



STATE OF NORTH CAROLINA

APPALACHIAN STATE UNIVERSITY

BOONE, 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

APPALACHIAN STATE UNIVERSITY

BOONE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

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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, Appalachian State University

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

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

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor
January 16, 2007

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Appalachian State University
Boone, North Carolina

We have audited the accompanying financial statements of Appalachian State University, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 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 Appalachian State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Appalachian State University Foundation or the Appalachian Student Housing Corporation, which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our 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 Appalachian State University Foundation and the Appalachian Student Housing Corporation were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Appalachian State University and its discretely presented component units as of June 30, 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.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2006, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Leslie W. Merritt, Jr.

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

November 15, 2006

APPALACHIAN STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statement Information

Appalachian State University is pleased to present its financial statements for fiscal year 2006. These statements are prepared in accordance with recent Governmental Accounting Standard's Board (GASB) Statement Numbers 34, 35, 39 and 40. GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, established a new reporting format for annual financial statements. GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, applied the new reporting standards to public colleges and universities. Also, in accordance with GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*, Exhibits B-1 and B-2 discretely present the component units, Appalachian State University Foundation and the Appalachian Student Housing Corporation. GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, was implemented in fiscal year 2004-2005 and those requirements are disclosed in Footnote 2B within the Notes to the Financial Statements.

Statement of Net Assets

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

Prominent changes in the Statement of Net Assets include a decrease of \$19,287,547.18 in Restricted Cash and Cash Equivalents. One element of this change was the Appalachian State University Foundation's withdrawal of \$6,675,111.89 cash temporarily invested with the University's pooled cash on deposit with the State Treasurer's Short Term Investment Fund. The remaining decrease was cash used in fiscal year 2005-2006 for the completion of the Student Recreation Center (\$6,979,363.19) and Lovill Residence Hall (\$4,172,728.66). The \$8,178,593.93 decrease in Restricted Due From Primary Government was allotment decreases from the 2000 North Carolina General Obligation Bonds, as the majority of the building approved for Appalachian in that package has now been completed and also a decrease in Repairs and Renovations allotments. The decrease in Nondepreciable Capital Assets is primarily due to several buildings (see the Capital Asset and Debt Administration discussion below) being placed into service, decreasing Construction in Progress. The increase in Capital Assets – Depreciable caption line is also due mainly to placing several buildings into

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

service (see the Capital Asset and Debt Administration discussion below). Those structures along with the demolition of the Old Rankin Science Building and Whitener Hall (to make room for the Library Parking Deck) account for the \$44,393,805.80 increase in the Capital Assets-Depreciable caption.

The \$6,530,549.46 decrease in Funds Held for Others resulted from the Appalachian State University Foundation withdrawing \$6,675,111.89 of cash temporarily invested with the University's pooled cash on deposit with the State Treasurer's Short Term Investment Fund.

In the Net Assets section, the decrease in Restricted Expendable Net Assets was primarily the Appalachian State University Foundation's withdrawal of cash temporarily invested with the University's pooled cash on deposit with the State Treasurer's Short Term Investment Pool as described in the previous paragraph. Overall, Appalachian had an increase of \$7,877,532.71 in total Net Assets.

Condensed Statement of Net Assets

	Fiscal Year 2006	Fiscal Year 2005	\$ Change	% Change
Assets				
Current Assets	\$ 77,162,148.91	\$ 73,532,106.17	\$ 3,630,042.74	4.9
Noncurrent Assets				
Restricted Cash and Cash Equivalents	11,543,252.30	30,830,799.48	(19,287,547.18)	(62.6)
Restricted Due From Primary Government	1,396,421.93	9,575,015.86	(8,178,593.93)	(85.4)
Capital Assets - Nondepreciable	38,127,571.63	61,376,796.79	(23,249,225.16)	(37.9)
Capital Assets - Depreciable, Net	299,281,144.15	254,887,338.35	44,393,805.80	17.4
Other Noncurrent	<u>18,732,287.64</u>	<u>18,018,042.20</u>	<u>714,245.44</u>	4.0
Total Assets	446,242,826.56	448,220,098.85	(1,977,272.29)	(0.4)
Liabilities				
Current Liabilities	29,572,615.99	27,822,518.58	1,750,097.41	6.3
Funds Held Others	3,622,624.34	10,153,173.80	(6,530,549.46)	(64.3)
Long-Term Liabilities	127,720,680.40	132,752,910.63	(5,032,230.23)	(3.8)
Other Noncurrent Liabilities	<u>4,098,338.85</u>	<u>4,140,461.57</u>	<u>(42,122.72)</u>	(1.0)
Total Liabilities	165,014,259.58	174,869,064.58	(9,854,805.00)	(5.6)
Net Assets				
Invested in Capital Assets - Net of Related Debt	228,161,748.00	214,644,235.08	13,517,512.92	6.3
Restricted				
Nonexpendable	6,827,508.38	6,677,543.45	149,964.93	2.2
Expendable	8,437,596.51	16,187,050.62	(7,749,454.11)	(47.9)
Unrestricted	<u>37,801,714.09</u>	<u>35,842,205.12</u>	<u>1,959,508.97</u>	5.5
Total Net Assets	<u>\$ 281,228,566.98</u>	<u>\$ 273,351,034.27</u>	<u>\$ 7,877,532.71</u>	2.9

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Revenues, Expenses, and Changes in Net Assets

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

Appalachian State experienced an increase in State Appropriations of \$10,229,214.00, for an 11.2% change. The \$26,975,598.96 decrease in Capital Grants was a decrease in utilization of the University's share of the North Carolina General Obligation Bonds for the UNC system capital projects. The increase in Capital Appropriations of \$1,635,400.00 was an increase in funding from the State's Repairs and Renovation program.

