant's salary to the Thrift Savings Plan, plus up to an additional 4% depending on employee's contribution, which can range from 0% to 15% of their salary. Total employee and employer contributions for the year ended June 30, 2006, were \$8,129 and \$113,845 respectively. For employees covered under FERS the total employee and employer contributions to the Thrift Savings Plan for the year ended June 30, 2006, were \$114,277 and \$49,650 respectively.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.8% 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, 2006, the University's total contribution to the Plan was \$15,985,260. 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 .52% 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, 2006, the University's total contribution to the DIPNC was \$2,187,457. The University assumes no liability for long-term disability benefits under the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 14 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage limits in any of the past three fiscal years, with the exception of one automobile liability claim settled in fiscal year 2004.

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 the University for 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, except for the peril of theft with an applicable \$1,000 per occurrence deductible. University departments, as an individual business decision, may also purchase through the Fund primary extended coverage for buildings and contents. Coverage may also be purchased through the Fund for theft, vandalism, sprinkler leakage, or all-risk perils. University departments also have the option to purchase all-risk coverage for computers and "miscellaneous equipment" on a scheduled basis.

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. While liability coverage is required by Statute for all University vehicles, departments may also

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

individually opt to purchase collision and comprehensive physical damage 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. The University is charged a premium by the private insurance company. Coverage limit is \$1,000,000 per occurrence with a \$25,000 deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance and the State's Agent of Record. The types of insurance policies purchased include: Medical Professional Liability, Veterinary Professional Liability, Fine Arts Property, Master Crime, Inland Marine Property for Musical Instruments, Campers Accident and Sickness, Athletic Accident, Boiler and Machinery, Watercraft, Oceanographic Equipment, and Nuclear Energy Liability.

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. The employer contribution rate was .16% for the current fiscal year.

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

NOTE 15 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$107,664,846 at June 30, 2006.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Pending Litigation and Claims – As previously reported, the Environmental Protection Agency (EPA) filed a civil action against the University pursuant to the Comprehensive Environmental Response, Compensation and Liability Act. The complaint sought relief that would cause the University to enter into remediation of a hazardous waste site known as “Lot 86.” The University is involved in ongoing discussions and negotiations with the EPA concerning the appropriate means for addressing the remediation. A Consent Decree executed by North Carolina State University and the EPA has been approved by the Court. Remedial clean-up pursuant to the Consent Decree continues. The remediation costs paid by the University for the year ended June 20, 2006, totaled \$53,106.

As previously reported, the NC School Boards Association, et. al. filed a civil action against various State officials in their official capacity seeking a judicial determination as to whether the State Constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. In part, this civil action includes a determination of whether monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations and library fines are “civil penalties” which the State Constitution requires to be paid to the school fund in the county where they are collected. On July 1, 2005, the NC Supreme Court held in favor of the school boards with regard to parking fines and held in favor of the University with regards to library fines. The matter had been remanded back to the trial court for disposition in accordance with the Supreme Court’s decision. Determination of the amount due from the University is pending. At issue are approximately \$6,851,699 in transportation fines since December 1995 to June 30, 2005.

On October 8, 2004, a lawsuit was filed by Cree, Inc. (Corporation) against the University for breach of contract alleging that NC State along with certain graduate students were attempting to establish a new start-up technology company to compete against the Corporation and the corresponding “Option and License Agreements.” The outside counsel fees and related litigation costs on the lawsuit and costs could exceed \$1,000,000 before the case is settled.

On June 30, 2006, Comstock Homebuilding Companies, Inc., North Shore Investors, LLC and North Shores Models, LLC filed a legal complaint against the Board of Trustees of the Endowment Board of NC State University and other outside parties alleging breach of contract, collusion and unfair trade practices. This claim is in excess of \$11,000,000; however, it is too early to predict the University’s potential liability, if any.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University is a party to other 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. Other Contingent Receivables** – The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied or, in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting principles generally accepted in the United States of America, these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year-end is as follows:

Purpose	Amount
Capital Improvement - State General Obligation Bonds	\$ 126,545,462

NOTE 16 - RELATED PARTIES

Foundations - There are 11 separately incorporated nonprofit foundations associated with the University. These foundations are the North Carolina Agricultural Foundation, Inc., North Carolina State University Foundation, Inc., North Carolina Tobacco Foundation, Inc., Pulp and Paper Foundation, Inc., North Carolina State University Physical and Mathematical Sciences Foundation, Inc., North Carolina Engineering Foundation, Inc., North Carolina Veterinary Medical Foundation, Inc., The North Carolina Forestry Foundation Inc., North Carolina Textile Foundation, Inc., NCSU Student Aid Association, Inc., and the North Carolina State Alumni Association, Inc.

These organizations serve as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. As described in Note 1 to the financial statements, the North Carolina State University Foundation, Inc., and the NCSU Student Aid Association, Inc., are considered component units of the University for reporting purposes and their financial statements are presented separately as part of the University's financial statements. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundations, except for support from each

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

organization to the University. This support of the foundations, excluding amounts from the North Carolina State University Foundation, Inc., and the NCSU Student Aid Association, Inc., approximated \$19,435,370 for the year ended June 30, 2006, for noncapital purposes.

Non-Profit Corporation – The Centennial Authority (Authority) was created by the 1995 General Assembly (Senate Bill 606) for the purpose of studying, designing, planning, constructing, owning, promoting, financing and operating a regional facility on land owned by the State. Prior to this act, the General Assembly authorized the construction by the University of a facility to be known as the “Entertainment and Sports Arena” (ESA). This facility serves as a regional sports entertainment center and is available for cultural performances, sporting events and other activities of the University or of other entities (the Centennial Center project). With the 1995 legislation, the Centennial Center project was transferred to the Authority.

The Authority entered into a Ground Lease with the State of North Carolina to lease land for the ESA for a period of 99 years at an annual rent of \$1. The University entered into a Use Agreement with the Authority. Both parties agreed that the University shall be the primary and preferred user of all areas of the ESA. The University is required to pay the greater of 10% of gross ticket revenues or \$44,051 for each men’s and \$19,266 for each women’s basketball game to compensate the Authority for facility rental and operating expenses. Rent and expense payments for miscellaneous events will be negotiated on an event by event basis based on the availability of the ESA and the anticipated attendance.

In fiscal year 2003 a naming rights agreement was executed to change the name of the ESA to the “RBC Center.” As a result of this agreement, the University will receive \$13,184,000 over a ten-year period beginning in the fiscal year 2003.

NOTE 17 - SUBSEQUENT EVENTS

On August 16, 2006, the University borrowed \$44,000,000 through the commercial paper financing program for construction projects.

NOTE 18 - DISCRETELY PRESENTED COMPONENT UNITS

The University’s discretely presented component units use the accounting and reporting standards promulgated by the FASB. Selected disclosures from the discretely presented component units audited financial statements follow:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NORTH CAROLINA STATE UNIVERSITY FOUNDATION, INC.

MARKETABLE SECURITIES

Marketable securities at June 30, 2006, consisted of:

	Cost	Fair Value
Cash	\$ 302,045	\$ 302,045
NC State Investment Fund, Inc.	53,454,679	59,064,009
U.S. Trust	6,482,035	7,037,917
Academy Centennial Fund, LLC	1,037,900	84,762
Citicorp Trust Bank	595,703	649,399
Total	<u>\$ 61,872,362</u>	<u>\$ 67,138,132</u>

Note: This amount does not include intermediate investments of \$4,622,751.

Marketable securities held by NC State Investment Fund, Inc. at June 30, 2006, consisted of the following:

	Cost	Fair Value
Corporate Common Stock	\$ 36,110,230	\$ 41,242,680
International Securities	801,374	925,334
Money Market Funds	883,530	880,491
Fixed Income Mutual Funds	11,701,786	10,941,114
Foreign Equity Mutual Funds	589,097	678,404
Real Estate Investment Funds	1,551,917	2,299,311
Limited Partnerships	1,816,745	2,096,675
Total	<u>\$ 53,454,679</u>	<u>\$ 59,064,009</u>

The Foundation's investment in the NC State Investment Fund, Inc. ("Fund") represents approximately 19.00% of the member equity of the Fund at June 30, 2006. The Fund's net assets were approximately \$296,911,000 at June 30, 2006.

The Foundation's investment in the Academy Centennial Fund, LLC, represents approximately 11.0% of the member capital of the Academy Centennial Fund, LLC at June 30, 2006. The Academy Centennial Fund, LLC's net assets were approximately \$784,000 at December 31, 2005, (latest date available), and consisted primarily of common and preferred stock and convertible debt.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Foundation's investments held by U.S. Trust primarily consist of bond mutual funds and equity mutual funds.

The Foundation's investments held by Citicorp Trust Bank primarily consist of common equity securities.

The Foundation invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investments securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of financial position.