In total, Operating Expenses grew by \$24,492,301.05. This represented a 10.9% increase. Salaries and Benefits increased from \$141,113,599.43 to \$149,923,936.99, or 6.2%. Supplies and Materials were \$32,223,499.70 this year as compared to \$27,382,495.87 for last year, an increase of 17.7%. This was due to an increase in building repairs that were not capitalized and rising fuel costs. Services increased 36.0%, to \$30,097,850.12 as opposed to \$22,130,267.84 last year due to an increase in building maintenance and additional operating costs of having the Library and Information Commons (placed in service late last year) and the new Student Recreation Center on line. Scholarships and Fellowships increased from \$8,812,920.13 to \$9,278,094.25, for a 5.3% increase. Utilities increased 7.0%. Those expenditures rose from \$14,265,592.23 to \$15,267,214.08. This increase was due to new structures placed into service and rising fuel prices. These expenditures are a concern in the upcoming year with the volatility of fuel prices. Finally, Depreciation increased 12.7% from \$11,097,493.80 to \$12,504,075.21.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	Fiscal Year 2006	Fiscal Year 2005	\$ Change	% Change
Operating Revenues				
Tuition and Fees	\$ 56,923,055.10	\$ 54,990,282.18	\$ 1,932,772.92	3.5
Grants and Contracts	8,409,672.79	8,637,470.06	(227,797.27)	(2.6)
Sales and Services, net	58,469,183.14	54,672,037.50	3,797,145.64	6.9
Interest Earnings on Loans	13,084.32	8,687.09	4,397.23	50.6
Other Operating Revenues	1,600,296.32	930,427.78	669,868.54	72.0
Total Operating Revenues	125,415,291.67	119,238,904.61	6,176,387.06	5.2
Operating Expenses	249,294,670.35	224,802,369.30	24,492,301.05	10.9
Operating Loss	(123,879,378.68)	(105,563,464.69)	(18,315,913.99)	(17.4)
Nonoperating Revenues				
State Appropriations	101,786,905.00	91,557,691.00	10,229,214.00	11.2
Other Nonoperating Revenues	16,321,237.35	16,041,770.90	279,466.45	1.7
Net Nonoperating Revenues	118,108,142.35	107,599,461.90	10,508,680.45	9.8
Income (Loss)				
Before Other Revenues	(5,771,236.33)	2,035,997.21	(7,807,233.54)	(383.5)
Capital Grants	10,452,607.04	37,428,206.00	(26,975,598.96)	(72.1)
Capital Appropriations	3,132,800.00	1,497,400.00	1,635,400.00	109.2
Capital Gifts	63,362.00	151,641.00	(88,279.00)	(58.2)
Total Other Revenues	13,648,769.04	39,077,247.00	(25,428,477.96)	(65.1)
Total Increase in Net Assets	7,877,532.71	41,113,244.21	(33,235,711.50)	(80.8)
Net Assets				
Net Assets at Beginning of Year, as Restated	273,351,034.27	232,052,333.26	41,298,701.01	17.8
Net Assets at End of Year	\$ 281,228,566.98	\$ 273,165,577.47	\$ 8,062,989.51	3.0

The University experienced a growth in net assets of \$7,877,532.71 for the year compared to a \$41,113,244.21 increase last year. The difference was attributable to the University having previously utilized most of its share of the 2000 North Carolina General Obligation Bonds for the UNC system capital projects and therefore having a \$26,975,598.96 reduction in Capital Grants coupled with increased Operating Expenses, previously discussed in the Statement of Revenues, Expenses, and Changes in Net Assets section. State appropriations were \$101,786,905.00 during fiscal year 2006, compared to \$91,557,691.00 in fiscal year 2005. Fuel prices continue to cause concern along with hurricane disasters as evidenced in recent years.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Capital Asset and Debt Administration

The University is involved in several construction, renovation, and property acquisition projects. The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of \$2.5 billion of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina System. The funds authorized are to be used solely for capital facilities costs on the University of North Carolina campuses as specified in the legislation. Appalachian State University will receive \$88,295,748.00 of this bond issue of which \$83,216,413.87 has been expended and accrued to date, for construction of new facilities, renovation of existing structures, and the purchase of additional buildings and land. Rankin Science South was one of the major projects constructed from this funding source. It was placed into service at a cost of \$8,470,384.50.

The Student Recreation Center was placed into service this year at a cost of \$28,567,160.35. Also, The Appalachian House (off-campus housing for class field trips, individual internships, or research projects, located in Washington D.C.) was opened at a cost of \$2,517,630.47. A new Water Treatment Plant came on line and at a cost of \$2,854,272.16. White Residence Hall was also renovated and re-opened at a cost of \$6,464,144.88.

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

- Owens Field House (Athletic Facility at Kidd Brewer Stadium) is scheduled to be reconstructed along with stadium seating upgrades and improvements to Varsity Gymnasium. The Athletic Facilities project has an estimated cost of \$35,800,000.00.
- The Wellborn Dining Hall replacement is expected to be completed in 2008. The estimated cost for this project is \$30,951,440.00.
- Hoey residence hall is currently being renovated for approximately \$7,000,000.00. Cannon residence hall will begin renovation in fiscal year 2007-2008 for approximately \$9,000,000.00. The funding for these residence hall projects will require external financing of approximately \$16,000,000.00 over the next four years.

Total annual debt service payments were \$10,438,071.44 in 2006 compared to \$9,366,219.55 last year.

Appalachian State University
Statement of Net Assets
June 30, 2006

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 48,211,935.17
Restricted Cash and Cash Equivalents	15,613,828.88
Receivables, Net (Note 4)	6,816,957.11
Due from State of North Carolina Component Units	69,984.60
Due from University Component Units	460,651.21
Inventories	5,191,004.27
Notes Receivable, Net (Note 4)	797,787.67
	<hr/>
Total Current Assets	77,162,148.91

Noncurrent Assets:

Restricted Cash and Cash Equivalents	11,543,252.30
Restricted Due from Primary Government	1,396,421.93
Endowment Investments	6,348,158.07
Other Long-Term Investments	8,999,222.82
Notes Receivable, Net (Note 4)	3,384,906.75
Capital Assets - Nondepreciable (Note 5)	38,127,571.63
Capital Assets - Depreciable, Net (Note 5)	299,281,144.15
	<hr/>
Total Noncurrent Assets	369,080,677.65

Total Assets	<hr/> <hr/> 446,242,826.56
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	13,178,130.53
Due to Primary Government	76,109.96
Deferred Revenue	7,145,128.61
Interest Payable	1,885,988.70
Long-Term Liabilities - Current Portion (Note 7)	7,287,258.19
	<hr/>
Total Current Liabilities	29,572,615.99

Noncurrent Liabilities:

Deposits Payable	236,023.17
Funds Held for Others	3,622,624.34
U. S. Government Grants Refundable	3,862,315.68
Long-Term Liabilities (Note 7)	127,720,680.40
	<hr/>
Total Noncurrent Liabilities	135,441,643.59

Total Liabilities	<hr/> <hr/> 165,014,259.58
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Appalachian State University
Statement of Net Assets
June 30, 2006

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	228,161,748.00
Restricted for:	
Nonexpendable:	
Research	20,000.00
Endowed Professorships	6,328,158.07
Loans	479,350.31
Expendable:	
Scholarships and Fellowships	118,194.96
Research	11,724.74
Departmental Uses	1,529,047.75
Capital Projects	(3,391,008.40)
Debt Service	8,185,031.62
Other	1,984,605.84
Unrestricted	<u>37,801,714.09</u>
Total Net Assets	<u>\$ 281,228,566.98</u>

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

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

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 56,923,055.10
Federal Grants and Contracts	6,669,253.19
State and Local Grants and Contracts	1,523,316.69
Nongovernmental Grants and Contracts	217,102.91
Sales and Services, Net (Note 9)	58,469,183.14
Interest Earnings on Loans	13,084.32
Other Operating Revenues	1,600,296.32

Total Operating Revenues	125,415,291.67
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EXPENSES

Operating Expenses:

Salaries and Benefits	149,923,936.99
Supplies and Materials	32,223,499.70
Services	30,097,850.12
Scholarships and Fellowships	9,278,094.25
Utilities	15,267,214.08
Depreciation	12,504,075.21

Total Operating Expenses	249,294,670.35
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Operating Loss	(123,879,378.68)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	101,786,905.00
Noncapital Grants	11,770,117.44
Noncapital Gifts	5,878,959.45
Investment Income	4,047,441.93
Interest and Fees on Capital Asset-Related Debt	(5,300,675.21)
Other Nonoperating Expenses	(74,606.26)

Net Nonoperating Revenues	118,108,142.35
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Loss Before Other Revenues, Expenses, Gains, or Losses	(5,771,236.33)
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Capital Appropriations	3,132,800.00
Capital Grants	10,452,607.04
Capital Gifts	63,362.00

Increase in Net Assets	7,877,532.71
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NET ASSETS

Net Assets - July 1, 2005, as Restated (Note 16)	273,351,034.27
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Net Assets - June 30, 2006	\$ 281,228,566.98
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The accompanying notes to the financial statements are an integral part of this statement.

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

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 123,793,335.08
Payments to Employees and Fringe Benefits	(150,551,020.66)
Payments to Vendors and Suppliers	(75,860,665.33)
Payments for Scholarships and Fellowships	(9,278,094.25)
Loans Issued	(1,087,775.00)
Collection of Loans	975,525.78
Interest Earned on Loans	12,025.58
Other Receipts	1,600,296.32
	<hr/>
Net Cash Used by Operating Activities	(110,396,372.48)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	101,786,905.00
Noncapital Grants	11,819,355.81
Noncapital Gifts	5,333,205.86
Related Activity Agency Receipts	644,450.54
Related Activity Agency Disbursements	(7,175,000.00)
Other Payments	(272,217.41)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	112,136,699.80

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

State Capital Appropriations	3,132,800.00
Capital Grants	18,631,200.97
Capital Gifts	152,381.02
Proceeds from Sale of Capital Assets	157,889.10
Acquisition and Construction of Capital Assets	(34,706,644.25)
Principal Paid on Capital Debt and Leases	(5,057,576.14)
Interest and Fees Paid on Capital Debt and Leases	(4,542,875.49)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(22,232,824.79)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	211,232.46
Investment Income	3,578,604.36
Purchase of Investments and Related Fees	(400,000.00)
	<hr/>
Net Cash Provided by Investing Activities	3,389,836.82

Net Decrease in Cash and Cash Equivalents	(17,102,660.65)
Cash and Cash Equivalents - July 1, 2005	92,471,677.00
	<hr/>
Cash and Cash Equivalents - June 30, 2006	\$ 75,369,016.35

Appalachian 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	\$ (123,879,378.68)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	12,504,075.21
Allowances, Write-Offs, and Amortizations	219,463.04
Nonoperating Other Income	545,753.59
Changes in Assets and Liabilities:	
Receivables (Net)	(1,019,770.96)
Due from State of North Carolina Component Units	(69,984.60)
Inventories	(631,549.87)
Accounts Payable and Accrued Liabilities	184,876.82
Due to Primary Government	7,676.84
Deferred Revenue	967,018.35
Compensated Absences	994,057.52
Deposits Payable	(2,400.67)
Note Principle Repayments	871,565.93
Notes Issued	(1,087,775.00)
	<u>(1,087,775.00)</u>
Net Cash Used by Operating Activities	<u>\$ (110,396,372.48)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 48,211,935.17
Restricted Cash and Cash Equivalents	15,613,828.88
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	11,543,252.30
	<u>11,543,252.30</u>
Total Cash and Cash Equivalents - June 30, 2006	<u>\$ 75,369,016.35</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 63,362.00
Change in Fair Value of Investments	694,029.41
Reinvested Distributions	468,146.73
Loss on Disposal of Capital Assets	232,495.36

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

Appalachian State University Foundations
Statement of Financial Position
June 30, 2006

Exhibit B-1

	Appalachian State University Foundation	Appalachian Student Housing Foundation
ASSETS		
Cash and Cash Equivalents	\$ 685,846.00	\$ 1,978,809.00
Investments	59,179,723.00	
Real Estate Held for Resale	83,021.00	
Cash Surrender Value of Life Insurance	151,907.00	
Assets Held by Trustees		4,469,532.00
Receivables, Net	230,943.00	6,402.00
Trusts and Promises to Give, Net	11,596,970.00	
Prepaid Expenses	31,377.00	71,873.00
Deferred Charges		309,246.00
In-Kind Gifts	8,242.00	
Property and Equipment, Net	2,577,147.00	21,208,112.00
Total Assets	<u>74,545,176.00</u>	<u>28,043,974.00</u>
LIABILITIES		
Accounts Payable and Accrued Expenses	76,953.00	407,235.00
Grants Payable to University	460,651.00	
Deferred Revenue	445,335.00	99,350.00
Interest Payable		45,775.00
Deposits Payable	7,869.00	
Split Interest Agreement Obligations	2,259,949.00	
Bonds Payable		23,710,000.00
Total Liabilities	<u>3,250,757.00</u>	<u>24,262,360.00</u>
NET ASSETS		
Unrestricted	7,162,167.00	3,781,614.00
Temporarily Restricted	26,059,476.00	
Permanently Restricted	38,072,776.00	
Total Net Assets	<u>\$ 71,294,419.00</u>	<u>\$ 3,781,614.00</u>