NCSU STUDENT AID ASSOCIATION, INC.

CONCENTRATIONS OF CREDIT RISK

The Association maintains cash balances at several financial institutions located in Raleigh, North Carolina, and in several brokerage accounts located in North Carolina. The balances in the financial institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. The balances in brokerage accounts are insured at varying amounts. The Association's uninsured cash balances totaled \$24,026,961 at June 30, 2006.

INVESTMENTS

The Association held the following investments at June 30, 2006:

	Historical Cost	Market Value
U.S. Government Obligations	\$ 5,223,100	\$ 3,727,902
Marketable Equity Securities	12,755,031	13,686,550
Other Marketable Debt Securities	2,807,008	2,778,837
Partnership Interests	1,450,843	1,638,747
Short-Term Investments	119,850	116,707
Mutual Funds	483,562	498,604
Total	<u>\$ 22,839,394</u>	<u>\$ 22,447,347</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investment income consists of the following:

	<u>Amount</u>
Interest	\$ 892,058
Dividends	280,005
Realized Gain (Loss) on Sale of Investments	245,543
Unrealized Gain on Investments	562,407
Investment Expenses	<u>(167,088)</u>
Total	<u>\$ 1,812,925</u>

PLEDGES RECEIVABLE

The Association carries its pledges receivable at cost less a discount for pledges receivable due in more than a year and less an allowance for doubtful accounts. On a periodic basis, the Association evaluates its receivables and establishes an allowance for doubtful accounts, based on history of past write-offs and current credit conditions.

Pledges receivable at June 30, 2006, are as follows:

	<u>Amount</u>
Pledges Receivable	\$ 62,481,317
Less Allowance for Uncollectible Pledges	3,124,066
Less Discount on Pledges	<u>14,672,191</u>
	44,685,060
Less Current Portion	<u>7,714,433</u>
Pledges Due After One Year	<u>\$ 36,970,627</u>

Pledges receivables due in more than one year are reflected at the present value of estimated future cash flows using a discount rate of 6%.

	<u>Amount</u>
Receivable in less than one year	\$ 8,120,455
Receivable in one to five years	24,160,383
Receivable in more than five years	<u>30,200,479</u>
	62,481,317
Less allowance for uncollectible pledges	3,124,066
Less discount on pledges	<u>14,672,191</u>
Net Pledges Receivable	<u>\$ 44,685,060</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2006, Goal Line Drive pledges totaling \$24,557,040 and Wolfpack Pride pledges totaling \$3,456,060 were pledged as collateral for the Goal Line Drive bond payable and the Vaughn Towers bond payable. These pledge totals are reflected at the present value of estimated future cash flows less an allowance for uncollectible pledges.

LONG-TERM DEBT

BOND INDENTURE - GOAL LINE DRIVE

The Association, through First Citizens Bank, trustee, and Bank of America, administrative agent, issued \$40,000,000 of bonds during 2002. The bonds are secured by the Goal Line Drive pledges, Wolfpack Pride Campaign pledges, and the Medlin property. The bonds are also secured by approximately \$2,000,000 in scoreboard revenues to be received from NCSU through 2012. The proceeds from these bonds were used for the Carter-Finley Stadium expansion and improvements. The bonds pay interest monthly at a variable rate equal to .35% plus the higher of the federal funds rate plus ½% or Bank of America's publicly announced prime rate. The Association also must pay the administrative agent a letter of credit fee. This fee, paid quarterly, is 1.5% of the outstanding debt balance. The Association must also pay annually \$17,000 of agency and \$5,000 of trustee fees. The Association pays a remarketing fee annually to the administrative agent. This fee is .1% of the outstanding debt balance. The bond matures in 2012.

The Association has also entered into a swap contract for a majority of this debt to hedge against interest rate fluctuations. The swap was issued at market terms so that it had no value at its inception. The carrying amount of the swap has been adjusted to its fair value at June 30, 2006, which, because of changes in forecasted levels of interest rates, resulted in reporting an asset at June 30, 2006, for the fair value of the net payments forecasted under the swap. The swap asset is classified as noncurrent since the Association does not intend to settle it within the next 12 months.