See Note 1 in the Notes to the Financial Statements

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

Exhibit B-2

	Appalachian State University Foundation	Appalachian Student Housing Foundation
CHANGES IN UNRESTRICTED NET ASSETS		
Revenues, Gains, and Other Support:		
Contributions	\$ 730,510.00	\$ 0.00
Investment Income	832,851.00	220,803.00
Rental and Other Auxiliary Income	68,711.00	3,950,173.00
Net Realized and Unrealized Gains on Investments	280,198.00	
Other Income	18,371.00	54,966.00
Subtotal	1,930,641.00	4,225,942.00
Net Assets Released from Restrictions:	5,469,054.00	
Total Revenues, Gains, and Other Support	7,399,695.00	4,225,942.00
Expenses and Losses:		
Program Services:		
General University Support	4,039,194.00	
Student Financial Aid	1,760,983.00	
Alumni Affairs	110,148.00	
Other	385,206.00	
Total Program Services	6,295,531.00	
Supporting Services:		
General and Administrative	67,543.00	438,952.00
Fund Raising	287,916.00	
Other		2,589,813.00
Total Supporting Services	355,459.00	3,028,765.00
Total Expenses	6,650,990.00	3,028,765.00
Transfers/Reclassifications to Other Funds	(189,538.00)	
Increase in Unrestricted Net Assets	559,167.00	1,197,177.00
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
Revenues, Gains, and Other Support:		
Contributions	6,373,058.00	
Investment Income	467,956.00	
Rental and Other Auxiliary Income	63,457.00	
Net Realized and Unrealized Gains on Investments	3,064,657.00	
Other losses	(5,224.00)	
Subtotal	9,963,904.00	
Net Assets Released from Restrictions:	(5,469,054.00)	
Total Revenues, Gains, and Other Support	4,494,850.00	

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

Exhibit B-2
Page 2

	Appalachian State University Foundation	Appalachian Student Housing Corporation
Net Increase in Allowance for Doubtful Promises to Give	44,622.00	
Net Change in Split Interest Agreement Obligation	(104,996.00)	
Transfers/Reclassifications from Other Funds	106,694.00	
Increase in Temporarily Restricted Net Assets	<u>4,541,170.00</u>	
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Revenues, Gains, and Other Support:		
Contributions	1,283,967.00	
Investment Losses	(34,308.00)	
Rental and Other Auxiliary Income		
Net Realized and Unrealized Gains on Investments	42,961.00	
Other Income (Losses)		
Subtotal	<u>1,292,620.00</u>	
Net Assets Released from Restrictions:		
Total Revenues, Gains, and Other Support	<u>1,292,620.00</u>	
Net Decrease in Allowance for Doubtful Promises to Give	(5,583.00)	
Net Increase in Change in Split Interest Agreement Obligation		
Transfers/Reclassifications to Other Funds	82,844.00	
Increase in Permanently Restricted Net Assets	<u>1,369,881.00</u>	
Increase in Net Assets	6,470,218.00	1,197,177.00
Net Assets at Beginning of Year	<u>64,824,201.00</u>	<u>2,584,437.00</u>
Net Assets at End of Year	<u>\$ 71,294,419.00</u>	<u>\$ 3,781,614.00</u>

See Note 1 in the Notes to the Financial Statements

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APPALACHIAN 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. Appalachian State University is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State’s *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University’s funds. The University’s component units are discretely presented in the University’s financial statements. Discretely presented component units’ financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

During the year ended June 30, 2006, the Foundation distributed \$6,295,531.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Vice Chancellor for University Advancement or the ASU Foundation President. The financial statements of the Corporation may be obtained from the Vice Chancellor for Student Development. The address is: Dougherty Administration Building, 438 Academy Street, Boone, NC 28608.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, 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 equity investments, mutual funds, money market funds, real estate investment trusts, and other asset holdings by the University. Except for real estate investment trusts 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.

Real estate investment trusts and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

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

- G. Inventories** – Inventories, consisting of expendable supplies, are valued at cost using the first-in, first-out method. Merchandise for resale is valued using the retail inventory method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations. Certain other assets are classified as restricted because their use is limited by external parties or statute.
- J. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The deferred losses on refunds are amortized over the life of the new debt using the straight-line method. Issuance costs are expensed.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, and debt service funds 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 \$73,036,337.30 which represents the 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 \$58,742.21. The carrying amount of the University's deposits not with the State Treasurer was \$2,273,936.84 and the bank balance was \$2,388,412.64. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

credit risk. As of June 30, 2006, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	\$ <u><u>2,144,010.88</u></u>
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B. Investments

University – The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

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

Investments of the University's component units, the Foundation and Student Housing Corporation, are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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.

Long-Term Investment Pool – This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the percentage method. Under this method, each participating fund’s investment balance is determined on percentage of original investment. The investment strategy, including the selection of investment managers, is based on the directives of the University’s Endowment Board.

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

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)	
		1 to 5	6 to 10
Debt Securities			
Mutual Bond Funds	\$ 4,012,686.28	\$ 2,419,130.72	\$ 1,593,555.56
Other Securities			
International Mutual Funds	1,465,717.57		
Other Mutual Funds	7,175,298.57		
Total Long-Term Investment Pool	\$ 12,653,702.42		

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	AA Aa
Mutual Bond Funds	\$ 4,012,686.28	X

Rating Agency: Standard & Poors

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

	Fair Value	Investment Maturity (in Years) Less Than 1
Investment Type		
Debt Securities		
Money Market Mutual Funds	\$ 2,604,084.63	\$ 2,604,084.63
Other Securities		
Closed-End Mutual Funds	29,690.82	
Other Mutual Funds	2,264.71	
Real Estate Investment Trust	6,519.71	
Domestic Stocks Held by Counterparty	50,116.60	
Other	1,002.00	
Total Non-Pooled Investments	\$ 2,693,678.47	

At June 30, 2006, the University’s non-pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAAm
Money Market Mutual Funds	\$ 2,604,084.63	X

Rating Agency: Standard & Poors

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2006, the University's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty's Trust Dept or Agent not in University's Name
Closed-End Mutual Funds	\$ 29,690.82
Other Mutual Funds	2,264.71
Real Estate Investment Trust	6,519.71
Domestic Stocks	50,116.60
Total	\$ 88,591.84

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

Investment Type	Fair Value
Debt Securities	
Mutual Bond Funds	\$ 4,012,686.28
Money Market Mutual Funds	2,604,084.63
Other Securities	
International Mutual Funds	1,465,717.57
Other Mutual Funds	7,207,254.10
Real Estate Investment Trust	6,519.71
Domestic Stocks Held by Counterparty	50,116.60
Other	1,002.00
Total Investments	\$ 15,347,380.89

Component Unit – Investments of the University's discretely presented component unit, the Foundation, are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements. Because the Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Cash with Brokers	\$ 71,680.00
Short-term Investment Fund	3,488,012.00
Money Market Funds	399,115.00
Certificates of Deposit	7,000,000.00
Equity Investments	26,879,599.00
Fixed Income Investments	9,867,668.00
Absolute Return Investments	6,832,727.00
Real Estate Fund Investments	<u>4,640,922.00</u>
	59,179,723.00
Real Estate Held for Resale	<u>83,021.00</u>
Total Investments	<u><u>\$ 59,262,744.00</u></u>

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which limits spending to 5% of an individual endowment account's net asset value at the end of the previous year. An earnings reserve must be held in each endowment account in an amount equal to 5% of the original contribution. Earnings in excess of the reserve amount as calculated at the end of each fiscal year are eligible for pay out. Realized and unrealized net capital losses that invade the original corpus amounts are recovered from accumulated income before any spending budgets are calculated. Subject to these limitations, the budgeted spending amount will be based on the net asset value of each individual endowment fund. At June 30, 2006, net appreciation was \$1,627,561.08 of which \$368,934.76 was available to be spent and was restricted to specific purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 2,132,510.51	\$ 512,708.70	\$ 1,619,801.81
Accounts	4,278,623.41	83,662.63	4,194,960.78
Intergovernmental	924,451.86		924,451.86
Investment Earnings	7,575.46		7,575.46
Interest on Loans	68,115.28		68,115.28
Other	2,051.92		2,051.92
Total Current Receivables	<u>\$ 7,413,328.44</u>	<u>\$ 596,371.33</u>	<u>\$ 6,816,957.11</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 796,765.67	\$ 0.00	\$ 796,765.67
Institutional Student Loan Programs	1,510.12	488.12	1,022.00
Total Notes Receivable - Current	<u>\$ 798,275.79</u>	<u>\$ 488.12</u>	<u>\$ 797,787.67</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 3,620,524.67</u>	<u>\$ 235,617.92</u>	<u>\$ 3,384,906.75</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Capital Assets, Nondepreciable:				
Land	\$ 16,199,095.24	\$ 10,000.00	\$ 1,400.00	\$ 16,207,695.24
Construction in Progress	45,177,701.55	29,100,696.16	52,358,521.32	21,919,876.39
Total Capital Assets, Nondepreciable	<u>61,376,796.79</u>	<u>29,110,696.16</u>	<u>52,359,921.32</u>	<u>38,127,571.63</u>
Capital Assets, Depreciable:				
Buildings	318,997,822.82	50,423,684.38	2,949,475.46	366,472,031.74
Machinery and Equipment	35,791,695.74	4,729,061.41	4,557,971.12	35,962,786.03
Art, Literature, and Artifacts	1,719,127.38	51,701.19		1,770,828.57
General Infrastructure	40,379,897.84	2,070,657.41	135,554.54	42,315,000.71
Total Capital Assets, Depreciable	<u>396,888,543.78</u>	<u>57,275,104.39</u>	<u>7,643,001.12</u>	<u>446,520,647.05</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	106,677,513.03	9,193,860.74	2,949,475.46	112,921,898.31
Machinery and Equipment	26,265,859.43	2,154,804.65	4,330,425.61	24,090,238.47
Art, Literature, and Artifacts	685,519.15	143,305.27		828,824.42
General Infrastructure	8,535,610.62	1,012,104.55	149,173.47	9,398,541.70
Total Accumulated Depreciation	<u>142,164,502.23</u>	<u>12,504,075.21</u>	<u>7,429,074.54</u>	<u>147,239,502.90</u>
Total Capital Assets, Depreciable, Net	<u>254,724,041.55</u>	<u>44,771,029.18</u>	<u>213,926.58</u>	<u>299,281,144.15</u>
Capital Assets, Net	<u>\$ 316,100,838.34</u>	<u>\$ 73,881,725.34</u>	<u>\$ 52,573,847.90</u>	<u>\$ 337,408,715.78</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 8,027,869.83
Accrued Payroll	2,331,906.05
Contract Retainage	2,788,514.02
Intergovernmental Payables	29,840.63
Total Accounts Payable and Accrued Liabilities	<u>\$ 13,178,130.53</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

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

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Current Portion
Bonds Payable	\$ 130,980,000.00	\$ 0.00	\$ 4,650,000.00	\$ 126,330,000.00	\$ 5,090,000.00
Deduct Deferred Charge on Refunding	(1,710,430.38)		(79,820.09)	(1,630,610.29)	
Total Bonds Payable	<u>129,269,569.62</u>		<u>4,570,179.91</u>	<u>124,699,389.71</u>	<u>5,090,000.00</u>
Notes Payable	2,137,057.29		487,396.23	1,649,661.06	401,507.38
Arbitrage Rebate Payable	25,507.78		25,507.78		
Compensated Absences	7,664,830.30	5,411,204.03	4,417,146.51	8,658,887.82	1,795,750.81
Total Long-Term Liabilities	<u>\$ 139,096,964.99</u>	<u>\$ 5,411,204.03</u>	<u>\$ 9,500,230.43</u>	<u>\$ 135,007,938.59</u>	<u>\$ 7,287,258.19</u>