Bond Indentures - Wolfpack Club Student Housing Foundation

The Housing Foundation, through Wachovia Bank, administrative agent and trustee, issued a \$23,710,000 Series 2003A bond and a \$1,235,000 Series 2003B bond in June 2003. The proceeds from these bonds were used to construct a residence hall for NCSU students and student athletes. The bonds pay interest monthly at variable rates. The Series 2003A bonds pay interest based on a variable rate established weekly by Legg Mason, remarketing agent. The Series 2003B bonds pay interest based on a variable rate established monthly by the remarketing agent. The Housing Foundation must pay a letter of credit fee quarterly to the administrative agent. This fee, paid

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

quarterly, is 1.25% of the outstanding balance. The Housing Foundation pays a remarketing fee semiannually to the administrative agent. This fee is .125% of the outstanding balance. The Series 2003A bonds mature in July 2035. The Series 2003B bonds mature in July 2009.

The Housing Foundation has entered into a swap contract for a majority of this debt to hedge against interest rate fluctuations. The swap was issued at market terms so that it had no value at its inception. The carrying amount of the swap had been adjusted to its fair value at June 30, 2006, which because of changes in forecasted levels of interest rates, resulted in reporting an asset at June 30, 2006, for the fair value of the net payments forecasted under the swap. The swap asset is classified as noncurrent since the Association does not intend to settle it within the next 12 months.

Bond Indenture - Vaughn Towers

The Association, through First Citizens Bank, trustee, issued a \$15,855,000 Series 2004A bond and a \$17,685,000 Series 2004B bond in November 2004. The proceeds from these bonds were used to construct Vaughn Towers at Carter-Finley Stadium. The bonds pay interest monthly at variable rates. The Series 2004A bond pays interest based on a variable rate established weekly by Wachovia, remarketing agent. The Series 2004B bond pays interest based on a variable rate established weekly by Banc of America Securities, LLC, remarketing agent. The Association must pay a 2% quarterly letter of credit fee. The Association pays an annual remarketing fee of .10% of the outstanding bonds to the remarketing agents. The Series 2004A bond matures in September 2024. The Series 2004B bond matures in September 2018.

The Association has entered into swap contracts for a majority of this debt to hedge against interest rate fluctuations. The swaps were issued at market terms so that they had no value at their inception. The carrying amount of the swaps have been adjusted to their fair value at June 30, 2006, which, because of changes in forecasted levels of interest rates, resulted in reporting an asset at June 30, 2006, for the fair value of the net payments forecasted under the swap. The swap asset is classified as noncurrent since the Association does not intend to settle it within the next 12 months.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

	<u>Amount</u>
Goal Line Drive Bond Indenture	\$ 25,900,000
Wolfpack Club Student Housing Foundation--Series 2003A	23,710,000
Wolfpack Club Student Housing Foundation--Series 2003B	1,235,000
Vaughn Towers Project--Series 2004A	15,855,000
Vaughn Towers Project--Series 2004B	<u>16,815,000</u>
	83,515,000
Amount Classified as Current Liability	<u>(6,710,000)</u>
Amount Due After One Year	<u>\$ 76,805,000</u>
Maturities of long-term debt are as follows:	
2007	\$ 6,710,000
2008	5,390,000
2009	5,480,000
2010	5,700,000
2011	5,675,000
Thereafter	<u>54,560,000</u>
Total	<u>\$ 83,515,000</u>

LETTERS OF CREDIT

Pursuant to the issuance of the Goal Line Drive bonds payable, the Association obtained an irrevocable letter of credit in an amount not to exceed \$40,460,274. The letter of credit will remain in effect until March 15, 2007. The letter of credit may be extended.

Pursuant to the issuance of the Wolfpack Club Student Housing Foundation bonds payable, the Association obtained an irrevocable letter of credit in an amount not to exceed \$25,318,618. The original letter of credit expired June 9, 2006, and has been extended.

Pursuant to the issuance of the Wolfpack Towers bonds payable, the Association obtained two irrevocable letters of credit. One letter of credit issued in an amount not to exceed \$16,034,441 expires November 17, 2007. The other letter of credit issued in an amount not to exceed \$17,939,373 also expires November 17, 2007. These letters of credit may be extended.



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

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

Board of Trustees
North Carolina State University
Raleigh, North Carolina

We have audited the financial statements of North Carolina 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, 2006, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 1, 2006. We did not audit the financial statements of the NC State Investment Fund, Inc., which represents 18.58%, 26.53%, and 5.41%, respectively, of the assets, net assets and revenues of the University; nor the financial statements of the North Carolina State University Foundation, Inc., and the NCSU Student Aid Association, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation

**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)**

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, and the General Assembly, 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

December 1, 2006

ORDERING INFORMATION

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

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

Telephone: 919/807-7500

Facsimile: 919/807-7647