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
<u>Housing and Student Center System</u>						
ASU Housing and Student Center System Revenue Bonds	I	5.5-5.8%	07/01/2007	\$ 1,760,000.00	\$ 1,515,000.00	\$ 245,000.00
	J	5.5-5.8%	07/01/2007	1,722,000.00	1,477,000.00	245,000.00
ASU Housing and Student Center System Revenue Bonds	2001	5.228044%	07/15/2027	6,680,000.00	610,000.00	6,070,000.00
ASU Housing and Student Center System Revenue Bonds	2002	4.304976%	07/15/2015	13,240,000.00	2,105,000.00	11,135,000.00
Total Housing and Student Center				<u>23,402,000.00</u>	<u>5,707,000.00</u>	<u>17,695,000.00</u>
<u>Student Union System</u>						
ASU Student Fee Revenue Refunding Bonds Student Union Building	1998	4.872630%	05/15/2012	8,050,000.00	3,910,000.00	4,140,000.00
<u>Utility System</u>						
ASU Utility System Revenue Refunding Bonds	1998	5.2885%	05/15/2024	27,535,000.00	2,400,000.00	25,135,000.00
<u>The University of North Carolina System Pool Revenue Bonds</u>						
Stadium Debt Fee Loan	(A)	4.338475%	10/01/2005	875,000.00	875,000.00	
Broyhill Inn	(B)	5.514747%	10/01/2015	1,590,000.00	400,000.00	1,190,000.00
Doughton Renovation	(C)	5.015619%	04/01/2027	4,940,000.00	390,000.00	4,550,000.00
Total The University of North Carolina System Pool Revenue Bonds				<u>7,405,000.00</u>	<u>1,665,000.00</u>	<u>5,740,000.00</u>
<u>ASU General Revenue Bonds</u>						
ASU General Revenue Bonds- Student Recreation Center	2003A	4.483238%	05/01/2028	25,635,000.00	2,015,000.00	23,620,000.00
ASU General Revenue Bonds- Housing, Athletics, Parking	2005	4.543322%	07/15/2030	50,915,000.00	915,000.00	50,000,000.00
Total General Revenue Bonds				<u>76,550,000.00</u>	<u>2,930,000.00</u>	<u>73,620,000.00</u>
Total Bonds Payable (principal only)				<u>\$ 142,942,000.00</u>	<u>\$ 16,612,000.00</u>	126,330,000.00
Less: Unamortized Loss on Refunding						<u>1,630,610.29</u>
Total Bonds Payable						<u>\$ 124,699,389.71</u>

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2007	\$ 5,090,000.00	\$ 5,819,221.26	\$ 401,507.38	\$ 74,888.92
2008	5,310,000.00	5,610,991.26	416,311.40	55,737.12
2009	5,280,000.00	5,408,868.76	431,842.28	35,858.46
2010	5,455,000.00	5,190,553.76	100,000.00	15,217.23
2011	5,720,000.00	4,961,108.76	100,000.00	10,869.44
2012-2016	29,110,000.00	21,030,457.59	200,000.00	8,695.55
2017-2021	27,115,000.00	14,478,798.20		
2022-2026	30,395,000.00	6,993,900.03		
2027-2031	12,855,000.00	1,362,712.50		
Total Requirements	\$ 126,330,000.00	\$ 70,856,612.12	\$ 1,649,661.06	\$ 201,266.72

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

On April 20, 2005, the University issued \$12,990,000 in ASU General Revenue and Refunding Revenue Bonds, Series 2005 with an average interest rate of 4.756613%. The bonds were issued to advance refund \$12,340,000.00 of outstanding ASU Housing and Student Center System Revenue Bonds, Series 2000 with an average interest rate of 5.588681%. The net proceeds of the refunding bonds were used to purchase U.S. government securities. These securities were deposited into an irrevocable trust to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability has been removed from the University's Statement of Net Assets. This advance refunding was undertaken to reduce total debt service payments by \$702,660.49 over the next 11.782 years and resulted in an economic gain of \$467,394.55. At June 30, 2006, the outstanding balance was \$12,015,000.00 for the defeased ASU Housing and Student Center System Revenue Bonds, Series 2000.

On April 20, 2005, the University issued \$10,040,000.00 in ASU General Revenue and Refunding Revenue Bonds, Series 2005 with an average interest rate of 4.756613%. The bonds were issued to advance refund \$9,540,000.00 of outstanding ASU Parking System Revenue Bonds, Series 2000 with an average interest rate of 5.588681%. The net proceeds of the refunding bonds were used to purchase U.S. government securities. These securities were deposited into an irrevocable trust to provide for all

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the University's Statement of Net Assets. This advance refunding was undertaken to reduce total debt service payments by \$552,090.38 over the next 11.782 years and resulted in an economic gain of \$367,238.57. At June 30, 2006, the outstanding balance was \$9,295,000.00 for the defeased ASU Parking System Revenue Bonds, Series 2000.

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2006	Principal Outstanding June 30, 2006
Electric Utility	BB & T	5.16%	05/31/2006	\$ 1,000,000.00	\$ 1,000,000.00	\$ 0.00
Visual Arts Center	J P Morgan Chase	4.91%	08/01/2008	2,700,000.00	1,750,338.94	949,661.06
Electric Utility	RBC Centura	4.30%	03/15/2013	1,000,000.00	300,000.00	700,000.00
Total Notes Payable				<u>\$ 4,700,000.00</u>	<u>\$ 3,050,338.94</u>	<u>\$ 1,649,661.06</u>

F. Component Unit – ASU Student Housing Corporation

Long-term debt at June 30, 2006 consists of the following:

Student Housing variable rate revenue bonds; dated September 19, 2006; original amount of \$9,935,000; interest at variable rate calculated weekly due serially from July 1, 2003 to July 1, 2031	\$ 8,816,000.00
Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$10,000,000; interest at variable rate calculated weekly due serially from July 1, 2002 to July 1, 2031.	8,928,000.00
Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$7,000,000; interest at variable rate calculated weekly due serially from July 1, 2003 to July 1, 2031.	<u>5,966,000.00</u>
Total long-term debt	23,710,000.00
Less current portions	<u>415,000.00</u>
Long-term debt, less current portions	<u>\$ 23,295,000.00</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Principal maturities over the term of the debt are as follows:

2006	\$	415,000.00
2007		445,000.00
2008		470,000.00
2009		505,000.00
2010		540,000.00
Thereafter		<u>21,335,000.00</u>
	\$	<u><u>23,710,000.00</u></u>

NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for equipment, office space, and parking facilities. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2006:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 652,788.89
2008	441,057.29
2009	67,496.46
2010	<u>2,708.34</u>
Total Minimum Lease Payments	<u><u>\$ 1,164,050.98</u></u>

Rental expense for all operating leases during the year was \$2,340,118.61.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	
Operating Revenues:						
Student Tuition and Fees	\$ 60,504,991.51	\$ 0.00	\$ 3,729,790.56	\$ (147,854.15)	\$ 56,923,055.10	
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 16,176,954.49	\$ 726,127.82	\$ 1,198,349.45	\$ 47,970.12	\$ 14,204,507.10	(A)
Dining	14,460,192.00	1,297,134.71	729,343.56	29,669.32	12,404,044.41	(B)
Student Union Services	146,373.29	32,125.50		(2,671.81)	116,919.60	(C)
Health, Physical Education, and Recreation Services	1,177,289.96	175,523.67	194,724.47	18,087.87	788,953.95	
Bookstore	8,139,872.32	654,116.36	162,963.77	26,142.86	7,296,649.33	(D)
Parking	2,024,528.07	16,815.00		12,024.61	1,995,688.46	
Camp Programs	2,699,170.63	77,605.94			2,621,564.69	
Steam Utility System	7,790,262.68	7,790,262.68				(E)
Athletic	3,234,508.56	11,119.00	386,265.92	6,515.62	2,830,608.02	
Other	8,495,247.99	2,779,398.00	538,539.91	184,274.23	4,993,035.85	
Sales and Services of Education and Related Activities	2,158,314.94	1,020,788.08	112,941.00		1,024,585.86	
New River Light and Power	14,826,885.48	4,632,451.28		1,808.33	10,192,625.87	
Total Sales and Services	<u>\$ 81,329,600.41</u>	<u>\$ 19,213,468.04</u>	<u>\$ 3,323,128.08</u>	<u>\$ 323,821.15</u>	<u>\$ 58,469,183.14</u>	

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 73,639,794.66	\$ 3,085,989.69	\$ 3,562,460.85	\$ 43,159.00	\$ 0.00	\$ 0.00	\$ 80,331,404.20
Research	793,583.32	243,420.04	302,261.92	14,600.00			1,353,865.28
Public Service	5,486,476.77	178,449.84	1,373,795.83	1,344,464.36	12,371.21		8,395,558.01
Academic Support	18,053,873.56	5,605,728.08	4,461,813.89	248,378.66	775.36		28,370,569.55
Student Services	5,025,509.43	186,642.40	760,793.41	129,565.44			6,102,510.68
Institutional Support	12,020,552.53	1,271,064.69	2,611,567.05		820.02		15,904,004.29
Operations and Maintenance of Plant	10,126,827.21	1,078,638.12	9,180,973.19		6,903,993.96		27,290,432.48
Student Financial Aid	38,970.93		47,037.57	6,110,348.63			6,196,357.13
Auxiliary Enterprises	23,809,279.95	10,602,800.67	6,825,088.83	1,387,578.16	8,349,253.53		50,974,001.14
New River Light & Power	929,068.63	9,970,766.17	972,057.58				11,871,892.38
Depreciation						12,504,075.21	12,504,075.21
Total Operating Expenses	<u>\$ 149,923,936.99</u>	<u>\$ 32,223,499.70</u>	<u>\$ 30,097,850.12</u>	<u>\$ 9,278,094.25</u>	<u>\$ 15,267,214.08</u>	<u>\$ 12,504,075.21</u>	<u>\$ 249,294,670.35</u>

NOTE 11 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 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 \$123,485,320.45, of which \$57,819,671.65 was covered under the Teachers' and State Employees' Retirement System. Total employee and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

employer contributions for pension benefits for the year were \$3,469,180.30 and \$1,352,980.32, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were \$1,352,980.32, \$1,254,475.08, and \$123,396.29, respectively.

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

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

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 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 \$123,485,320.45, of which \$48,171,599.85 was covered under the Optional Retirement Program. Total employee and employer

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

contributions for pension benefits for the year were \$2,890,295.99 and \$3,294,937.43, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans** – IRC Section 457 Plan – The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$112,588.00 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 \$38,364.63. The voluntary contributions by employees amounted to \$762,479.25 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 \$1,619,332.12 for the year ended June 30, 2006.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees –** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.8% 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 \$4,027,668.31. 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 \$551,154.61. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to 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. The University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, flood, and "all risks" for buildings and contents.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the University's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The University is responsible for paying medical benefits 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 14 - COMMITMENTS AND CONTINGENCIES

A. Commitments – The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$36,285,058.73 and on other purchases were \$2,435,966.67 at June 30, 2006.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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
Endowed Professorship	\$ 500,000.00

NOTE 15 - RELATED PARTIES

A member of the Board of Trustees of Appalachian State University is also a member of the Watauga County Commissioners. On June 7, 2006, the Board of Trustees of the Endowment fund of Appalachian State University (“Board”) entered into a contract to sell 59.074 acres of land to Watauga County (“County”) for the sum of \$2,450,000.00. Closing of the transaction is set to occur on or before November 30, 2006; however, the County’s performance of obligations under the agreement are contingent upon satisfaction of several conditions, including 1) the County’s sale of property where the existing high school is located; 2) the County’s acquisition of additional properties adjoining or near the tract owned by the Board, and 3) local government approvals necessary for closure of a street and development of the subject property for its intended use (new county high school).

NOTE 16 - NET ASSET RESTATEMENTS

As of July 1, 2005, net assets as previously reported was restated as follows:

	Amount
July 1, 2005 Net Assets as Previously Reported	\$ 273,165,577.47
Restatements:	
Correction to Student Deposits	1,570.00
Correction to Bond Interest Payable	20,590.00
Correction to Fixed Assets	163,296.80
	\$ 273,351,034.27

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 17 - SUBSEQUENT EVENTS

On June 2, 2006, the Board of Trustees of Appalachian State University Adopted a resolution requesting and approving the issuance of bonds for a new central dining facility and to renovate residence halls. Subject to approval by the UNC Board of Governors, ASU General Revenue Bonds will be issued in mid November for approximately \$43,135,000.00 to provide funds for the new dining facility (\$23,000,000.00), renovation of a residence hall (\$7,000,000.00), advance refund a portion of the 2000 and 2002 housing bonds (\$4,440,000.00), and refund a portion of the 2003 General Revenue Bonds (\$8,695,000.00).



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
Appalachian State University
Boone, North Carolina

We have audited the financial statements of Appalachian State University, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2006, which collectively comprise the University's basic financial statements and have issued our report thereon dated November 15, 2006.

Our report was modified to include a reference to 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 opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Audit Findings and Recommendations section of this report.

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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Finding

1. Inadequate Controls over Cash Receipts and Deposits
2. Noncompliance with Policies and Procedures over Purchasing
3. Internal Control Weaknesses over Payroll Functions at New River Light and Power

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

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, which are reported in the Audit Findings and Recommendations section of this report, disclosed 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

November 15, 2006

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements or other matters.

1. INADEQUATE CONTROLS OVER CASH RECEIPTS AND DEPOSITS

New River Light and Power does not issue system-generated prenumbered receipts. Cashiers collect payments from customers and stamp the bill and stub "PAID." Manual receipts are issued for meter deposits. The cashiers count their collections and prepare their own Daily Cash Report. No system-generated cash report is available. A cashier other than the collector posts payments to customer accounts but the current computer system does not provide an audit trail to verify or identify who posted payments to accounts. All cashiers can prepare and submit daily deposits. The Cashiering Supervisor has the ability to make adjustments to customer accounts and collect cash through the cashiering system, prepares bank deposits, and is involved in the billing process. In addition, this employee prepares the deposit to redeposit bad checks.

Recommendation: We recommend that Management design and implement policies and procedures to ensure adequate segregation of duties over the cash receipts and daily deposits. Since New River is in the process of purchasing a new computer system and software, Management should ensure that the new system provides an audit trail for receipts, posting of payments, and cash reports.

ASU Response: Staffing levels do not permit collecting, recording, depositing, and reconciling cash receipts among different individuals. New River Light and Power has compensated with controls such as thorough management review and supervision and strict individual accountability.

A comprehensive computer conversion is scheduled for completion by December 2007. The new system will provide an audit trail for receipts, posting payments and cash reports as recommended by auditors in 2006. System highlights include:

- Payments will be posted in "real time" by the cashier receiving the cash payment.
- A system-generated audit trail will verify the employee who posted payment to an account.
- System-generated receipts will be printed for consumers.
- A system-generated cash report will be printed for each cashier for daily balancing.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- Adjustments to consumer accounts will be limited to an employee who does not collect cash.

2. NONCOMPLIANCE WITH POLICIES AND PROCEDURES OVER PURCHASING

New River Light and Power is not complying with Purchasing policies and procedures provided by the University. During our examination of expenditure transactions, we noted that payments were processed without the issuance of purchase orders. Changes to the Purchasing policies and procedures were implemented without appropriate University approval. No written documentation was available for the implemented changes to the policies and procedures.

Recommendation: We recommend that the University take the necessary steps to ensure that all departments and areas comply with the Purchasing policies and procedures as outlined in the ASU Resource Manual. In addition, we recommend that the proper policies and procedures be followed regarding documentation of changes to policies and procedures prior to implementation.

ASU Response: New River Light & Power will follow purchasing policies as outlined in the ASU Resource Manual. Also, New River Light & Power will follow ASU procedures when recommending changes to policies and procedures. That process includes the Office of Business Affairs, the Office of Internal Audits and the University Attorney's Office.

3. INTERNAL CONTROL WEAKNESSES OVER PAYROLL FUNCTIONS AT NEW RIVER LIGHT AND POWER

On July 26, 2006, the University's internal auditors released a payroll review that reported failures of internal controls over payroll functions at New River Light and Power. The report noted:

- Unapproved employee time sheets
- Temporary employee working without authorization
- Temporary part-time employees earning and banking compensatory time
- Payroll personnel physically taking employee deposit tickets and checks to various banks in lieu of direct deposit
- Key management positions being held by retired personnel working as temporary part-time employees

In addition, during our examination of payroll, we noted the following errors:

- One temporary part-time employee did not have a current employment authorization on file.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- Another temporary part-time employee's timesheets did not reflect all hours worked. We noted that several of his timesheets reflected hours worked that were actually taken off as compensatory time recorded on a separate carryover time record.
- A terminated full-time employee was overpaid due to the incorrect hourly rate being used to calculate her terminal pay, resulting in an overpayment of \$256.67.

Recommendation: We recommend that the University take the necessary steps to ensure that all temporary employees have current employment authorizations on file, timesheets include all hours worked, and terminal pay is correctly calculated. We also recommend that the internal auditors continue to monitor the payroll process at New River Light and Power until they are satisfied that the process is working properly.

ASU Response: Responses to the Audit findings are addressed as follows:

- *Unapproved employee time sheets*
The Personnel Officer is currently requiring completion of time sheets on a daily basis. Incomplete or unapproved timesheets are not accepted.
- *Temporary employee working without authorization*
As of January 04, 2007, New River Light and Power has one employee classified as temporary status. A Temporary Employment Authorization form for this employee has been completed and is current.
- *Temporary part-time employees earning and accruing compensatory time*
Compensatory time is no longer allowed for temporary employees.
- *Payroll personnel physically taking employee deposit tickets and checks to various banks in lieu of direct deposit*
Payroll personnel at New River Light and Power no longer deliver employee deposit tickets and checks to the various banks.
- *Key management positions being held by retired personnel working as temporary part-time employees.*
Key management positions at New River Light and Power include the General Manager and the Facilities Engineer Supervisor. On October 9, 2006, the position of General Manager was filled by a permanent, full-time employee. The individual currently serving in the part-time position of Facilities Engineer Supervisor remains on staff. However, all major decisions within the areas of

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

responsibility of the Facilities Engineer Supervisor are only to be made following discussion and approval with the General Manager. It is anticipated that a permanent, full-time employee will fill this position prior to 2008.

- *One temporary part-time employee did not have a current employment authorization on file*

The last day of employment of this employee was January 4, 2007.

- *Another temporary part-time employee's timesheets did not reflect all hours worked. We noted that several of his timesheets reflected hours worked that were actually taken off as compensatory time recorded on a separate carryover time record*

The earning of compensatory time is no longer allowed for temporary employees.

- *A terminated full-time employee was overpaid due to the incorrect hourly rate being used to calculate her termination pay, resulting in an overpayment of \$256.67.*

It is our position that the above stated occurrence was an isolated error. Payroll issues will be closely monitored by management in the future.

In addition to the responses stated above, the ASU Office of Internal Audits will monitor the payroll process at New River Light & Power until they are satisfied that the process is working properly.

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